389

NEW PLAN FOR INTERNATIONAL MONETARY RESERVES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

FIRST SESSION

NOVEMBER 22, 1967

Part 2—Rio Monetary Agreement

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

84-610 O WASHINGTON : 1967

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 25 cents

૧૪૬

JOINT ECONOMIC COMMITTEE

[Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.]

WILLIAM PROXMIRE, Wisconsin, *Chairman*
WRIGHT PATMAN, Texas, *Vice Chairman*

SENATE

JOHN SPARKMAN, Alabama
J. W. FULBRIGHT, Arkansas
HERMAN E. TALMADGE, Georgia
STUART SYMINGTON, Missouri
ABRAHAM RIBICOFF, Connecticut
JACOB K. JAVITS, New York
JACK MILLER, Iowa
LEN B. JORDAN, Idaho
CHARLES H. PERCY, Illinois

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HALE BOGGS, Louisiana
HENRY S. REUSS, Wisconsin
MARTHA W. GRIFFITHS, Michigan
WILLIAM S. MOORHEAD, Pennsylvania
THOMAS B. CURTIS, Missouri
WILLIAM B. WIDNALL, New Jersey
DONALD RUMSFELD, Illinois
W. E. BROCK 3D, Tennessee

JOHN R. STARK, *Executive Director*
JAMES W. KNOWLES, *Director of Research*

ECONOMISTS

WILLIAM H. MOORE
JOHN B. HENDERSON
GEORGE R. IDEN
DONALD A. WEBSTER (Minority)

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

HENRY S. REUSS, Wisconsin, *Chairman*

HOUSE OF REPRESENTATIVES

RICHARD BOLLING, Missouri
HALE BOGGS, Louisiana
WILLIAM S. MOORHEAD, Pennsylvania
WILLIAM B. WIDNALL, New Jersey
W. E. BROCK 3D, Tennessee

SENATE

WILLIAM PROXMIRE, Wisconsin
STUART SYMINGTON, Missouri
JACOB K. JAVITS, New York
CHARLES H. PERCY, Illinois

JOHN B. HENDERSON, *Economist*

CONTENTS

Page

Announcement of hearing ---- 93

MORNING SESSION

Reuss, Rep. Henry S., chairman of the Subcommittee on International Exchange and Payments: Opening remarks ---- 93

Bernstein, Dr. Edward M., formerly Director of Research and Statistics, International Monetary Fund ---- 95

Harrod, Sir Roy, Oxford University ---- 104

AFTERNOON SESSION

Triffin, Prof. Robert, Yale University ---- 135

"The International Monetary Problem After Rio," by Robert Triffin, Yale University ---- 128

Chart: U.S. net international investments, monetary reserves, and liquid liabilities, 1913–67 ---- 155

NEW PLAN FOR INTERNATIONAL MONETARY RESERVES

WEDNESDAY, NOVEMBER 22, 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 S-407, the Capitol, at 10 a.m., Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representative Reuss; Senators Proxmire and Symington.

Also present: John B. Henderson, staff economist.

Chairman REUSS. Good morning. The Subcommittee on International Exchange and Payments of the Joint Economic Committee will be in order.

At this point in the record we will include the published announcement of this hearing.

(The announcement follows:)

CONGRESS OF THE UNITED STATES, JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

HEARING ON RIO MONETARY AGREEMENT, WEDNESDAY, NOVEMBER 22, 1967

Congressman Henry S. Reuss (D.-Wis.), Chairman of the Subcommittee on International Exchange and Payments of the Joint Economic Committee, announced today a one-day hearing for Wednesday, November 22 on the international monetary agreement reached in September at Rio de Janeiro.

The witnesses will be: Professor Robert Triffin of Yale University; Professor Fritz Machlup of Princeton University; Sir Roy Harrod of Oxford University; and Dr. Edward M. Bernstein, for some time director or research and statistics, International Monetary Fund.

In announcing the hearing, Congressman Reuss noted that the Rio resolution for the creation of new international reserves was in substantial compliance with Guidelines for Improving the International Monetary System, a report issued in August 1965 by the Subcommittee. "The progress represented by this agreement is heartening, but it represents only a potential," said Congressman Reuss. "We must make sure that the potential will be realized.

"The interest of a growing world economy will be served best by a steady growth in the supply of international monetary reserves. At a time when the growth of international reserves has been checked, the prompt ratification of the plan, and also its prompt activation, are in the interest of the entire world economy. We hope to examine at this hearing the means by which the new special drawing right can contribute to this purpose."

The hearing will take place on Wednesday, November 22, 1967, at 10:00 a.m. in room S-407 (Joint Committee on Atomic Energy hearing room), in the Capitol Building.

Chairman REUSS. This hearing has been called to examine the outline plan approved at the annual meeting of the International Monetary Fund at Rio last September. Under the proposed timetable the outline is to be converted into the form of a legal amendment by next March 31, and thereafter the legislatures of the member states of the IMF are to be called upon to ratify it; and if a sufficient number, 80 percent of the voting power, ratify the amendment, it would be adopted by the Governors of the IMF at the annual meeting next September.

The special drawing rights proposed under this plan are to supply a new international monetary reserve. Unfortunately, neither the plan itself nor the debate at Rio made it entirely clear what it is that the Congress is to be called upon to approve when the new proposition is presented to it next year.

The period ahead during which the negotiating process will reach its final stages and work on related matters will proceed is crucial. There is to be an IMF report accompanying the presentation to the national legislatures of the amendments to the Articles of Agreement. We must be assured that the contents of this report are acceptable.

We have convened here a panel of four very distinguished experts in the field of international monetary affairs: Prof. Robert Triffin of Yale University; Prof. Fritz Machlup of Princeton; Sir Roy Harrod of Oxford University; and Dr. Edward Bernstein, formerly director of research and statistics of the International Monetary Fund.

Unfortunately, I have already heard from Professor Machlup that air travel conditions caused him to have to turn back from his trip to Washington. I suspect that the same thing may happen to Professor Triffin. Accordingly, we shall go ahead with Sir Roy Harrod and Dr. Bernstein. I am sure Mr. Machlup and Mr. Triffin will be able to give us their thoughts in the form of a letter, although we will miss their dialog.

I especially invite comment of the panel on four main fields of the subject matter before us:

One: the question of activating these SDR's after the agreement has been ratified. When would that be likely to be? What is to be the basis for deciding on activation? What hazards, if any, are there in the fact that while it takes 80 percent of the voting power to ratify the agreement, it takes 85 percent in order to actually activate it? The 85 percent means that 15 percent could have a vehicle of effective veto and since six of the Common Market already have 16½ percent of the voting power, and since under Common Market procedures apparently one of the six can prevent action by the other five, does this mean that activation stands at the mercy of a veto by one Common Market country, in effect? Must activation await perfection of the U.S. balance of payments? How many SDR's are to be created in the first place, and how can the number be changed in the initial 5-year period?

Two: The second group of questions has to do with the so-called parallel proposals of the European Common Market. From the Rio agreement and out of the debate there emerged the idea that there must be some changes in the regular structure of the IMF, for example, to change the voting majority for such things as quota increases with the end in view of giving the Common Market an effective veto over that.

What should the attitude of the United States be about such proposals and their parallelism? Alternatively, would it make sense to invite the Common Market to earn a veto power by increasing its present quotas under the regular IMF?

Three: The third line of inquiry has to do with the link between special drawing rights and economic development aid.

Discussion of that possible link enters the picture because the IMF at Rio did decide to take a look at methods of stabilizing the prices of basic commodities exported by developing countries. Once you put your mind on that, you are necessarily looking at the process of economic development and we, therefore, thought it useful to ask the panel whether there is some way of linking aid and SDR's.

Four: The fourth series of questions has to do with possible regional pooling of special drawing rights, whether countries should be permitted to pool them in order to marshal them most effectively.

We also, needless to say, would welcome the panel's comments on more recent events, particularly the devaluation of sterling over the weekend, its effect on the dollar, and if anybody wants to comment on what that does to the necessity for, or prospect of, a tax increase, we would be happy to hear views on that.

I think, perhaps, it will be most useful, if it is agreeable with members of the panel, if we take these subject matters up one by one, consider them for a while, and then go on to the next, and when I am through I would hope to throw it open to the widest discussion possible.

Does that sound all right, gentlemen? If so, I will call on Mr. Bernstein first and then Sir Roy; would you address yourself to the first question which has to do with the activation of special drawing rights? What should be the position of the United States on that? Should we accept the pleas of the French for no activation without either a great improvement or perfection in the balance of payments of the United States? Do we undergo any risk by entering into an international monetary agreement which could, in theory at least, be stalemated by the refusal of other members to activate even though by any rational standard activation is necessary?

Mr. Bernstein, would you first address yourself to that?

STATEMENT OF DR. EDWARD M. BERNSTEIN, FORMERLY DIRECTOR OF RESEARCH AND STATISTICS, INTERNATIONAL MONETARY FUND

Mr. Bernstein. Mr. Chairman, it seems to me that the time to activate the proposal for a new reserve asset is when the world economy has reached the stage where its need for the additional reserves has become clear.

The purpose of the new reserve asset, the special drawing rights, is to assure an adequate growth of reserves. When the managing director of the International Monetary Fund, with the advice of his technical staff, comes to the conclusion that the growth of reserves in the form of gold and foreign exchange is not adequate for an expanding world economy, that is the time the plan should be activated.

I think in a practical sense this means activation about as soon as the technical facilities for managing the new reserve asset can be arranged. We know that there is not going to be a large increase, if any at all, in the gold reserves of the world. On the contrary, there is a strong probability that in this new environment and in this coming year, there will be a drain from the monetary stock of gold into private holdings of gold.

The devaluation of sterling means the writing down of approximately $1 billion in the value of £2.3 billion of reserves that are held in the form of this important currency.

Chairman REUSS. If I may interrupt you there because you are stating a truism, that I think may have escaped many of us. The free world reserves over the weekend went down, you are saying, by a sum on the order of $1 billion?

Mr. BERNSTEIN. Well, omitting any transactions which are not yet reported and which may have a nominal effect on gross reserves, I would say that, in terms of dollars, the gross reserves of the world dropped by roughly a billion over the weekend. That is because there was something like £2.3 billion of reserves in the form of sterling and these are worth 40 cents less per pound. Of course, there is a good deal of sterling held by nonmonetary authorities, although these holdings are partly offset by claims in sterling.

Chairman REUSS. So the need for activation——

Senator SYMINGTON. Mr. Chairman, let me be sure I understand. Are you saying that the British have $7 billion in gold reserves?

Mr. BERNSTEIN. No, sir.

What I am saying is that countries throughout the world hold official balances, balances of their monetary authorities, in the United Kingdom, other liquid assets, which amount to, or amounted to, something like $6.4 billion in dollar equivalent at the old rate of exchange.

We now have to reduce that by one-seventh in dollar equivalent. That is a drop of a little over $900 million.

Senator SYMINGTON. Are you saying there is $6.4 billion of sterling held in Great Britain and other places redeemable in gold upon call?

Mr. BERNSTEIN. Not in gold; although the sterling is convertible into dollars.

Senator SYMINGTON. I want to be sure I understand.

Mr. BERNSTEIN. The sterling is held in the same way as dollars, either deposited in banks, or invested in liquid assets that can be converted quickly. The claim of the holder is a sterling claim. The sterling I am talking about is that held by foreign monetary authorities—by Australia, and so on. With the change in the gold parity of sterling, the dollar equivalent of these sterling balances is $900 million less than it was last week.

Senator SYMINGTON. I see.

Chairman REUSS. Sir Roy, did you want to comment at that point?

Sir ROY HARROD. No.

The thing has been made plain.

Chairman REUSS. Right.

Mr. BERNSTEIN. As the purpose of the plan for a new reserve asset is to meet the world's need for reserves, that should be the sole test on activation. When the managing director of the International Monetary Fund finds that we need more reserves because the growth of reserves is too small, that is the time to activate the plan. I have merely observed that the present indications are that that would mean activation about as soon as the plan is ratified and the International Monetary Fund can make the technical arrangements for proceeding.

In my opinion, it is a mistake to make activation depend upon the balance of payments of the United States, except as this balance of payments may have some ancillary effect on the reserves of the world.

In the first place, the very concept of what is the balance of payments of the United States is not an easy one. Well informed men can differ within hundreds of millions of dollars as to what it means, and what is more, technical economists may in the course of a generation have a completely different approach to the balance of payments.

The liquidity definition of the balance of payments is subject to so much arbitrariness of definition as to be almost meaningless.

Money-market assets are counted as settlement items if the maturity date is a couple of days earlier, but are counted as foreign capital inflow if the maturity date is a couple of days later. I am talking about the investments in CD's of more than 1-year maturity.

The liquidity definition takes the approach that if private foreigners hold more deposits in this country, it is a settlement item. On the other hand, if our banks make loans to foreign governments or to foreign banks, to say nothing of loans to foreign business, that doesn't go into the settlement items.

If our banks borrow abroad, as they did in the Eurodollar market, that is no alleviation of a balance-of-payments deficit. In the days of Bagehot, in the classical gold standard, it was regarded as the most practical way to eliminate a balance-of-payments deficit quickly and to relieve the pressure on gold reserves.

The Review Committee on Balance of Payments Statistics brought in a unanimous report but we were divided equally 4 to 4 on the question of whether we should set up in our balance of payments an account called banking transactions which would have had in it borrowings by our banks from foreign banks, but also the lending by our banks to foreign governments and foreign banks. We would have kept out all transactions with nonbanks or nonmonetary authorities from that account. As I said we were divided 4 to 4 on that and we didn't pursue it.

It doesn't seem to me that it is reasonable to make an improvement in the U.S. balance of payments a condition for activating the new reserve plan.

This is without prejudice to the proposition that if the U.S. balance of payments is being financed by a big increase in foreign holdings of dollars, official holdings of dollars, then that is a growth in monetary reserves that would affect my conclusion. On the other hand, if there is no growth in aggregate monetary reserves, the growth in official holdings in dollars being relatively small, I would say that a U.S. payments deficit is no reason for postponing the activation of a plan for creating reserves.

I am willing to leave for later the question whether we can have a stalemate on activation and what is the significance of a veto for the Common Market countries. Do you want me to add a word or two on that?

Chairman REUSS. Yes. But might I ask a question on where you have gone so far, which is to say that there is certainly no automatic relationship between the U.S. balance-of-payments deficit and the need for new SDR's and that, therefore, our balance-of-payments situation should not be taken into account in the decision to activate except insofar as our deficit leads to an increase in foreign officially held exchange reserves. I think that is what you said.

Mr. BERNSTEIN. That is what I am saying. I have no objection to their looking at the U.S. balance of payments as much as they wish and if they have good advice I am glad to have them offer it to us.

Chairman REUSS. Let me then, before you go on to the other important point, ask you how should this govern the action of the U.S. authorities and later on the action of the U.S. Congress in view of the statement by the French Finance Minister at Rio in which he quite plainly said that unless there is marked improvement in the U.S. balance of payments, no activation. What should we do if we continue to be confronted by that? This may relate to the next part of the question.

Mr. BERNSTEIN. Yes.

I would say that the answer to that is the following: When the U.S. balance of payments is being financed by the considerable accumulation of dollars by other countries, which they hold as reserves, then there may be something in the argument that there is no need to create a new reserve asset to supplement the accumulation of dollars at such a time.

But as it is very unlikely that this would be the case, I would say that the behavior of the U.S. balance of payments is not a relevant and certainly not a decisive consideration in the activation of this plan, however important an improvement in the U.S. balance of payments is for many other purposes.

Senator SYMINGTON. Could I ask a question?

Chairman REUSS. Surely.

Senator SYMINGTON. Your position is clear, and I respect it. But based on the political operations along with the economic philosophy of General de Gaulle, it is also clear that he doesn't agree with you.

My question, therefore, is: How important do you think his disagreeing will be? I have noted the International Monetary Fund and its various proposals. I think it was called the CRU at that time; and also noted the SDR, or whatever is the new proposed currency. However, it seems to me that control of decision in this field is shifting from the IMF people to the BIS people; I get from various Government agencies, that future decision might be at least as much with the BIS as with the IMF.

With the premise De Gaulle doesn't agree, my question is: How important to our ultimate actions is his disagreement?

Mr. BERNSTEIN. Senator, I would like to qualify what you have said in this way: I don't believe that the International Monetary Fund as an institution can be thought of as having final authority to make important decisions in the guise of recommendations of its managing director and staff without the consent of the great financial powers. That has always been true.

Senator SYMINGTON. Let me rephrase my question then. There was a time when we controlled the situation.

Mr. BERNSTEIN. That is right.

Senator SYMINGTON. Because, in effect, we controlled the International Monetary Fund.

Mr. BERNSTEIN. In a sense.

Senator SYMINGTON. We don't control the situation anymore, as I see it, because we don't control the BIS, the Basle boys. With that premise, I wonder what you thought, based on what has happened in recent days, would be the influence of the French with respect to any decision.

Mr. BERNSTEIN. I do agree with your question. I just wanted to make it clear that it has always been true that the great powers exercised the real influence that decided what the policies would be. It is not the men at the BIS, they are very good friends of mine, but they have no more to say on these things than the staff of the IMF. They are listened to very carefully because they are very wise men, but their views aren't decisive in any sense.

There is a big shift of power, Senator. Inevitably power moves to those who have the resources that others are trying to borrow. When the dollar was virtually the only currency that was drawn from the International Monetary Fund, we exercised that power. In my opinion it was generally exercised in a reasonable way. But sometimes it was not. It is not easy to make people who are at the top of the financial world look objectively at these problems. Because they are at the top of the financial world they are apt to think their policies are exceptionally wise.

We may run into the same problem with the Common Market. It is inevitable that the Common Market countries should have more influence in the International Monetary Fund and more influence in the creation of the new reserve asset than they ever had before.

On the whole, this is not a bad thing. No system is going to work in which real resources have to be transferred from one country to another for a fiduciary asset unless the countries that are giving the real resources feel reasonably assured that the system is working well, and not against their longrun interests.

Even the International Monetary Fund as it stands today is a less effective instrument because the voting power of the Common Market countries is less than it should be to reflect their present strength in world affairs.

I want the Common Market countries to take more responsibility on international monetary matters. I don't believe, Senator, that this will lead to a veto or a stalemate. In fact I am sure it won't, and I had better explain why I think so. We have given the Common Market countries a veto power over the creation of the new reserve asset. Incidentally, Senator, since you have mentioned the CRU, I want to point out that the asset we have actually created is in every respect equal to the CRU. As a matter of fact, it is the CRU, in fact if not in words.

Senator SYMINGTON. Sort of a Dr. Jekyll and Mr. Hyde?

Mr. BERNSTEIN. Well, I think something like this must have happened, Senator. When they got around to trying to do what the French wanted to do, that is to create a kind of super reserve credit which isn't a reserve asset, they found it was impossible to differentiate it from ordinary reserve credit without making it a reserve asset. So the Group of Ten, including France, wound up making the special drawing rights a true reserve asset with some qualifications as to how much countries could use on an average over a period of time.

Chairman REUSS. We want to be sure it is not a picture of Dorian Gray. [Laughter.]

Senator SYMINGTON. As I get it, the CRU is an elderly SDR.

Mr. BERNSTEIN. But we elderly people ought to be very pleased with it. I am. I don't mind at all France's having the name it wants for the new reserve asset. And if anyone wants to classify special drawing rights as a reserve facility rather than a reserve asset, that suits me. I want the system to work well; that is all I care about.

Senator SYMINGTON. Mr. Chairman, you have been very kind. We are having a vote at 11 o'clock on social security so I perhaps won't be able to get back. I wanted to find out the thoughts of the possibility of creating a new currency along with such problems as taking care of our balance of payments, the constant draw on the IMF, what the British have done recently, unfortunate especially after what Mr. Wilson said here only last July, and what Mr. Callahan and Mr. Wilson both said more recently. So what is the effect of the French decision not to go along? Naturally, I would like to see us get bailed out of this increasingly serious problem.

Mr. BERNSTEIN. I don't think the French can veto this plan. A baby has been born. Any country that wants to kill it is going to be guilty of infanticide. It is going to have to do this in the face of the opposition of 106 members of the International Monetary Fund. I don't think it will be done, Senator.

Senator SYMINGTON. That is the answer to the thrust of my question.

Mr. BERNSTEIN. I expect the Common Market countries to use their power in bargaining to get this or that concession at the margin including delay: "If you wait a couple of months we can make it unanimous"; and to hold down the amount of SDR's that are created: "If you limit it, say, to $1,500 million a year, we will go along, but if you insist on $2 billion we are going to have a long drawn-out fight." That sort of thing. The 85 percent vote is an instrument, an extra instrument, in their hands to secure a compromise more favorable to their view.

Now, Senator, the SDR's cannot be a direct solution to balance-of-payments problems. They can't be a direct solution to balance-of-payments problems for a variety of reasons. The most important is that no country is going to get allotments of special drawing rights on a scale, even with a generous creation of special drawing rights, that would make a major contribution to solving its balance-of-payments problem.

For example, even with a $2 billion creation, we would get a little bit under $500 million. Well, you can't even estimate the deficit of the United States within $500 million, much less solve the balance-of-payments problem with such a sum. So, Senator, I think the way the SDR plan helps us is that it will provide a world in which reserves are growing. In such a world, trade can keep expanding and the problem of solving a balance-of-payments problem is somewhat easier. Just as the problem of solving unemployment is much easier in an expanding national economy, so the problem of solving balance-of-payments difficulties is easier in a world that has expanding trade.

Senator SYMINGTON. Yes, I see that; but I don't want to get off my main point which has nothing to do with balance of payments, rather with French intransigence about what we now want to do, and presumably what the British want to do also. We had a local fellow here in town the other day who said he had $92 million assets and $85 million in liabilities; and he would have been all right if one man hadn't brought a suit for only $175,000.

What I would like to know is what you think French resistance to all this could do? My interest at this point has relatively little to do with any balance-of-payments problem.

Mr. BERNSTEIN. Senator, I don't think the French can stop it. What they can do is what I have said. They can use it as a bargaining device to get more favorable conditions for creating and operating the system.

Senator SYMINGTON. Could I ask does Sir Roy agree?

Sir ROY HARROD. May I defer that until I make my statement?

Senator SYMINGTON. I did not understand.

Sir ROY HARROD. May I defer it until I make my statement?

Senator SYMINGTON. I hope I can stay to hear it. We have a vote at 11:00.

Chairman REUSS. Would you then, Mr. Bernstein, come to the point I raised? Suppose at post-Rio negotiations the French attempt to write into either the outline plan or the accompanying report of the IMF some sort of language which does attempt to link the U.S. balance-of-payments deficit and the activation of SDR's, which linkage you have just said, and I agree with you, would be inappropriate. Should we then go ahead with the agreement in the face of that, or by so doing would we be possibly immobilizing ourselves from other alternatives, such as proceeding without France, if it came to that?

Mr. BERNSTEIN. I think that if the French wanted to use this test, the improvement in the U.S. balance of payments, the staff of the International Monetary Fund would say to them: "What do you mean by the U.S. balance of payments? Does it or does it not include as a receipt short-term funds brought into the United States? If you mean the official reserve settlements deficit, why, yes, we will take that into consideration because it will show up in our examination of the growth of world reserves and whether it is adequate."

Senator SYMINGTON. France, though, judged by Mr. Debré's speeches, would not agree. They have placed more store in supposed perfection in our balance of payments than just that portion of our deficit that goes into actual reserves for aiding other countries.

Mr. BERNSTEIN. I am not sure how that would finally come out. We have talked about the BIS before. The BIS in its annual review of the world pattern of payments uses the official reserve settlements definition because it is the only one that can be used symmetrically.

I think the staff of the IMF which will have the task of providing the technical memorandum on activating this system will think along the line I have suggested to you.

Chairman REUSS. Meanwhile, though, the agreement put to the Congress and the other legislatures will have to have some language in it with respect to activation. If you leave it just as it is, you are confronted by a grave ambiguity in the legislative history whereby France can say: "Look, we told you at Rio that we meant by activation no activation absent near perfection in the U.S. balance of payments."

Mr. BERNSTEIN. Well, there is going to be an actual amendment to the Articles of Agreement of the IMF. That will be the final authority on what the activating conditions will be.

If at the time the French make a speech and say they interpret it so and so, it will be part of the legislative history. But I am not a lawyer and I don't know how decisive that would be.

My guess is that nobody will agree with them.

Chairman REUSS. Let's suppose though that the amendment to the Fund Articles and the accompanying report don't spell out what the terms of activation shall be any more than has so far been spelled out in the outline plan tentatively adopted at Rio, and that this is accompanied by French legislative history by speechmaking or footnotes or other words, which later give them a standing to say: "No, we didn't agree to activate under circumstances where the United States is still running a substantial balance-of-payments deficit." Have we in such circumstances disadvantaged ourselves? Is there anything that we could not then do by way of an alternative plan which we could do had we demurred at the threshold?

Mr. BERNSTEIN. The history of reservations to international agreements is a very old and long one. There are 107 countries that are going to act on this agreement, ratify it. I think if each one makes a speech saying what it thinks about each of these different sections to suit itself, they will have no significant effect on the agreement.

A reservation to be effective must be accepted by the others. I do not think France's reservation, if it makes such a statement, will be decisive in the operations of this new plan. I am inclined to think that the amendment states clearly that the purpose of the plan is to assure the growth of reserves, and the test of activation will have to be whether reserves have grown.

Chairman REUSS. You do think then, I gather, that the United States must take care, and other countries who agree with us must take care, that whatever the gratuitous legislative gloss put on this by the French, whether they say black means white or whatever they may say, that we should be very careful that the actual language of the amendment to the Articles and of the accompanying IMF report give no nourishment whatever to the notion that activation must await substantial improvement in the U.S. balance of payments.

Mr. BERNSTEIN. Mr. Chairman, I mean precisely that. You have summarized just what I think.

Chairman REUSS. Before turning to Sir Roy, have you had an adequate opportunity, as it seems to me you have had, to respond to the first question that I put?

Mr. BERNSTEIN. Oh, yes. I have said everything that I want to say now. If I have anything more I will add it.

Chairman REUSS. All right. Sir Roy, would you address——

Senator SYMINGTON. Mr. Chairman, may I ask one question before we leave Professor Bernstein?

As a continuation of our dialog, somebody who has had a lot of experience in this field states:

> In the first place, the agreement at Rio during the annual meeting of the IMF which has been hailed by some as a great success, nevertheless provided the European countries with an effective veto over the activation of the new liquidity plan. But if the Europeans are unwilling to finance our deficit by holding dollars, and if European countries show little concern over reducing their surpluses, why would they provide unlimited financing for a continued United States balance-of-payments deficit?

It would seem to me a rather pertinent observation.

Mr. BERNSTEIN. First, I do not think that last sentence is pertinent—it seems to me to be irrelevant. Whoever said any plan is going to provide unlimited financing for the U.S. balance-of-payments deficit? This expert has set up tests of what a new international monetary system should be that no one on earth has urged, not even we.

As you can see, Senator, I do not think this is a valid point. It does not seem to me to be touching the merits of the question.

The system we are setting up is the most radical change in the international monetary system that the world has ever known. It is the creation of a new reserve asset, fiduciary in character, intended to grow year after year.

Before some of our young experts in this field have become old men there will be more fiduciary reserve assets than gold in the international monetary system.

It is in the nature of such an innovation that it should start reasonably conservatively. I just want to be sure that the actual operation is done intelligently. In my opinion, the new reserve asset will be managed in an intelligent way. That does not mean that the new reserve asset must be the quintessence, the universal solvent, the philospher's stone. It is unreasonable to expect that there will be no international financial problems hereafter if we create special drawing rights. That is a nonsense test of whether the agreement for a new reserve asset is a good one.

Senator SYMINGTON. One more question. As I understand it, the French control more than the 15 percent required to veto any plan based on Rio?

Mr. BERNSTEIN. Oh, I do not think so.

Senator SYMINGTON. They control the Common Market. I want to be sure I have your thinking. This is not any criticism. I am trying to be informed——

Mr. BERNSTEIN. Yes.

Senator SYMINGTON. As I understand it (*a*) you feel that France does not control the Common Market and (*b*) therefore, regardless of their feeling as a creditor nation as against our and other nations' problems, all that will be overcome in the ultimate decision; is that correct?

Mr. BERNSTEIN. Yes, sir.

Senator SYMINGTON. Thank you.

Mr. BERNSTEIN. Senator, I believe the French cannot carry the rest of the Common Market with them on this question. They tried and did not succeed. Second, in my opinion, the French are at the peak of their capacity to influence the Common Market.

Their economic strength is not growing relative to that of the rest of the Common Market. The power of France to get its way at present is to a large extent due to the fact that its partners in the Common Market do not want any political exacerbation of their relations at this time. It has nothing to do with the economic strength of France being great enough to overcome what the other members of the Common Market want to do.

Senator SYMINGTON. Thank you, Doctor.

Chairman REUSS. Now, Sir Roy, would you address yourself to this first question which has in it the elements of, one, is the United States balance-of-payments position in itself a legitimate criterion in a decision as to the activiation of the new SDR's and, two, to what extent, if at all, does the United States jeopardize its later freedom of action by entering into a ratification when the activation may be subject to some of the hazards described.

STATEMENT OF SIR ROY HARROD, OXFORD UNIVERSITY

Sir ROY HARROD. Well, I first must say that I deeply appreciate the honor of being asked to express my views here when I am not a citizen of the United States.

Secondly, I must rather stress that I should not be taken to represent the views of the British Government nor even to be expressing the opinions that are typically British, still less, as I hope, opinions that are slanted in the British interest.

I have in rather extensive writings published in a great number of countries put forward certain opinions and I hope, therefore, that I shall be regarded as entirely objective and impartial and international in my approach.

However, I can just say that I have for many years followed the affairs of this country rather carefully and with sympathy, ever since I started giving a course of lectures, a regular course of lectures, on the Federal Reserve System at Oxford in 1925.

I have jotted on this bit of paper a number of respects, five respects, in which I regard this agreement as a real and important advance, but I do not think you want me to deal with those, because I think you want me to push on and talk about activation, and so on.

Anyhow, I have got them here. I can always go back to them. The five points of real importance in which I think there is great advance over anything that has been thought of——

Chairman REUSS. If you could summarize those five points we would welcome them.

Sir ROY HARROD. I will try to state them very shortly then because they are at variance with what has been discussed for so long in the Group of Ten and are at variance with what some people want.

One is that the special drawing rights are unconditional. That makes them nearer Bernstein's CRU's than the old drawing rights.

Secondly, while there has been a great argument about repayment, now called "reconstitution," there does remain the vestige of the requirement for repayment, but I would say it would be minor and, indeed, in the working of the thing I guess if they retain this 70 percent formula, a complicated one, people will probably not draw more than 70 percent of their SDR's and thereby have no repayment obligation.

Thirdly, a very important point is that it includes the obligation of creditor countries to recieve in payment twice as much in SDR's as they have been allotted.

Now, that is not logical, but I think it is a pragmatic solution that will probably work, and it gets us away from what I regard as an objectionable feature in the General Arrangements to Borrow that the creditor countries, when they advance credit have some special right to interfere.

The fourth point is that, except for one clause, which I won't mention now, I could come back to it, V.1(a), the less-developed countries seem to be fully privileged along with other countries and have equal facilities.

And the fifth point is that the International Monetary Fund itself is in full control of the thing; it is going to run the thing; it will be the sovereign power.

Only a year ago people were proposing a sort of bicameral institution in which the IMF had to agree, and then the Group of Ten had to agree separately. All that is gone.

Those are five points in my opinion where there has been a great advance.

Then, of course, I am very worried that the great central shortcoming is, as we have been discussing, no activation date, nor any statement of the amount for the first 5 years.

It seems to me those two things are linked because an activation date would be meaningless if the amount in the first 5 years was only, say, $100 million a year or some trivial sum. So we want an activation date and the amount. Now, these are not yet in.

There could be a very long delay. Now, I want to concentrate rather on this activation date.

We have talked about what Monsieur Debré has said, but I brought the text in here, and what he said was rather stiffer than what has been said in dialog here.

He said the plan is subject to three conditions, all of which are difficult. The first condition is that the mechanism cannot come into play until a worldwide shortage has been collectively recognized to exist. Those words "collectively recognized" are rather formidable.

Secondly, it cannot come into play until there is more satisfactory operation of the adjustment process. That is just a point on which people have very widely differing opinions—about what the adjustment process should be in the case of this country, for instance.

And then, thirdly, the crucial point, the mechanism cannot come into play until the balance-of-payments deficits affecting the countries whose currencies are designated as "reserve currency" have disappeared.

He does not say "diminished," he says "disappeared." Well, that is a very strong condition.

The German Finance Minister—I have his statement here—was more moderate. He did not talk about disappearance but diminution. But I think the German point of view—I do not think we should feel that the French would be the only ones to take this point of view—the Germans are, basically, very near the French.

I cannot talk—Mr. Bernstein is a great authority—on the probabilities of what may happen. I just want to address myself to one point, and that is, I suggest, that activation should be embedded in the amendment before the legislatures are asked to ratify—embedded in the amendment.

Now, I am told there is no possibility of renegotiating that now. The various people, the people who wanted a progressive solution, have gone as far as they can, and there is no possibility of renegotiation by which you could get that activation date embedded.

Well, I accept that from those who know, I accept that that is so. But I do not think it is germane because given the existing attitudes, there is going to be a considerable delay anyhow.

A refusal to ratify until an activation can be embedded need not prolong the delay at all. A procedure is laid down in section III.3 whereby the Managing Director of the International Monetary Fund shall take the initiative in ascertaining whether there is a broad support for activation.

Well, he is presumably going to be vigilant—on the lookout. The moment he sees there is a broad support for activation, he will report it. He won't be laggard in trying to find out whether there is a broad support or not.

Well, now, I would suppose there would be some constitutional procedure here by which Congress could make it plain that, as soon as it was reported that there was a consensus for activation, and a sum must be put in, too—a sum for the first 5 years—that Congress would ratify. I do not see that that leads to any delay.

Supposing it does not ratify it now? Mr. Schweitzer will get busy. Whether he can get consensus in the next year or the year after, we just do not know. But if it is understood that, as soon as the activation date and a satisfactory sum are put in, Congress will ratify, this should not take extra time. I assume hearings by this committee will develop further in the months ahead and will have been completed in good time.

Senator SYMINGTON. Excuse me, Sir Roy, how would you define a conclusion as to broad support?

Sir ROY HARROD. That is up to the managing director to discover. In the debate, the word "consensus" has been used. Broad support are the words in the document, but in discussions we said that all of these Group of Ten people really have all got to agree. Now, I do not see that my plan really would involve delay.

I am going to list three objections, as I see them, to immediate ratification without an activation date. Two are minor and one is major.

Of the two minor ones, one is that ratification in advance of activation date would raise the majority required for activation from 80 to 85 percent. That point has been made already here this morning.

What has to be inferred from that, I think, is very difficult to say—85 percent, of course, gives the Common Market a veto. Whether the Common Market will act together is very difficult to say. They did succeed in acting together in a rather remarkable way on the Kennedy Round of negotiations.

We cannot say. But they might take the line: "Well, in introducing a big change we are not going to agree on a proposal unless we have unanimity." Of course, they may not say that. That is a gamble.

But if there is no harm in delaying ratification, and if there is that danger in regard to the 85 percent hanging over you, why not do so?

If there is no harm in delaying ratification, and as, by ratifying you raise, you automatically raise from 80 to 85 percent the ratio required to agree to activation, why not delay ratification?

Secondly—this may come under your second question—but I just listed the point here. Some of the amendments to the existing articles are, as I have heard, going to be restrictive in character, restricting the powers that the IMF has under the existing articles. Amendments to the existing articles would come into effect at once, if there was ratification. So, you see, you would have the restrictive clauses right away after ratification, whereas the more liberal plan, the great plan, which is going to astonish the next generation, that great plan, is held up sine die. The restrictive clauses will come into force at once.

Chairman REUSS. What are the restrictive clauses?

Sir ROY HARROD. Well, I think they have not been spelled out. But the changes in the existing articles, which it is generally believed are going to go in a restrictive direction limiting the powers of the Fund itself in certain respects, altering definitions of——

Senator SYMINGTON. Limiting the powers of what? I did not catch the word.

Sir ROY HARROD. Powers of the Fund, limiting their powers, by making certain things they can do now on their own initiative, dependent on an 85-percent majority. These may include altering the definition of "reserve positions," and so forth. They are said to be, on the whole, restrictive, but they have not been spelled out. Those are the two minor objections.

Now, the major one in my view is that, if there is going to be a long delay in getting this thing forward—I feel the French attitude has got to be taken seriously, if I may say so—our British experience with the French is that they do not usually go back on what they have said; they rather tend to stick to it.

If there is to be a long delay, it might be deemed desirable for like-minded countries who could constitute a big majority of the free market world, to get together and implement an interim scheme that was less than universal. It would be open ended, it would be free for everyone to join, it would be terminated as and when the universal scheme was "activated."

Well, now, if there is going to be delay for 2, 3, 5 years, a delay that, the mounting tensions in the international monetary system—which, unhappily, I am afraid will not have been relieved by the sterling devaluation—might create a rather urgent need to get going with some scheme.

You could have an interim scheme with which the vast majority would agree—and anybody else could come in as and when they wanted. We say this is the "interim" scheme, to go on with, until the big scheme is activated.

But, I think, if you ratified the big scheme, that would be very prejudicial to getting together and getting an interim scheme to work. That, I feel, is the big objection.

So, on this part, on these answers to the first question, I call up to mind an ancient slogan which the Americans used against the British, but I am glad to recall that some famous British people, like Chatham and Edmund Burke, cordially agreed with the Americans, "No taxation without representation," and I would give a similar slogan now to preserve the just liberty and freedom of action of this country, "No ratification without activation."

Mr. BERNSTEIN. Mr. Chairman, I am going to have to add a word to this. It may help to take a look at how these negotiations went.

At a very important stage in the neogitations for a new reserve asset, the French said they did not want to have any plan at all. The trouble with having a plan is that if you have it, you are bound to want to try it.

If you assemble a flying machine, an airplane, you are bound to try to see whether it will really go into the air.

I think the fear that activation will be unduly delayed is mistaken. I believe that to attempt to set a date now for activation of the plan would be an even bigger mistake.

The Articles of Agreement of the International Monetary Fund provided simply that when it is ratified the Fund will be organized. Thereafter, the exchange operations of the International Monetary Fund were to begin after the Executive Directors had agreed on the par values, and even then, of course, they could decide to lend or not to lend.

Between the date the IMF agreement was ratified in December 1945 and the date that the Executive Directors——

Sir ROY HARROD. By their country, not by all countries at that time.

Mr. BERNSTEIN. I am sorry. The Articles of Agreement were ratified before January 1, 1946, Roy, and the Executive Directors had their organization meeting about 2 months later. They needed a little time to get elections of directors.

In March 1946 we had an inaugural meeting of the Board of Governors, not just the directors, in Savannah. I believe it was March 1946.

But in any case it was about February 1947, that is more than 1 year after the Fund was organized, that the directors declared the Fund was ready for exchange operations, and even then there were no operations for a time until the first country, the Netherlands, came to borrow something like $8 million in sterling, which was the first exchange transaction of the IMF.

Senator SYMINGTON. Doctor, do you feel the position of the United States and France in 1945 are roughly comparable to what they are today?

Mr. BERNSTEIN. No, sir.

Senator SYMINGTON. As you present the illustration?

Mr. BERNSTEIN. No, sir. I do not believe the position of the countries is the same. But the two plans, Bretton Woods of 1944 and the Special Drawing Rights of 1967, are at a similar stage of activation. The plan for special drawing rights, when it is ratified, is ready for operation whenever the IMF decides on the creation and the issue of the special drawing rights.

That is one reason why the French did not even want a technical plan prepared.

Second, I think the provision that the Managing Director should propose the time of activation and recommend how much special drawing rights should be created on the basis of his finding general support for these steps is the most favorable provision we could have, because a Managing Director with 107 members is bound to be very much influenced by the opinion of 100 or more of them, even if one or two are a little reluctant to go ahead.

I am confident that this plan will be activated at the right time, and that is when the Managing Director is advised by his technical staff that the growth of reserves has been at a rate which is not appropriate for the expansion of the world economy and that it is necessary, therefore, to create the new reserve asset.

This seems to me the most favorable provision for activation we could have put into the agreement.

So I point out this, Senator:

(*a*) The country that did not want a detailed agreement at all, and I mean France, did not prevail. The Agreement was prepared.

(*b*) The view that the Special Drawing Rights should be a type of credit instead of a reserve asset did not prevail. It became, in fact, a reserve asset.

Even the 30 percent of the Special Drawing Rights that must be reconstituted are more readily available than the gold tranche in the IMF, and we call the gold tranche a reserve asset.

The provision that it is the Managing Director and his staff who shall take the initiative in determining when to activate the plan is very much in our favor.

Can I say something off the record?

Senator SYMINGTON. It is pretty hard to have it off the record today. I promise I won't tell anybody.

Chairman REUSS. This will be off the record.

(Discussion off the record.)

Chairman REUSS. This is on the record.

Sir ROY HARROD. May I have one countercomment?

I do not feel that my old friend Mr. Bernstein's review of what happened at the beginning of the IMF is really germane. There was no activation date in the Articles of Agreement of the IMF, true.

But the point was, at that time, once they met at Bretton Woods and had gotten together, everybody wanted to have it. I mean there was no question of people having agreed to it. The Russians agreed but then they walked out and did not want it. Everybody agreed, so it did not matter putting in an activation date or not. It did not matter. Everyone knew when they had these discussions and preliminaries and everything fixed it was going forward.

That is entirely different from the present situation where we know quite well there are some people who do not want it to be activated, they might want to have it in the background.

I do not see that the Managing Director of the Fund is going to judge whether the reserves of the world are adequate. There is no reference in the plan to the staff. The Managing Director, if he is satisfied that the conditions referred to have been met, will conduct consultations to ascertain there is broad support among the participants. It is clearly the Managing Director, who is going to feel he can trigger this thing off once he has got this consensus. That is the point. I do not think the staff is going to play much part. Finally, as regards the French, it is quite true, I remenber very well over a year ago, they said, "We don't want to, we won't agree to, a contingency plan, because it is dangerous to have a plan in existence."

They might want to activate it, and I would say simply the French felt they could not stand their——

Senator SYMINGTON. You will have to excuse us. There is that vote coming up.

Sir ROY HARROD. I am sorry.

Senator SYMINGTON. I wanted to listen.

Chairman REUSS. Let me do a little devil's advocating against your stirring "no ratification without activation."

Mr. BERNSTEIN. He is a good phrasemaker, isn't he?

Chairman REUSS. Although why a Britisher at this particular time in our history needs to come over here and urge us to adopt patriotic slogans I do not know, but anyway you are very welcome.

I think what we are doing here is weighing political risks, and I do not find any fundamental difference in the testimony of Mr. Bernstein and Sir Roy on the general expectable benefits of the new SDR agreement.

The question is largely a tactical one for the U.S. Government or the U.S. Congress.

If either the U.S. governmental representatives at the post-Rio meetings, or the U.S. Congress in looking at the proposed ratification, said "No ratification without activation," and since there has not been this "go round" by the managing director of the IMF, and we do not really know either the date or the amount of the first activation, if that were the position we took, might it not be a plausible excuse for people like the French to say: "Now, look, we have gone along and have made tremendous concessions right down and through Rio, but now it turns out that the United States wants something additional which wasn't in the Rio outline at all, namely, a showdown on the first activation go around before it ratifies."

It seems to me, without answering my own question, that there is some danger of that, and if we gave France an opportunity this late to torpedo the whole thing and still look good in the world's eyes, so that it could be said by some reasonable people, "Well, you can hardly blame the French. The United States suddenly reneged," this is a hazard that we have to, it seems to me, take into account.

Looking at the other side of the picture, suppose we do ratify without a firm commitment as to activation, with nothing more than the hope and hunch that Mr. Bernstein has that having gone this far and set up the machinery, it would be used, have we, in fact, really put our head into the noose to a very great extent if the worst happens—if France, using what suasion it can on the rest of the Common Market, prevents any meaningful activation, say, within 2 years after ratification? Is it not then open to the United States and other like-minded countries to form a consortium less France or other dogs in the manger, if thus they turn out to be, which could be a good interim second best?

As to the other minor hazards you pointed out, namely, the restrictions on the existing IMF, the parallel proposal, I certainly think you have a point there. That point perhaps, though, could be met by typing the "no ratification without activation" to that, and providing that the restrictions on the regular IMF shall come into force and effect only after an initial activation in satisfactory amount.

How would you rebut the analysis I have tried to give?

Sir ROY HARROD. I think your last-mentioned proposal would require rather big renegotiation. I do not think that is one that would be very readily accepted, namely, that the amendments of the existing articles should be deferred until there was activation of the main scheme.

Chairman REUSS. You would defer them under your "no ratification without activation" position?

Sir ROY HARROD. I would defer them as a consequence of there being no ratification date, but I would think you would have to alter the proposal somewhat.

The proposal would be that there would be ratification as soon as an activation date was embedded in the scheme, which is at present a shell, a mere empty shell, which could be activated or might never be, after which, but only then, the changes of the existing articles would come into force at once. Well, you might say as regards the changing of the existing articles, "Wait until the main scheme is activated," but that would be a big renegotiation point.

Mr. BERNSTEIN. I am afraid there is a great misunderstanding there.

First, I would like to accept the view expressed by the chairman on activation. It seems to me completely right.

I would just like to add a point or two to what he said. If the United States had bargained with the Group of Ten for putting an activation date in the agreement, a long struggle involving compromise and probably involving a rather late date would have had to be put into the agreement, with plenty of chance of everybody's saying: "Well, with that late date for activating there is no hurry about putting the plan before Parliament for ratification."

The Managing Director of the Fund is much more likely to choose an earlier activating date than any you could have agreed on in a compromise within the Group of Ten. I come back to the proposition that the Managing Director of the International Monetary Fund has 107 members. To him a consensus does not mean that every single member must say "Yes." He would be glad to have the support of every large country. But I cannot see how he could regard the will of the other 100 members as of negligible importance.

I would like to add a word on the proposition that we cut ourselves off from the possibility of a second best alternative by ratifying the agreement that will come out of the Rio resolution.

There are many less attractive alternatives to an international monetary system based on fixed exchange rate, using as reserves gold, dollars, and sterling, as well as the new reserve asset. But the best thing to do with these alternatives is to have other people aware that they exist.

That is much wiser than threatening to use a big stick, because there is very grave danger that when you are brandishing the stick you will find, and maybe they will too, that it is not as potent a weapon as you thought, or not a weapon that could be used without considerable injury to the wielder.

So I think that the alternatives have not been lost. They are all there. The Common Market countries are aware of them and they are more wisely left unspoken.

Chairman REUSS. Just to be entirely clear on this, is it your belief, Mr. Bernstein, that if we ratify in the next year, and the requisite number ratify, and if thereafter the activation is either nonexistent or is of such a niggling nature as to disappoint you, would you feel that we have not foreclosed ourselves from other alternatives, and if specifically there is a world liquidity squeeze, the avoidance of which is the whole reason for SDR's, that other alternatives, such as proceeding without France, would be about as freely available to us, as if we had not undertaken the initial ratification?

Mr. BERNSTEIN. I would say more freely available to us, even, Congressman.

I think I can put it this way: In my opinion the capacity of France to stop the activation of the plan for a new reserve asset has never been less than it is today.

The French lost most of their capacity to stop the new plan when they approved the text of the London agreement.

When they agreed to the Rio resolution under which the International Monetary Fund directors are required to bring in a formal amendment on the new reserve asset, they lost more of their power to stop it.

When they accepted the provision that the managing director shall propose when the activation of the plan shall take place, they became one out of 107 whose views must be taken into account. True, a very important one but not a decisive one.

So I would say the French capacity to stop this plan is less now than it was at any stage up to now.

Chairman REUSS. To pull together, then, what has been said in the last few minutes, you think that the ratification of the Rio agreement, if thereafter there is a failure to activate, would in no way prevent the United States from exercising complete freedom of action on what alternatives to adopt, and you think, furthermore, that with the legislative history being made here this morning, and which would possibly be made in whatever guidelines the Joint Economic Committee may see fit to emit as a result of these hearings, France and others would be on notice that later intransigence is not going to get them anywhere, and that the United States would feel free to take whatever actions were always available to it?

Mr. BERNSTEIN. Yes, Mr. Chairman.

What Sir Roy has proposed is that the United States should say to the Common Market, "We are going to walk out of a universal agreement if we don't have our way on a specified date for ratification." Actually, by getting this agreement ratified with the Managing Director having the right to propose activation at an appropriate date and to recommend the amount of special drawing rights to be created, we are turning the tables.

If the French do not like an international agreement along those lines after it is ratified, they are the ones who will have to break a consensus, not we.

I think that is a much better way to approach this problem.

As I said, the alternatives to the new plan are known to everybody. These alternatives involve a great break from the postwar system.

I think these alternatives should be understood as alternatives, but we are in a stronger position to encourage cooperation when others understand that they exist than if we speak out loud and threaten to use them.

Sir ROY HARROD. I must say——

Chairman REUSS. Yes. Would you come back at that, Sir Roy? And, in your comeback, take into account the fact that it has been asserted here that not only would we, the United States, and other like-minded countries, have a complete legal right to strike out anew if the agreement, once ratified, was aborted, but that there is, as a result of this hearing, and as a result of future events, plenty of notice to all parties that there would be no hesitancy to exercise that legal right if stultification is the result of ratification.

Mr. BERNSTEIN. At least, in my opinion; I do not want it to appear to be anyone else's.

Sir ROY HARROD. I merely wanted to say that I did not suggest that the United States would walk out under any circumstances.

My suggestion was—and I do not claim to know the constitutional niceties—that Congress should make it plain that it approved of the scheme and was prepared to ratify it whenever an activation date was put in. That is not walking out.

Well, then, if there were prolonged delay, and a more limited group of countries got together and devised their own mutual accommodation scheme, which would still be a provisional, an interim, one, the undertaking of the Congress that it would ratify the main scheme as soon as an activation date was put in would remain; it would remain. This would not be a "walkout."

Of course, there are certain other proposals by Americans which would involve a very great departure. I was thinking simply of an interim scheme for mutual support by a more limited group of countries, and that would not be "walking out" at all. It would be merely going on with something, while the willingness of Congress to ratify the universal scheme would still be on the table, as soon as anybody wanted to get it going.

Chairman REUSS. I wonder if you have fully addressed yourself to the "devil's advocate" argument I was making that if Congress said: "No, we are not ratifying, we are turning down the Rio agreement, because there is no activation date or amount in it," could not France or another country say: "Well, now, here we have gone along this far and we were ready to ratify it and go ahead in good faith under it, but Congress said to the Rio agreement, 'No' "?

Wouldn't, therefore, the U.S. interests be adequately protected if Congress, through the Joint Economic Committee, in the very near future, and through the U.S. executive branch, made it clear at this stage that in ratifying it was expecting good-faith early activation, and that the failure of such good-faith early activation would be the signal for the United States to explore and implement whatever alternatives existed?

I wonder, in short, if you couldn't get most of the prudential values out of your position without exposing the United States to the charge of bad faith and backing out.

Mr. BERNSTEIN. As well as giving other countries a second chance to say, "Well, no, let's not have it at all."

Chairman REUSS. That is what I am saying. We are getting down to quite fine points, but I suppose that is the point of this hearing.

Sir ROY HARROD. I think, if it were made absolutely plain that the United States was not "backing out," but that it was perfectly simple and reasonable that it was not going to sign a blank check—you wait before you sign to see what figure is put in—and if you perfectly plainly announced that that was the U.S. attitude, it would not create a bad impression. As to whether the French would be able to do something consequent upon this to save their face, if I may say so, I think it is a psychological mistake in regard to the French. They do not care whether they save their face or not. They rather like to do things the other way around because it magnifies them, it makes them more important.

I do not think it is French psychology to take the excuse of the United States delaying ratification, saying, "Oh, well, we ourselves are no longer interested."

Chairman REUSS. Mr. Bernstein, let me raise, because it has not really been answered, Sir Roy's self-styled minor point that we, the United States, really would lose something if we sat still for the revision of the regular IMF rules, particularly with respect to the voting majority on quota increases, and as part of a package, and then it turned out that the SDR package was later frustrated. We would then have really lost something.

This brings us, I think, to question No. 2, which is what about the proposition of these Common Market countries that there should be a parallel redo of the regular IMF? Maybe you two gentlemen would address yourselves to that point.

Mr. BERNSTEIN. Before I discuss what the content of such an amendment might be, I would like to make one point. This amendment is going to be written by the executive directors of the International Monetary Fund.

I think Sir Roy is unduly frightened by what may come out in that proposed amendment. I see no reason at all to be frightened about it. I can even conceive of an improved International Monetary Fund coming out of it.

In any case, let us not forget that, if the two amendments are put up as a package for ratification, we do not have to ratify if we do not want to. But I am persuaded that there is no reason to be afraid that the amendment drawn up by the executive directors for changes in the present Articles of Agreement are going to be bad. In fact, they may very well be constructive changes.

Chairman REUSS. The French and some of the other Common Market countries have hinted, at least, that what they wanted is a change in the voting arrangements of the regular Fund so that an 85 percent majority is needed on quota increases and, hence, they would have a veto over that which they do not now enjoy.

Would that be good or bad?

Mr. BERNSTEIN. Actually, Mr. Chairman, they have that veto pragmatically today.

If the Common Market countries, who are the big creditor countries of the International Monetary Fund, refused to take a quota increase of their own, then any increase in the quotas of all other countries would seriously impair the liquidity of the Fund and make it impossible for the Fund to provide more reserve credit despite the larger quotas than before.

Nevertheless, I am not in favor of changing the requirement to 85 percent. As a matter of fact, I would like to use this opportunity to achieve something I have been trying to get for a very long time.

I am very much in favor of the Common Market countries having more responsibility in the International Monetary Fund. But I believe that the way to get more responsibility is to put in more resources into the Fund. The Fund needs more resources, particularly of these creditor countries, the Common Market countries.

I think that we ought to be glad that the Common Market countries show they want to take more responsibility. Let us give them greater responsibility in the way that the Articles of Agreement provide. Their votes can go up with their quotas, and I hope they get the votes necessary to exercise a veto, if they wish it, by putting in more resources.

Chairman REUSS. So you are hopeful that the so-called parallel agreement relating to the regular IMF will be a good one; that is, one that enables the Common Market to earn a veto by putting in more resources through raised quotas, which should have been done some time ago?

Mr. BERNSTEIN. Right.

Chairman REUSS. And, too, with such other technical amendments as are constructive?

Mr. BERNSTEIN. I would like to point out that some of the other amendments that are talked about by the Common Market countries are actually very favorable, although it might be bad constitutional procedure to have some of them subject to very restrictive voting requirements.

Let me show you what I mean. First, the Belgians want to declare the gold tranche as, in fact, a deposit-type asset that can be withdrawn without any repayment obligation.

I would say that making the gold tranche a deposit-type asset is not a bad idea.

It is true that the Common Market countries have proposed that the regulations established by the executive directors for quota drawings, the granting of credits, in each separate credit tranche should be frozen as they are today, and that it should require an 85-percent vote to change these regulations.

What they fear, of course, is that these credit tranches, or one of them, will be made automatic. This fear is unfounded. Actually the Fund does not have the resources to permit automatic drawings in the credit tranches. Besides, the more we build up the SDRs to be a reserve asset, the less important the reserve-substitute aspect of the present Fund will be, and the more important will be its recognized reserve-credit function, giving loans of reserves.

There is something to be said for having this distinction clearly understood. The probability is that in the future, far from wanting to loosen the present regulations to make the credit tranches automatic, the directors might want to make drawings even more like credit, with more rigorous tests of credit worthiness.

If the Common Market countries succeed in freezing the present regulations, they are going to make it impossible to tighten the credit-worthiness provisions in the present regulations.

I think some Common Market countries are aware of this point.

Mr. Chairman, my proposition is that the natural evolution of the general account of the International Monetary Fund is toward becoming a lender of reserves on tests that are likely to become stricter on credit worthiness precisely because reserves will be created in the form of special drawing rights and will be allotted to all members of the Fund.

If the Common Market countries freeze the present tests for drawing on the credit tranches of the IMF, they will really freeze their own capacity to set up tighter rules in the future. That is precisely the opposite of what they want to do.

Chairman REUSS. Let us look at the worst possibility. Suppose the Common Market countries, instead of adopting the constructive approach to the amendment of the regular IMF articles which you have suggested, suppose the Common Market countries stick to the point which they, at least, have been hinting at, namely, that without any increase in quotas for them or anybody else, the voting majority required for quota increases shall be increased to 85 percent, which would give them, in effect, a veto.

Now, you have said that that——

Mr. BERNSTEIN. I do not think that is reasonable.

Chairman REUSS. That is unreasonable.

Mr. BERNSTEIN. I do not see any need to change very reasonable working rules in the Fund agreement, especially as the quotas of not only the Common Market countries, but of Japan and Canada, are too small. The only countries in the Group of Ten whose quotas are really adequate, are the United States and the United Kingdom. So I am in favor of giving other members of the Group of Ten more responsibility by giving them larger quotas.

Chairman REUSS. But suppose that the Common Market keeps insisting for its parallel package on the unreasonable approach that you have just described, and suppose 4 months from now the United States is confronted by a Common Market which says, "Look, we will proceed with the ratification of the SDR agreement only if we get the kind of parallel agreement with respect to the regular IMF that we, the Common Market, have been insisting on."

In your judgment, what should the United States do with that impasse? Should we hold our nose and go along with the Common Market parallel proposal or should we say the deal is off?

Mr. BERNSTEIN. I would be perfectly willing to leave it to the good judgment of the Executive Directors of the International Monetary Fund, who represent an awful lot of countries besides the Group of Ten.

Personally, I feel that the Common Market countries would be getting nothing they do not actually have now if the 85-percent vote for quota increases were adopted.

As I have said, it is impossible to raise quotas in the International Monetary Fund now unless the Common Market countries say, "Yes, we will take the same general increase in quotas that you are giving to the others."

If the Common Market countries were to say, "Look, the biggest increase in quotas you can give us is 10 percent. You go ahead and do what you want with the others," then we could not give the others more than 10 percent. If we gave other countries a larger quota increase, it would be impossible for the IMF to work effectively because of a lack of liquid resources. So in practice the creditor countries can set the limit of a general increase in quotas.

I do not think it is right to tie up the constitutional procedure of the IMF any more than it is—in fact, it may have been a mistake for us to emphasize the veto at Bretton Woods. Remember, we have always wanted these vetoes for ourselves.

Let us not get indignant because the Common Market countries together, now the biggest creditors of the International Monetary Fund, want the same veto that the United States alone has.

My own feeling is that, perhaps, even the 80-percent requirement is unjustified. But we did insist on it, and we have it.

Giving the Common Market countries a formal veto on a general increase in quotas would not be giving them anything of any consequence in hampering the operations of the Fund. They can already do that by saying, "We don't want an increase in our quotas."

Chairman REUSS. So that while you would advocate a stanch position by the U.S. Executive Director, and by whatever other Executive Directors were persuaded to your point of view, if in the end they were unsuccessful and were outvoted by other Executive Directors who had temporarily taken leave of their senses, you would say, "Swallow this as part of a package," because you think it would not be devastating in its ultimate effect.

Mr. BERNSTEIN. I do not know why we should assume that it is any worse for five countries to have a veto if they are bigger creditors than we are than for one country to have a veto.

I think the veto is not sensible. I would not want to make it a veto easier than it is, but personally I would feel they are not getting anything if they get a veto on a general increase in quotas.

Actually, what you give countries when you raise the voting requirement is not the power to stop an increase in quotas; you give them more power to bargain down the amount of the increase.

The five countries together would not try to stop an increase in quotas. But by threatening to use the veto, they could get the United States, the United Kingdom, Canada, Japan, to come around and compromise on a smaller increase in quotas.

We have done that before. The Common Market countries would have more formal power but no more real power than now. If they did not want to take an increase in their own quotas, regardless of how many votes it takes to approve a general increase in quotas, the Fund could not do any good by increasing quotas. The increased quotas could not be used.

Sir Roy Harrod. I have not got the last point. If they did not——

Mr. Bernstein. If the Common Market countries exercised the authority they have in the present Articles of Agreement, to say they do not want any increase in their own quotas, then they could effectively stop the IMF from increasing the quotas of everybody else, because the IMF then would not have the money to lend to other countries that try to exercise their increased quota-drawing rights.

Chairman Reuss. Sir Roy, would you now address yourself to the second point?

Senator Proxmire. Could I ask at this point, Mr. Chairman—and I will be brief—I would like to ask a somewhat broader question of you two gentlemen.

I am wondering about the kind of conditions that would make ratification and activation likely and what, if anything, this country can do to promote them.

I have felt for a long time that the reason why we have had as much international liquidity as we have had is because of the deficit in our own balance of payments, that we have provided the liquidity through that deficit, and that as long as there is no need for expanding reserves because of the dollar deficit—there is at least no imperative obvious transparent need—we are unlikely to get effective activation of a greater reserve.

Now, if this is true, would not the balancing of the U.S. payments tend to promote a situation of diminishing international liquidity which, in turn, would tend to promote both ratification and activation?

Is it possible that the international community is working this rationally and this logically, and you can rely on this?

Mr. Bernstein. I do. I think, Senator, you have asked the most important of all questions.

The most important question is not what second thoughts Sir Roy Harrod or I can dig up on the plan we have. The most important question is how do we speed the ratification and activation of an agreement which seems to me to be a very reasonable one and a very good one.

The best way to speed up ratification is for us to ratify the agreement when the formal amendment is submitted to the members of the International Monetary Fund. The principles of the agreement as stated in the Rio resolution are excellent. Once the United States ratifies, many other countries will say, "They are getting ready for business, let's ratify, too."

I think to insist on January 1, 1969, or any other specific date for activation, and spending a year trying to get agreement on such a date, is more likely to delay ratification and activation than to speed it up.

The second question is how do we get prompt activation. Well, there are two points we must bear in mind. The first is to retain the provisions that are in the agreement because they give to the people on whom we can rely most for objectivity the initiative in proposing activation—that is the Managing Director of the International Monetary Fund and his staff.

Second, create an environment in which there will be a consensus of reasonable people that activation is necessary, and that brings me to your point. If the U.S. balance of payments is improved, if there is no big deficit on an official reserve settlements basis so that reserves in the form of dollars are not growing, then I think the Managing Director will feel that it is up to him to move quickly to activate the plan. On the other hand, if foreign holdings of dollars keep growing, while the Managing Director might still go ahead, his case for activation is much stronger when he finds there are no dollars or very few dollars being added to monetary reserves.

I do not think the world needs a zero deficit in our balance of payments, even on an official reserve settlements basis, before it activates this plan. But it certainly will be encouraged if there is an improvement in our balance of payments on an official reserve settlements basis.

Senator PROXMIRE. Dr. Harrod?

Sir ROY HARROD. There is just the one point that the United States might pay its deficits in gold, rather than through the increased holding of dollars by the monetary authorities in other countries, so that if you just leave out the United States, well there would have been the point—the U.S. deficit is still causing an increase in world reserves.

Mr. BERNSTEIN. No.

Sir ROY HARROD. Wait, now, let me finish my sentence. Of course it is true that when the United States pays for its deficit in dollars there is an increase in world reserves, while, if it pays in gold, there is not, since what the outside world gains, the United States loses.

But some European powers do not look at it in this way. They very much dislike the U.S. deficit. When gold flows out of the United States that increases reserves outside the United States. The fact that it at the same time decreases reserves in the United States, they regard as a good thing, because it finds pressure on the United States to terminate its deficit.

So they do not regard the position as unsatisfactory if reserves outside the United States rise while the U.S. reserve goes down.

Mr. BERNSTEIN. I think there would be a feeling that if the growth of aggregate reserves is pretty much halted, which means we are not adding dollars to the official reserves, there is a strong case for increasing world reserves.

No country, even among the Common Market countries, really believes that the allotment we would get from the creation of a new reserve asset is of significant size in financing a large and continuing deficit, and that is what they are disturbed about.

Now, improvement in the U.S. balance of payments——

Senator PROXMIRE.. Let me just interrupt at that point to say is it of significant size, however, to finance the increase in world trade? The increase in world trade has been so great, and we hope it will continue to increase at a rapid rate. Does the SDR offer sufficient flexibility, and so forth, so that in the absence of a U.S. deficit they will be in a position to finance a very sharp and continuing increase in world trade?

Mr. BERNSTEIN. This is another reason why I believe a small U.S. payments deficit, not financed by dollars, would not prevent activation.

Senator PROXMIRE. I see.

Mr. BERNSTEIN. In my opinion, the plan as it stands, reouires the Managing Director to determine on an objective basis what is the appropriate growth of reserves.

If you put in not less than $1 billion in SDR's, it would have some benefit in setting a floor. But there is a grave danger once more that this would prolong the debate on the amount of SDR's to be created: "Look, we can satisfy everything by just having this $1 billion. Why do you want to debate so much? Why don't you compromise?"

I am very much in favor of having the flexibility in the system resting with the Managing Director, because I am confident that he will act objectively and on the basis of technical considerations. That is the best way of assuring an adequate growth of reserves by way of special drawing rights.

Senator PROXMIRE. Let me ask this one other small question. Does the British devaluation do anything, in your view, to hasten the feeling in the international community that we should or should not ratify and activate the SDR's?

Mr. BERNSTEIN. Well, of course, I cannot speak for the international community, Senator. If you ask whether I feel that it had improved the environment, my answer is "Yes."

Senator PROXMIRE. All right.

Mr. BERNSTEIN. I will tell you why.

In the first place, the British balance of payments is bound to become quite strong. I think the devaluation is in an excellent environment, and I think people are underestimating its magnitude.

This is a devaluation of 14 percent against 90 percent of the world trade, with no other great industrial country sharing the benefits of the devaluation.

In 1949 we had a 30-percent devaluation, just under 31 percent, but with countries accounting for 60 percent of the world trade then, much more now, devaluing against a handful of countries, of which the United States and Switzerland were the major ones not to devalue.

So if you take the two dimensions, the size of the devaluation and the extent of the economic area to which it applies, this is really a good-sized devaluation. It is going to be successful.

The impact of the British devaluation will ultimately have to rest on three big groups of countries, the United States, the Common Market countries, and the EFTA countries and other industrial exporters.

About one-fourth of the total impact will be on us. I estimate that the Common Market countries alone will be at least twice as much affected as we are, if for no other reason than that they account for twice as much imports from the United Kingdom as we do, and in third markets it is my feeling that the heightened U.K. competition will be felt more by German and other continental exporters than by us.

It is true that in Canada, and in Australia, the third market competition is going to be felt mainly by us, and it is true that in the Far East it is going to be felt mainly by Japan.

Because the greater part of the improvement in the British balance of payments is through a reduction of the surplus of the European surplus countries, then although our deficit remains, the world pattern of payments will be much improved. By reducing the European surplus, their objection to activating the reserve plan ought to be lessened.

Now, if on top of that we get some more strength in our balance of payments—and remember we cannot afford to absorb the initial impact of the British devaluation on us, we have to pass it on to the surplus countries—then I think we would really have improved considerably the environment for activating this new scheme.

Senator PROXMIRE. Dr. Harrod, you had quite a critical reaction, as I recall, to the devaluation in 1949. What is your reaction as far as the effect on the activation of the drawing rights is concerned?

Sir ROY HARROD. Talking about the British devaluation only?

Senator PROXMIRE. The current British devaluation.

Mr. BERNSTEIN. Its effect on activation.

Sir ROY HARROD. I should think it ought to have a good effect, and for the reason that Dr. Bernstein has mentioned, namely, that it does reduce the world reserve, that part of it held in sterling, which has lost something of its dollar value.

I hope that what we have just heard, the optimistic account of the act of the British devaluation on balance of payments, is correct. I hope it is. I mean I do not profess to have studied the figures in the last 2 or 3 days.

My general experience is that you do not get the full benefit of the devaluation right at once. It may take some time. But I may say that I would rather not have had this devaluation, mainly for internal reasons.

It is going to set up inflationary pressures, it is going to make our incomes policy on which we were having success more difficult. It is against one objective of policy, namely, price stability. It is price-inflationary.

Furthermore, I think the British balance of payments would have come right without it.

Now, I cannot quite see how one can be optimistic as regards the United States, because, after all, the British and Americans are the great competitors around the world against each other.

The British have given themselves—I ought not to say they have "given" themselves, because the devaluation was forced on the British; they certainly did not want to do this, not right up to within a matter of days. They did not want to do this—but they have given themselves a competitive edge of 14 percent against American exporters. Isn't that bound to have an adverse effect?

Mr. BERNSTEIN. First, Sir Roy, I think the improvement in the balance of payments in the United Kingdom, the short one, the quick one, must be on capital account. It obviously cannot work immediately on trade account.

I am allowing a full year to reach the height of the full benefits on the trade account.

I agree the United States has to absorb, will absorb, initially probably close to one-fourth, maybe a little less than a fourth, of the adverse impact.

I think that much more of it will fall against the Europeans, both the Common Market and the EFTA countries. Some of it will fall against Japan.

I do not think that the competition of the United Kingdom with the United States is anywhere near as great as the competition of the United Kingdom with Germany, Belgium, Netherlands, Sweden.

They are a much bigger trading group. The direct effect will be much bigger.

I do not think, for example, that our imports from the United Kingdom are going to rise very much at our balance-of-payments expense.

As to Scotch whiskey, there is not going to be very much increase in imports because (*a*) the British are not going to reduce the dollar price much, and, (*b*) in any case, three-fourths of the dollar price probably consists of the Internal Revenue stamp.

Second, we will buy more British cars, but I think the displacement of Chevrolets and Fords by these British cars will be much less than the displacement of the same-sized European imports.

I would be very glad to see the British gain a big export advantage in the United States at the expense of the Common Market countries, especially the big surplus countries there, and this is what I think will really happen.

But, of course, I agree with Sir Roy that in the first instance both in direct and in third-party competition—third-market competition mainly—our balance of payments must deteriorate, but it will be a small fraction of the total. The greater part must fall on the Europeans.

Senator PROXMIRE. Thank you very much.

Chairman REUSS. Before we leave this fascinating——

Sir ROY HARROD. On that point, just to finish it off—I could not possibly compete with Mr. Bernstein's estimate of these elasticities in these areas—there will be some deterioration in the U.S. balance of payments, which is bad for our objectives, is it not, because it strenthens those who say this "scheme" must not be brought into effect until the U.S. balance improves.

Now, it may be that the United Kingdom balance will improve, but I think these people have their eyes more on this country.

Senator PROXMIRE. Of course, it is so frustrating, Dr. Harrod, because you cannot improve the British balance of trade on your assumptions without adversely affecting the American balance of trade which, in turn, adversely affects the American balance of payments.

We have such a steady surplus in our balance of trade, still about $5 billion, I notice in the latest statistics we have here that it seems to me somehow, sometime, we are going to have to pay that price, and in view of the urgency of the situation in Britain, it would seem to me we would have to pay it now and find other ways of reducing our investments abroad to bring our balance of payments into closer balance.

I am sorry to take so long.

Chairman REUSS. Before leaving this fascinating subject of the effects of the British devaluation, it seems to me that, while the British devaluation may have some untoward effects on the British internal economy in terms of wages of labor, domestic inflation, and so on, from the standpoint of the United States and the dollar, the net effect of the British devaluation is good.

In the trade field, while initially there will be some swiping of American exports by lower-priced British exports, it should not be terribly great, and American industry ought to get some good by the added breath of competition. Ought not this to have a favorable effect on our wage-price structure? I should think so.

Secondly, if Britain had not devalued, and if the pound had continued under pressure, I would have thought that people would have been dumping pounds for dollars, and dollars would have gotten into central bank hands, and some of those central banks would have demanded more gold than they otherwise would have demanded, and the dollar would have been pretty soon less strong than it is today. So I would ask you gentlemen whether you would agree with my overall hunch that on balance the U.S. dollar is better off as a result of the British devaluation than would have been the case had no devaluation taken place.

Mr. BERNSTEIN. I would like to remind my friend, Sir Roy, that if the British balance of payments had been restored by the program that had been in effect, and restored to the extent that was needed, say, roughly $1 billion from the 1966 position, we would have felt the same effects on the U.S. balance of payments. It would have had to be at somebody's expense, and I have no reason for thinking that it would have been less at our expense under a deflation program that worked than under a devaluation program.

The real difference between the deflation and the devaluation is that it does raise the psychological difficulties. If this could happen to sterling, could it happen to the dollar? This question may arise in some minds.

Personally, I believe that while the initial impact is to make people worry and be frightened, in the long run, a strong sterling, a United Kingdom balance of payments which is in surplus, a United Kingdom economy which is not subject to repeated crises and which can run nearer its productive capacity, is a benefit to the whole world, because it stimulates world trade.

Much as I would have wanted to see the deflation program succeed, I think we have to accept the proposition that it was known to objective observers that the program was not going to work, I mean during the past few months.

The British had a right to try their program. I think the program had ancillary benefits in greater stability of prices and wages in the United Kingdom. It has released productive capacity for taking advantage of this export expansion. But I would not have wanted to see the United Kingdom struggling 2 more years to achieve through still greater deflation what I am hoping it will now achieve through the devaluation.

Chairman REUSS. Just one final question on this point, Mr. Bernstein.

If our Chairman, Senator Proxmire, has been right in recent months in his opposition to a U.S. income tax increase—and I do not ask you to comment on whether he has been right or not—but if he has been right, is he still right in opposing it after the British devaluation, because the British devaluation has not wounded the long-term standing of the dollar?

Would you care to encourage our Chairman?

Sir ROY HARROD. I really do not think that the devaluation can have much relation to the need for a tax increase here, because I suppose that in the short term in so far as the British devaluation increases British exports, it is bad for the U.S. export-import pattern, and that that would be a deflationary factor for this country, and to that extent it would make the tax increase less necessary.

Senator PROXMIRE. One other point, of course, is that it has had the immediate impact of increasing our interest rates. We do not know how pervasive that is going to be or how permanent, but this is another deflationary element.

Sir ROY HARROD. Yes, but it will be short-lived.

Mr. BERNSTEIN. I do not think it will stay.

Senator PROXMIRE. Well, I say it will be temporary.

Mr. BERNSTEIN. It is likely to be temporary.

You see, Senator, I do not want to be in the position of commenting on the legislative judgment of the Congress of the United States.

Senator PROXMIRE. You would if you agreed with this comment. If you do not, I understand.

Mr. BERNSTEIN. That is precisely my point, Senator. I, myself, favor the tax increase. I believe that, in fact, the devaluation of sterling does make it more important to have the tax increase.

I hope that the Congress and the administration will work out a solution on taxes and expenditures that is satisfactory to both, and that will improve the budget considerably.

Chairman REUSS. Why does the devaluation make it more important?

Mr. BERNSTEIN. Mainly I think it makes it more important because we cannot afford a further deterioration in our balance of payments.

I think our big loss on the balance of payments is a consequence of the Vietnam war. You cannot help spending $1,500 million or more across the exchanges for that war.

But we must be absolutely sure that we are not impairing our competitive position for a long period ahead by allowing an inflation of our prices and costs as a consequence of the war, the budget deficit, and everything that goes with it.

Senator PROXMIRE. Dr. Bernstein, here we have a slack capacity, and it is getting slacker by the quarter. This economy was operating at 91 percent of capacity a year ago; the first quarter of this year it was down to 87½; the second quarter, 85; the third quarter, 83.8; this quarter it seems to be lower, maybe in the area of 81, 82; hours of work in our factories are close to the lowest level in 6 years; unemployment has increased in the last 2 months more rapidly than any 2 months in the past 7 years—from 3.8 to 4.3 percent—and you put all these things together and it seems apparent to me this is not an inflation that is caused by excessive demand, it is an inflation that is caused by increasing costs, and under these circumstances a tax increase not only has some deflationary impact, it always does; but it also is a cost to corporations that tends to be passed on to the consumer in higher prices because of the cost-push nature of this particular inflation we are having now.

I do not mean to get you off the main subject now; but I do not feel that I could resist it.

Mr. BERNSTEIN. I think every point you made is important, and I would like to answer briefly, and I think it is relevant to the balance-of-payments question we have today.

Senator, I was not originally in favor of a tax increase for this year.

In January I said that the Congress has to stay flexible in considering what fiscal policy should be in the calendar year 1967.

My opinion now is that we do need the tax increase effective January 1, and I will tell you why. Every statement you have given proves that it would have been an economic cost perhaps to have had this tax in effect July 1 or October 1.

But in my opinion an economy like that of the United States is not going to have in 1968 such an accidental conjuncture as it had in 1967 of inventory liquidation, a decline in housing, a decline in consumer expenditure on durable goods, a big increase in consumer savings generally. It is very unlikely to have that in 1968 in an environment in which the Government's budget is in such a big deficit.

The truth of the matter is, the deficit of the Government is an enormous expansionary force.

Senator PROXMIRE. But counteracting that is the fact that the big stimulating forces in our economy from 1964 to 1966 were two. One was business investment in plant and equipment. We may or may not be overbuilt, but on the basis of the McGraw-Hill estimates, and the fact we are operating far below capacity, it makes no sense that we should continue to have that kind of expansion, that kind of accelerator effect on the economy that we got from business investment in plant and equipment from 1964 through 1966 when we increased our investment by a smashing 15 percent or so each year.

The other big impact was escalation in Vietnam. That is history.

Mr. BERNSTEIN. That is right.

Senator PROXMIRE. The statistic we now have that the Joint Economic Committee has been getting since the first of August indicates that Vietnam spending is on a plateau—they indicate no stimulating effect from the Vietnam war.

Under the circumstances, it is possible or theoretical that people will stop their propensity to save, that they have engaged in in the last few months which, incidentally, is about the same level they had during much of the fifties, and it seems a more stable pattern—it is possible they will reverse that—even if they do think how far we have to go before we engage our resources to get up to 91 percent of capacity or to use our manpower to put pressure on in such a way that we begin to employ people seeking work in this country.

Mr. BERNSTEIN. Senator, I hope you do not want to get back to the pressures that we had in 1966.

I would be much more content if we were not operating above 90 percent of manufacturing capacity.

Senator PROXMIRE. There is not much danger of that.

Sir ROY HARROD. I would like to narrate, I think—I would like to introduce a note of levity, but I did happen to ring up London yesterday. I am very perplexed—I did not want to talk about the tax increase, but I am very perplexed—since I find all the economists saying that all the economic indicators are pointing upwards, and when I look at them, I find that they are not pointing upwards; but people say there are certain underlying factors making for expansion.

So I rang up London yesterday, and I asked why is it that the estimate was that this devaluation might cause an increase of output, both for exports and also for products competing with imports in the home market, of £500 million—whether this is an estimate or a target I do not quite know—and so we have had deflationary pressures simultaneously amounting to nearly £500 million. I said, "Why have you done this, because you know perfectly well that about £2,000 million would be the figure for unutilized British capacity. There is no shortage of capacity to enable us to have the £500 million extra on exports without inflationary pressures."

They said, "Oh, well, we think there are certain *underlying* factors increasing demand."

I said, "Am I in America or am I listening to England?"

There is something in the mentality of the official authority which makes them see "underlying" factors of increase even when there are not any.

Mr. BERNSTEIN. You see, it is the same underlying language in the United States and the United Kingdom, it is gobblydegook.

I was not trying to bring out the point that my friend, Sir Roy, has probably emphasized as much as any economist in the world, which is that a budget deficit of this magnitude has enormous expansionary effects, and that in an environment in which certain temporary restraining features have disappeared, its expansionary effects would be very disturbing to us.

I do not want to get to 90 percent, above 90 percent, of capacity utilized. I do not want to get down to 3.7 percent or less unemployment, not with all this overtime, too.

I would rather have demand grow—moderately and steadily so that our prices and costs behave more nearly in conformity with our balance-of-payments needs and the stability, the internal monetary stability, that we all want.

The tax increase was not needed this year; but I would love to have it for January 1, 1968.

Chairman REUSS. Welcome, Professor Triffin of Yale. We know the difficulties you had in getting down here this morning. We are tremendously grateful that you are here.

You will be able to be with us this afternoon?

Mr. TRIFFIN. Yes.

Chairman REUSS. Because I want to give you a full opportunity to be heard. Sir Roy, can you stay with us this afternoon?

Sir ROY HARROD. Yes.

Chairman REUSS. Now, Mr. Bernstein cannot.

Mr. BERNSTEIN. I cannot.

Chairman REUSS. I wonder if, with the agreement of all concerned, we could examine Mr. Bernstein on the remaining two points and that will give him a chance to go pretty soon. Can you stay another 10 minutes?

Mr. BERNSTEIN. Well, Mr. Chairman, I have to write a paper on the devaluation, and I cannot give up a full day's work. But I will stay all of this morning.

Chairman REUSS. Why don't we cover in the remaining, oh, 5 minutes, some questions I had.

You have addressed yourself to points 1 and 2 extensively.

Let us talk about point 3: namely, the link between SDR's and economic development aid.

There the IMF is generally invested with this question as a result of one of the Rio resolutions. Obviously, one would not want to delay the ratification and activation of SDR's at this late date by bringing in the question of the possible partial use of SDR's to achieve development aid.

But I would ask you this question: Would it not be useful for discussions to start in the World Bank and in the International Monetary Fund looking toward a possible future use of SDR's for a partial linkage with development aid specifically, and after the SDR device had been used for awhile, would it not be feasible in a given year in which, say, $2 billion worth of SDR's were about to be created, if let us say 20 percent of them, $400 million worth, where channeled into, let us say, the International Development Association through bonds or debentures, either by taking 20 percent of the new SDR's across-the-board and having the International Monetary Fund buy IDA bonds or debentures, or by asking the developed countries to dedicate a portion of their new SDR's toward the task of development aid by again buying IDA bonds or making a loan to IDA, so that before the new SDR's came to their final resting places in the coffers of the developed countries, they might have served a useful apprenticeship in the field of foreign aid?

Is there anything about that proposal, if it is carefully separated from the immediate agenda ahead, that bothers you?

Mr. BERNSTEIN. I have no objection to facilitating aid in every possible way, and I certainly do not object to examining how SDR's could do it.

But I would like to point out the following: we are starting with a new reserve asset, and there are some countries very much afraid that this fiduciary asset represents a step into the unknown, and if they ever wanted to withdraw from the system, they could never get back the real value of the SDR's they acquire from other countries.

I think the operation of such a system on a conservative basis in the first few years is very desirable.

I think, if we started a discussion now of using SDR's for aid it would raise the reluctance of the creditor countries and delay the ratification of the present agreement.

The second thing I think we have to bear in mind is the following: if you take any fraction, 20 percent of the SDR's pro rata from every member of the IMF, then you would be taking 20 percent from what the United States would otherwise have got with the same allocation, and 20 percent from what the United Kingdom would have got.

If we earned back in SDR's from the less developed countries the same proportion that we now have in trade with them, we would not have earned back as much as we would give up by surrendering our part of the allotment. That is to say, our exports to the less developed countries that are likely to be eligible for this sort of aid, compared to the rest of the world, are less than the proportion of our quota to total quotas in the IMF.

I would not say that is decisive. Maybe we have to give something up.

The main point is, I would rather not raise this issue today as part of the discussion on the creation of a new reserve asset, its ratification and its activation, for fear that it will raise so many questions among the present creditor countries in the international monetary system that they will begin to have some second thoughts.

Chairman REUSS. But after activation, you are ready to talk?

Mr. BERNSTEIN. I am willing to be a lot bolder after activation. In the beginning, I like to be conservative.

Chairman REUSS. Let me then come to the fourth point, Mr. Bernstein. And that is, whether under the new SDR proposal it should be permitted that regional groupings of countries pool their SDR's in order to marshal them most effectively.

Specifically, at Rio, I talked to some of the Andean countries who have a homogeneous group going there, and the question is raised, suppose in a given year Chile is hurting very much for foreign exchange and Venezuela is sitting pretty. Would it make sense for the Andean countries to pool their SDR's, and, by their internal decision, however arrived at, to allocate them in a given year to the benefit of poor Chile and away from temporarily wealthy Venezuela?

Mr. BERNSTEIN. I am aware of all sorts of plans among the Latin Americans for bringing together a pool of reserves in dollars and in SDR's, and in other ways.

But my approach to this is very simple. I am in favor of giving countries the greatest freedom to use SDR's as reserves.

One of the nice qualities about reserves that you own is you can lend them if you want to. I have no objection to any group of Latin American countries bilaterally, multilaterally, or in any other way lending to each other SDR's which belong to them.

Chairman REUSS. There is nothing in the outline plan which prevents that that I can see.

Mr. BERNSTEIN. No; I think not.

I would not want to make the outline plan so tight that countries cannot lend SDR's to each other. We may want to borrow some ourselves. I hope not. We may want to lend some.

Chairman REUSS. Well, we are very grateful to you, Mr. Bernstein.

We will stand adjourned until 2 o'clock in this place, for further exploration.

(Wherepon, at 12:20 p.m., the committee recessed, to reconvene at 2 p.m., the same day.)

AFTERNOON SESSION

Chairman REUSS. The Subcommittee on International Exchange and Payments will be in order for a continuation of our hearing of this morning.

We are delighted that Professor Triffin is here.

Professor Triffin has submitted a longer statement entitled "The International Monetary Problem After Rio," and without objection that will be made a part of the hearing record and printed in full.

(The above-referred-to document follows:)

THE INTERNATIONAL MONETARY PROBLEM AFTER RIO

BY ROBERT TRIFFIN, Yale University

An ecumenical council of the world monetary "establishment" assembled at Rio de Janeiro, last September, to initiate the long overdue "aggiornamento" of an anachronistic and crumbling international monetary order.

Writing on the eve of this September gathering, I irreverently introduced as follows my summary of its probable achievements and shortcomings: "The pregnancy has been inordinately long. Four years have elapsed since the launching of the official debate on international monetary reform at the 1963 IMF meeting in Washington. Everybody will be relieved, therefore, even though the Agreement to be delivered by the official midwives at Rio to an expectant world rather looks like a mere EGG, whose hatching will still require one and a half years, or more, of legal drafting, approval by Governments, and ratification by Congresses or Parliaments before it can come into actual operation." [1]

MAIN SHORTCOMING OF THE RIO AGREEMENT

Looked at in a short-run perspective, the Rio achievements are thus extremely meager. The so-called new "reserve assets" or "credit facilities " will not see the light of day until this protracted hatching process is over, and the chicken can burst out of its shell. Even then, they will not be activated—the bird will not be allowed to walk, and even less to fly—until the United States (and the United Kingdom?) have achieved a substantial and durable improvement—or even equilibrium—in their balance of payments and members agree that the adjustment process is likely to work better in the future than in the past.[2] The Rio decisions will not come into operation, therefore, until *after* the major problems that threaten the international monetary system today have been solved.

At that point in a still distant time, the nations of the world will try to fill the foreseeable gap in world liquidity by agreeing on the deliberate creation of international reserves, in the form of special IMF drawing rights (SDR, for short), adjusted to the requirements of non-inflationary growth in world trade and production. Unfortunately, the dimensions of this foreseeable gap will remain totally unpredictable as long as no agreement is reached on the role that the other two, and more traditional, components of world reserves (about 90% of the total) should play in the *overall* reserve system of tomorrow.

The first of these is monetary gold, whose supplies will continue to be governed by the hazards of gold production in the non-Soviet world, gold sales by the USSR, and gold purchases by industry, dentists, jewelers, hoarders, speculators, and mainland China. Gold supplied more than 80 percent of world reserve increases in the late 1930's, and was expected by the IMF, only a few years ago, to supply at least seven-eighths (87%) of the requirements for additional reserves over the decade 1958–1967.[3] My own estimates were less sanguine, ranging from 29% to 55%, but were still overoptimistic. Gold has provided in fact only 26% of reserve increases over these ten years, and its contribution has now become negative. Over the last year, private and Chinese purchases have exceeded total gold production in the Western world by more than $300 million, while USSR sales have stopped entirely, after accounting for nearly 85% of the increase in Western monetary gold over the preceding four years (1962–1965).

The second of the two traditional components of world reserve increases is foreign-exchange reserves, *i.e.* the balances in *national* currencies—overwhelmingly dollars and sterling—accumulated by central banks as *international* reserves, alongside gold itself. Their actual role in reserve creation oscillates between a maximum—about $2.3 billion in 1963, for instance—determined by the vagaries of U.S. and U.K. balance-of-payments deficits, and a minimum—*minus* $2

[1] "Alchemy in Rio: The Problems Ahead," *Interplay*, November 1967.

[2] These "prerequisites" for activation have been spelled out in various ways, at various times, by the various participants in the negotiation, but have been repeatedly emphasized, in some form or other, by all of them. See, for instance, the *Communique of the Ministerial Meeting of the Group of Ten* on July 25th and 26th, 1966, in The Hague, paragraph 6A and *Report of the Deputies*, paragraphs 48 and 98(8).

[3] *International Reserves and Liquidity*, IMF, Washington, D.C., 1958.

billion, for instance, in the first half of 1965—determined by the uncoordinated decisions of several scores of central banks to liquidate not only their current accruals of sterling and/or dollars, but even outstanding balances accumulated over many years of past functioning of the absurd Monte-Carlo roulette glorified as the "gold-exchange" standard.

The common-sense agreement reached in Rio is that gold cannot be expected to provide more than a fraction of future reserve needs, and that further piling-up of dollars and/or sterling IOU's can no longer fill the gap without raising strenuous objections against the indefinite financing of the large and persistent U.S. and/or U.K. deficits implied in such a "system."

These objections spring from three sources. The first is the increasing uneasiness of foreign central banks about the ability of the U.S. and the U.K. to preserve the convertibility of their currencies at the present gold price, in the face of their declining gold holdings and increasing reserve liabilities. The net reserve position of the United Kingdom has long been negative—liabilities exceeding assets—and that of the United States has fallen precipitously from about $23 billion at the end of 1949 to $11 billion ten years later, and *minus* $3 billion today. In the same period, the reserves of countries other than reserve centers have more than tripled, passing from $18 billion to $54 billion, while those of the two reserve centers together, net of their indebtedness to central banks and the IMF, have dropped from $18 billion to *minus* $8 billion.

The second objection raised against the system is that it exempts the U.S. and the U.K. from the so-called balance-of-payments discipline, as long as they can finance a large portion of their deficits (50 to 60 percent over the fifteen years 1950–1964) by passing on their IOU's to the central banks of the creditor countries. On the other hand, this discipline risks to be brutally restored at any time, under the rules of the system, if foreign central banks decide to cash into gold not only the dollar and sterling IOU's currently acquired by them, but also some of those piled up over many years past.

This happened in 1965 when foreign countries liquidated about $1400 million of their foreign exchange holdings, instead of adding about $1400 million to them as they had done yearly, on the average, over the previous five years. The trouble with such delayed balance-of-payments "discipline," is that it may place unbearable strains on the reserve currency countries and, as a consequence, on the international monetary system itself. The gold absorbed by the non-reserve center countries in 1965 was about ten times the amount available from current production and huge USSR sales. It thus came mostly from a depletion of U.S., IMF and BIS gold stocks, which could not continue at such a rate without bringing about a collapse of the world monetary system.

The third objection is political, rather than economic. It is that some of the surplus countries cannot be expected to finance indefinitely, through dollar and/or sterling accumulation, U.S. and/or U.K. deficits ascribable to policies with which they deeply disagree, such as an excessive rate of direct American investments in their own market, the escalation of the war in Viet Nam, etc.

The fact is that foreign exchange reserves—other than largely reciprocal U.S. and U.K. holdings—have actually declined, by about $250 million to June 1967, since the end of 1964. This contraction would have been much larger indeed if foreign exchange liquidation by the developed countries ($2.8 billion) had not been largely made up by continued accumulation ($2.6 billion) by the underdeveloped countries, far more dependent on U.S. assistance, particularly in Latin America ($600 million) and Asia ($900 million). Further accumulation of dollars as reserves thus tends today to become limited to an informal "dollar area," just as sterling reserves have long tended to become confined to the "sterling area."

The cessation—or rather decline—of both gold and foreign exchange as reserve components since the end of 1964 has finally convinced the world of the need to organize collectively the deliberate creation of a new kind of international reserve asset, in the form of special drawing rights on the International Monetary Fund. This was hailed by many Governors as a "milestone in the evolution of the international monetary ststem," bringing under rational policy decisions by the international community a process of reserve creation left up to now to the hazards of gold production, gold speculation, fluctuations in the balance of payments of two countries, and waves of confidence, or diffidence, in their currency.

I trust that this enthusiasm will prove justified in the long run. It is, however, premature as of now. Rational decisions—and particularly firm commitments—regarding the amounts of new reserve assets to be created will remain out of reach, as long as no parallel agreement is reached regarding the additions to overall reserves to be expected from gold and foreign exchange. New reserves well in excess of $2 billion a year might have to be created if foreign central banks not only refuse to pile up more dollar and sterling balances as reserves, but convert into gold—as they did in 1965—large amounts of such balances accumulated over fifty years past. On the other hand, any creation of new reserve assets would be objected to by many countries as inflationary if dollar and sterling accumulation were to be resumed on a substantial scale in the future.

Although improbable at first view, this second possibility cannot be ruled out in view of the enormous financial, economic and political leverage which the United States can use on many countries to deter conversions of their dollars into gold. We can suspend our foreign aid to some, apply the interest-equalization tax to those not now subject to it, withdraw our troops from others, refuse to deliver to them military equipment or repair parts, etc., etc. Some such pressures were probably applied to Germany, for instance, to wrest from it last March a famous "declaration of intention" placing it in fact, at least temporarily, in the "dollar area," and to Canada and some other countries to induce them to *sell* gold to us, rather than convert their surplus dollars into gold at our Treasury.

POSSIBLE REMEDY

This is undoubtedly the reason why the future activation of the Rio plan was made conditional upon "the attainment of a better balance-of-payments equilibrium," as already noted above. This is an absurd decision, since the inability of the U.S. and/or the U.K. to reach such equilibrium might indeed induce a dangerous flight from outstanding dollar and/or sterling reserves into scarce gold metal. A better solution would be to gear the creation of Special Drawing Rights to any actual gap that may develop between reserve increases from present sources—gold, foreign exchange, and reserve positions in the IMF—and a targeted presumptive rate of increase of global reserves of let us say, 4 (or 3, or 5?) % a year.

The accompanying table shows what such a rate would have implied if adopted a few years ago. It would have barred any creation of SDR's in 1963, for instance, but authorized a growing creation of SDR's in the following years. Over the quinquennium 1963–67 as a whole, the average annual rate of authorized SDR creation would have been about $1250 million, i.e. close to the minimum amount informally mentioned in recent Group of Ten discussions ($1 billion to $2 billion a year).

ACTUAL EVOLUTION OF GLOBAL RESERVES AND HYPOTHETICAL CREATION OF SDR's, 1963–67

[In millions of dollars]

	Global reserves		Authorized SDR creation (col. (a) minus col. (b))
	Targeted 4-percent increase	Actual increase	
	(a)	(b)	(c)
1963	2,540	3,370	−830
1964	2,650	2,230	430
1965	2,740	1,745	995
1966	2,810	1,370	1,440
1967	2,865	−1,350	4,215
1963–67	2,725	1,475	1,250

SOURCES AND NOTES

1. Calculated from reserve estimates of International Financial Statistics.
2. Estimates for 1967 based on a yearly projection of January–June estimates.
3. The estimates in the 1st 4 lines are actual estimates which would have been modified in fact by the creation of SDR's. The last line gives average annual rates, based on actual developments (2d column) and on the maintenance of a cumulative 4-percent rate of increase in global reserves (1st column) through SDR creation (3d column).
4. The estimates in the 1st and last column are based on the assumption of a presumptive 4-percent rate of targeted reserve growth, and should be modified if a different rate were selected, and/or if this targeted rate were modified in the light of current developments.

This proposed criterion, however, might have to be modified to overcome two legitimate objections.

The first, and less controversial, is that no creation of *additional* reserves can meet the danger of *inflationary* excesses in the growth of other reserve media, and particularly of the foreign exchange reserves which might flow from our deficits as long as enough countries choose—or are induced by bilateral "arm-twisting"—to finance such deficits by dollar (or sterling) accumulation.[4]

[4] Gold reserves themselves might grow at an excessive pace in the—still-unlikely—event of large disgorging by speculators from the massive private hoards accumulated in recent years.

The second is that the creation of SDR's should not become a sort of "garbage can" for the dollar and sterling balances which central banks might choose to drop into it. In other words, it expresses the fear that we shall continue to finance our deficits through the accumulation of dollar and/or sterling IOU's by foreign central banks, and the call for the creation of SDR's only when this policy fails and central banks decide to convert the dollars or sterling previously accumulated by them.

To take care of these objections, we should agree that *future* accumulation of dollar and sterling balances by central banks, beyond normal working balances, should properly be limited in accordance with the proposed so-called "multilateral surveillance" criteria, and that our future deficits should be financed—like those of other countries—from our own gross reserves, *plus* borrowings from the IMF.

We should, on the other hand, claim protection against the massive cashing into gold of old dollar and sterling balances accumulated over many years past. Unwilling holders should be given instead the alternative of converting such balances, if they wished, into SDR's, carrying a gold-value guarantee, but a much lower rate of interest than we are now paying. If we are really sincere in our determination to eschew a dollar devaluation, the guarantee should be costless, while interest-savings should be substantial.

Let me note in addition that—

(1) Such an agreement would be a main deterrent to gold speculation and might release for dollar and sterling investments a large portion of current and past gold hoarding by speculators;

(2) This would enhance the interest of central banks themselves to hold on to the dollar and sterling balances accumulated in the past; and

(3) Many central banks—particularly in Japan, Latin America and most underdeveloped countries—would not be really free to liquidate dollar and sterling balances which they must hold as a condition—and informal collateral—for their borrowings, and those of their residents, in New York and London.

I have long been convinced [5] that our past reluctance to discuss similar suggestions by Italy, Germany, the Netherlands, etc., constitutes a total misunderstanding of U.S. vital interests in this matter.

General agreement on sensible and viable reforms of our anachronistic world monetary system thus depends on the development of such a comprehensive approach, encompassing the respective role of be assigned in the future to all *three* components of world reserves, *i.e.*, to gold and foreign exchange as well as to collectively created reserve assets.[6]

Fortunately, or unfortunately, the sterling and/or dollar crises that are most likely to recur again over the forthcoming months will require new salvage operations and should induce the United States and the United Kingdom, as well as their prospective lenders, to re-open this co-existence problem which they have so far tried to sweep under the carpet. The problem of sterling balances is also recognized now as one of the major issues in the British application of admission into the European Economic Community. Its most obvious solution, and the one most beneficial to *all* concerned, would be along the lines suggested above, but which might also be recast provisionally into an agreement between the United Kingdom and the European Community as long as the United States continues to fight a rear-guard battle against its own true interests in this matter. Such a solution of the sterling problem. however, could not fail to stimulate also renewed interest in a broader agreement covering the reserve role of the dollar as well as of sterling in the world-wide framework of the IMF.

There are good reasons to hope, therefore, that some progress will be made on this front before the Rio agreement is ready for activation, some two years from now.

Other Desirable Amendments

While this is undoubtedly the most urgent revision needed to make sense of the Rio agreement, other improvements should also be considered as soon as practicable.

[5] and have argued elsewhere, particularly in *Guidelines for International Monetary Reform*, Hearings of the Subcommittee on International Exchange and Payments, July 27-29, 1965, Part I, pp. 164-184, and *Contingency Planning for U.S. International Monetary Policy*, Joint Economic Committee, December 1966, pp. 136-138.

[6] This problem was last debated between academics and officials at Bellagio, in June 1967. See my article on "The Coexistence of Three Types of Reserve Assets" in the *Banca-Nazionale del Lavoro Quarterly Review*, June 1967, pp. 107-131.

The first is the restoration of the traditional link, which it purports to break, between reserve creation and development financing. The past accumulation of sterling and dollar IOU's by foreign central banks was largely used by the United Kingdom and the United States to sustain far larger outflows of foreign aid and development capital than they could have sustained otherwise. If claims on the IMF are to substitute for such sterling and dollar accumulation, the IMF should also use the consequent increase in its lending potential to provide, directly or indirectly, such development financing to the underdeveloped nations.

A familiar objection raised against such a link was that the *liquid* monetary obligations of the IMF could not be properly invested in *long-term* assets. Professor Machlup refuted wittily this unwarranted extrapolation from commercial banking norms to the norms applicable to a world-wide institution in his *Quarterly Journal of Economics* (August 1965) article on "The Cloakroom Rule of International Reserves: Reserve Creation and Resources Transfer." An institution encompassing virtually—as the Fund—all the nations of the world, need not retain liquid assets in order to finance settlements between its customers: For international payments in the same world, the assets (amounts, quality, composition, liquidity) of the international reserve bank (or an appropriately organized IMF) are irrelevant; they become relevant only for payments to persons, banks, or reserve banks on other planets, that is, for interplanetary payments." (p. 343)

In any case, if the old taboo against long-term IMF lending had any shade of validity, the Rio agreement would sin far more in this respect than my own proposals, since it requires only the "reconstitution" of 30% of the SDR's actually used by deficit countries. In common parlance, this technical language means that 70% of the credits granted under the new system will not even be long term credits: they will be grants, never to be repaid at all, except if the borrower becomes a creditor or, more hypothetically and in this case mysteriously, in the event of withdrawal from, or liquidation of, the SDR system.

The automatic allocation of the new Drawing Rights in proportion to IMF quotas is as indefensible economically as it is morally. It assigns about one-third of the total to two countries alone—both among the richest in the world—and about three-fourths to the developed countries, leaving the 81 less developed countries of the Fund to share little more than one-fourth of the total amount. Any automatic system of allocation contravenes, moreover, the sacro-sanct principle repeatedly affirmed by the Group of Ten: that is the need to link the creation of new reserve assets to the strengthening of the balance-of-payments adjustment mechanism. Can one seriously believe that countries would be willing to underwrite indefinitely, through the automatic distribution of drawing rights, persistent deficits ascribable to policies with which they fundamentally disagree, whether economically or even politically—such as, for instance, our present war escalation in Viet-Nam?

Fortunately, the Rio Agreement on automatic distribution of Special Drawing Rights is limited to the first five years of operation of the new system. It should be revised at the first opportunity to earmark this new lending potential of the IMF for the support of *agreed* policies rather than of *unilateral* national policies. These agreed policies could encompass a wide variety of objectives, such as national stabilization policies, development financing, etc., including—why not—peacemaking activities of the United Nations.

An early opportunity for amendment may be provided by another resolution, initiated by France and fourteen French-speaking African countries, and unanimously adopted at the Rio meeting. This resolution calls for a study of the conditions in which IMF, IBRD and IDA could participate in the elaboration and financing of suitable mechanisms for price stabilization of primary products at a remunerative level. This could indeed be one, among many others, of the collective objectives to which the lending resources derived—as a by-product—from collective reserve creation could be assigned in the future.

Finally, future amendments to the Rio Agreement should ease the awesome task of collective decision-making in this field by decentralizing the responsibilities of the IMF through their systematic coordination with the regional economic and monetary groups and organizations now emerging in various parts of the world. This should also facilitate cooperation between such groups across a—let us hope—vanishing "iron curtain" and facilitate in time the reintegration of Eastern Europe and the USSR in the world economic community.

These, however, are tasks for the future. Rio will be a success only if we all regard it as a starting point rather than a dead end, and as opening toward further evolution of the world monetary system a path long blocked until then by the age-old myths and taboos of conservative bureaucrats and nationalistic politicians.

The Absurdity of Traditional Negotiating Techniques

The history of the Rio negotiation and of its historical precedents may be worth pondering by policy-makers as well as by political scientists and economists. It demonstrates once more that man is controlled by its institutional environment far more than he is able to control it.

The international liquidity debate is not new. It began, about a century ago, in the guise of a marathon debate on silver and bimetallism, in which one of the main arguments was the need to retain silver as a monetary metal in order to ward off a threatening shortage of gold, and not to crucify mankind on a "cross of gold." The problem was solved, however, outside the conference room, by unforeseen increases in gold production and, most of all, by the enormous increase of paper money in the form of currency and bank deposits.

The debate was resumed, after the first world war, in the other marathon debates of the Brussels and Genoa conferences and of the Gold Delegation of the League of Nations. Once again, it was solved, not at the conference table, but outside it, by the devaluation of sterling in 1931 and the dollar in 1933, and at the cost of a disastrous aggravation and prolongation of the world economic recession of those days.

The issue was raised again by a few academic economists in 1959, but disdainfully shrugged off by the officials. As for the proposals which I advocated myself at the time, they were scathingly dismissed as a utopian, naive and dangerous dream. Our brilliant Undersecretary of the Treasury, Mr. Roosa declined to elaborate on them since "all such elaboration would represent a fruitless exercise. . . . That . . . is the inescapable conclusion dictated by the actual ways of the world—today and *for any foreseeable future* [italics mine]— . . . The money created by a super-bank would be the most high-powered ever generated by a man-made institution, yet it would have no supporting super-government to make good on its debts or claims. . . . Simply to establish the super-bank would require all countries of the world to give up their present reserves and accept instead the fiat issue of a super-authority existing without a super-state." [7]

The "foreseeable future" of Mr. Roosa did not, apparently, extend very far. Although he still did not yet see, one year later, "any reason to presume that daring or revolutionary approaches will in fact emerge for the future," [8] he rightly expected by 1964 "that the months and years ahead will see more of a reappraisal and rediscovery of the dimensions and potentials of the International Monetary Fund for our payments system and as a center of international liquidity," and was "sure that new forms will emerge as needs appear." [9] He was soon indeed throwing his full weight behind the now defunct CRU (Composite—or Collective—Reserve Unit) proposal, and concluded his latest book with a clarion call for "the world's first effort to create—through the joint action of independent and autonomous nations—a money that can be universally acceptable among the central banks of the world." [10]

This complete turnabout was somewhat candidly explained by the imperative of the U.S. national interest: he had had to argue in 1962 *against* any proposals looking toward the creation of a new international currency because "it was clearly necessary, first, to reestablish the strength of the dollar," lest confidence be shaken, triggering massive conversions of dollars into gold, disorderly exchange rates, a shrinking of trade, an increase of national protectionism, and "widespread suspicion that the United States, if it then persisted in proposing major currency reforms, was seeking only relief from its own immediate balance of payments pressures. . . ." [11] In brief, to use a favorite slogan of other national officials, here and abroad, we should "negotiate from strength."

This condition was apparently fulfilled to Undersecretary Roosa's satisfaction by the summer of 1963, even though our deficit, far from disappearing, increased that year by $468 million, rose still further in 1964, and is now officially expected to continue as long as the Viet Nam war itself continues. . . .

Negotiations were thus opened in 1963, and dragged on for four years before a tentative, and still only partial, agreement was reached in Rio. They were marked by other bizarre reversals of "negotiating positions" among the major participants. The CRU proposal was initially advanced by the French in order to give them a stronger influence than that they could muster in the IMF, and to freeze out the underdeveloped countries. We opposed it strenuously at that time, and

[7] Robert V. Roosa, "Assuring the Free World's Liquidity: Panaceas or Prerequisites," *Business Review*, Federal Reserve Bank of Philadelphia, September 1962, reproduced in *The Dollar and World Liquidity*, Random House, 1967, p. 102.

[8] *Op. cit.*, p. 125.

[9] *Ibid.*, pp. 157-159.

[10] *Ibid.*, p. 261.

[11] *Ibid.*, pp. 6-7.

expressed a preference for using the traditional machinery of the Fund. In the months preceding the Rio agreement, however, the French had withdrawn their own proposal and now favored IMF drawing rights, while we now argued in favor of collective reserve units. The initial objective of this technique—*i. e.* to keep out the underdeveloped countries—had, in the meantime, vanished from the horizon of practical politics.

Traditional negotiating techniques could hardly be better designed to frustrate the national interests of the negotiating countries themselves. The opening of a negotiation presupposes that all the participating countries agree that there are sufficient "convergent interests" to make such a negotiation orth while. Even if such converging interests encompass 90% of the problems under discussion, however, the diplomatic game tends to lose sight of them and to concentrate instead on the 10% on which interests diverge, and on which each delegation will fight to obtain the best possible deal for its own country.

Before going to the negotiating table, each delegation will hammer out, at home, a "nati~nal negotiating position" motivated by its officials' own view—correct or mistaken—of the national interest. But the last thing it will do is to disclose such motivations at the conference table. It will not argue that other countries should accept its proposal because it embodies the national interests of the delegation's own country. On the contrary, it will argue that the proposal is in the best interests of the *other* countries, and/or is technically superior to *their* proposals.

Each delegation adopts the same technique and pretends to justify incompatible negotiating positions on an altruistic basis which bears little or no relation to what it itself believes. Each delegation is nevertheless forced by the rules of the game to meet, and contest, the argumentation of the others, even though it knows full well that none will change its mind because a good case has been made out to show what it already knew, *i.e.*, that its proposals reflect its country's interests rather than those of the others.

This phony haggling process inevitably tends to obscure the substantive issues under discussion and the converging interests that the negotiation should serve and make operational through international agreement and commitments. A new format of international negotiation is badly needed to facilitate and accelerate agreements among *theoretically sovereign but actually interdependent* countries. Some progress in this direction has been made in fact through the new negotiating techniques developed in OEEC in the early 1950's, in the European Economic Community in the late 1950's, etc. Their exploration, however, would exceed the scope of this paper and my ability to handle a problem requiring a close cooperation between historians and lawyers as well as between social scientists.

Future Evolution of the International Reserve System

Let me close instead with a bold prophecy about the future evolution of our international monetary system. This evolution may be helped, but will not in any case be frozen, by the decisions arrived at in Rio. The historical trend toward the national displacement of commodity money by fiduciary money, and toward the increasingly centralized orientation and management of the latter by national authorities, will be duplicated in the international field by a similar displacement of gold reserves by fiduciary reserves, and by an increasing subordination of the latter to joint orientation and management. This evolution is already well underway indeed. Gold reserves have already dropped, for all countries taken together from 91 percent in 1937 to 74 percent in 1949 and 57 percent in 1966. *Nationally* created *international* fiduciary reserves—*i.e.* overwhelmingly dollars and sterling—constitute today as much as 41 percent of the global reserves of countries other than the two reserve centers of the system, but are down from 56 percent in 1949. *Centralized reserves* on the IMF have grown, on the other hand, for the same countries from 1 percent only of total reserves in 1949 to 11 percent in 1966.

The inadequacy of the agreements that may be reached in the present phase of the negotiations and the new crises that may be unleashed thereby upon the world economy would probably reverse this trend in the short run, as was the case in the early 1930's, when fiduciary reserves declined temporarily from 24 percent of world reserves in 1928 to only 5 percent following the devaluation of sterling and the dollar. They will not, however, permanently arrest a movement which is part and parcel of a far broader evolution, which only the blindest of so-called "realists" are unable to read in our world's history.

The displacement of commodity money by fiduciary money and of commodity reserves by fiduciary reserves reflects the effort of man to control his environment instead of being controlled by it, in the monetary field as well as in others.

The displacement of national fiduciary reserves by *international* fiduciary reserves should similarly be viewed as one aspect of the adjustment of the former tribal, feudal and national institutions through which this control could previously be asserted to the ever-changing realities of a more and more interdependent world.

Both phenomena should be inserted in a vaster historical perspective: the long march of mankind towards its unity and a better control of its own fate.

Chairman REUSS. Would you now proceed, Professor Triffin, to present orally your reactions to some of the questions that have been raised here.

STATEMENT OF ROBERT TRIFFIN, YALE UNIVERSITY

Mr. TRIFFIN. Thank you very much, Mr. Chairman.

The Congress of the United States is certainly one of the many hens whose active participation will be essential to the hatching of the Rio de Janeiro egg. This will have to be done not only by us but by scores of Congresses and Parliaments throughout the world.

If Congress refuses to hatch that egg, it will be dead, and a world monetary collapse a la 1931 and 1933 is clearly around the corner. If you insist at this late stage on imperative amendments making it a different egg, other hens will refuse to participate in the hatching, or will not be ready to do so in time to ward off a world catastrophe.

I. ACTIVATION

On the other hand, if you agree to hatch the present egg as it stands, and do nothing further about it, the bird that emerges will not be allowed to fly or even to crawl until after the most urgent problems that we confront today have been solved, since the agreement is not supposed to be activated until we and the British have succeeded—without its help—in achieving a better and lasting equilibrium in our respective balances of payments.

The logic of this prerequisite, which was insisted upon in former and happier days by our own negotiators as well as by the Europeans, is that there will be no general reserve shortage and, therefore, no need to create additional reserve assets, as long as the U.S. deficits continue to pump vast amounts of dollar balances into the world reserve pool.

The need to create a new reserve asset will emerge only, according to this reasoning, as we reach or approach equilibrium.

This used, indeed, to be the main argument of our officials in favor of what they called contingency planning.

This logic, however, is only partial, and therefore misleading. The persistence of our deficits by no means guarantees that foreign central banks will continue to finance them through further piling up of dollar I O U's in their reserves. World reserves will *not* increase if they convert their current dollar accruals into gold. They could even decline precipitously if the persistence of our deficits induced further conversions into gold of some of the huge dollar balances—well over $16 billion—accumulated by them over many years past.

On the other hand, the restoration of equilibrium in our balance of payments might well trigger opposite operations, by private gold hoarders and speculators as well as by central bankers. A new faith in the dollar and the vanishing of expectations of a proximate increase in the price of gold might trigger vast switches from gold into dollar balances and investments and, therefore, large increases in world reserves.

The problem of a world liquidity shortage might therefore arise—paradoxically, and contrary to the Group of Ten's analysis—from the persistence, rather than from the elimination, of our deficits.

In view of these uncertainties—both as to the future course of our deficits and of their impact on switches between gold and dollars—it is impossible to determine in advance how many SDR's should be created in future years.

The obvious solution would be to create SDR's in whatever amounts may prove necessary to preserve any desirable level of world reserves in the future. If a presumptive growth of 4 percent a year in overall world reserves were deemed desirable, for instance, we should undertake to create SDR's to the extent necessary to fill the gap between this presumptive target and the actual growth of reserves from other sources; that is, gold, foreign exchange and reserve positions in the Fund.

I might mention in passing that, if such a rule has been adopted in 1962, it would have resulted in the creation of no SDR's at all in 1963, but in a growing creation of SDR's in subsequent years, with an average creation of about $1,250 million a year over the period as a whole. That is pretty close to the figures which have been informally mentioned in the discussions—$1 billion to $2 billion a year.

Taken by itself, however, such a solution is hardly negotiable with the major surplus countries which would be called upon to finance it. Indeed, it would mean that the new SDR system would become the "garbage can" of the reserve-center countries' failure to retain, or pressure, other countries into their "dollar area" or "sterling area."

It would call for the automatic creation of SDR's whenever foreign countries refused to absorb and retain a sufficient amount of dollars and/or sterling in their monetary reserves and tried instead to convert such dollars and sterling into gold. Well over a third of the new SDR's created would be given—according to the Rio "distribution" rules—to the two reserve centers and enable them to pass them on to any country that wished to convert its dollars or sterling into gold.

In other words, if foreign central banks refused to finance the United States or United Kingdom deficits bilaterally—through dollar or sterling accumulation— they would have to finance them through SDR accumulation. This they are hardly likely to agree to do.

Therefore, the tentative solution which I have just indicated must be supplemented by other provisions, making it a reasonable basis for negotiation.

The reserve center countries could legitimately ask to be protected against the sudden cashing into gold of dollar and sterling reserves acquired in the past, thus preserving at the same time the world reserve system itself against the ensuing contraction of the world reserve pool. New SDR's, carrying adequate guarantees against unilateral blocking or devaluation, should be created to *substitute* for the dollars or sterling balances which countries no longer wished to retain as reserves.

Countries other than reserve centers, on the other hand, could properly insist that all future additions to the world reserve pool in the form of dollar or sterling balances, as well as SDR's, should be subjected to international agreement. International credit reserves—in either form—should be created only in the amounts necessary to preserve the targeted increases in overall reserves, let us say, of 3 or 4 percent a year.

Whether such increases should then take the form of additional dollar or sterling reserves, or of SDR's, should be left to international decisions, rather than to the hazards of the United States and United Kingdom balance-of-payments deficits, and unilateral action.

II. ALLOCATION

A second amendment to the present Rio agreement seems to me also vitally needed in the future. This refers to the distribution rules of the new SDR's.

I feel that international decisions should govern the allocation of SDR's among members as well as their overall amounts. The international lending power derived from SDR creation should logically be earmarked for the support of internationally agreed policy objectives, rather than of unilaterally chosen national policies.

These internationally agreed objectives might include, among others:

(*a*) The support of monetary stabilization programs by countries experiencing difficulties in their balance of payments—as is the case for traditional IMF operations;

(*b*) The neutralization of speculative movements of private funds, now financed by the IMF "General Arrangements to Borrow;"

(*c*) The purchase of IBRD obligations, or contributions to IDA, et cetera, in support of agreed development programs in the less-developed countries;

(*d*) The financing of price stabilization mechanism for primary products, such as envisaged in the second resolution unanimously adopted at Rio, last September;

And, finally, possibly in the longer run, SDR's might even finance, also, other agreed activities of the United Nations, FAO, WHO, UNESCO, and so on. I see no limit to what could be done in that respect in the long run.

The investment of short-term funds into such long-term financing used to be condemned as unsound, on the basis of a totally unwarranted extrapolation of commercial banking criteria to the operations of a worldwide reserve center.

The opposite—and correct—view was, however, adopted at Rio: if a contraction in the world reserves is to be avoided, the assets of a world reserve center should continue to increase, and could take the form, therefore, of long-term investments, or even grants, to its members. The provision, adopted at Rio, of a 30-percent reconstitution of SDR's means, in effect, that 70 percent will not be subject to any fixed repayment obligation.

If this is true, the bankers have indeed changed their minds completely over the last few months, and many of the objections, some of which were presented again this morning in our discussion, would, of course, fall to the side.

On the other hand, the Rio decision to distribute SDR's in proportion to IMF quotas seems to me as absurd as unviable in the long run:

(a) It would allocate well over a third of any SDR's to be created to two of the richest countries in the world—the United States and the United Kingdom—another 40 percent to two dozen other developed countries, and leave less than one-fourth to be divided among 80 less developed countries;

(b) This automatic allocation would support whatever national policies each country chooses to pursue, without any regard whatsoever for their folly or soundness, and for their impact upon the rest of the world. It seems hard to believe that prospective creditors would continue, in fact, to agree to the creation of the large amounts of SDR's that may be required in the future if this entails the automatic financing by them of national policies on which they have not been consulted, with which they may be in fundamental disagreement, and which they may regard as directly contrary to their own interests. I think that realism clearly coincides here with morality, and that the system proposed at Rio is as unviable in the long run as it seems to me immoral.

The solution suggested above might have to be further adjusted, however, to take into consideration the special role which major financing centers—primarily the United States and the United Kingdom—inevitably play, and will continue to play in the world reserve system.

I think that this would leave, in fact, a very large role for dollars and sterling as vehicle currencies, as working balances for central banks, and even as reserve currencies for the countries whose reserves are primarily borrowed in New York and London. So that many of the fears that have been expressed in this respect are totally unfounded. The refusal of our negotiatiors, so far, to examine these sorts of proposals seems to me to express one of the greatest possible misunderstandings of the true interests of our country in this matter.

III. Pooling

I would like to refer briefly to a third amendment, and this is that some effort should be made to lighten the awesome burden of collective, worldwide, decisionmaking which the above proposals would place upon the International Monetary Fund.

This could be done by decentralizing the IMF responsibilities through the encouragement of the regional monetary cooperation called for, anyway, by the implementation of regional economic agreements such as have emerged in recent years in Europe, Central America, and Latin America, and may develop tomorrow in other parts of the world, such as the ECAFE region.

The resources to be assigned to monetary cooperation could be divided between such regional monetary institutions and the IMF, the regional groups assuming responsibility for the handling of balance-of-payments disequilibria among their members, and the IMF for the handling of disequilibria between each regional group, taken as a whole, and the rest of the world.

This would not only lighten considerably the task of collective decisionmaking by the institutions concerned, it would also instill more realism in the conditions governing each country's access to international assistance, since these conditions would be debated among countries more familiar with each other's problems and realistic policy alternatives.

Finally, it would minimize creditors' objections to the present distribution of voting power in the IMF, which rewards with an equal number of votes the prospective borrowing rights and prospective lending commitments of members. Each group would retain full control over the use of the funds contributed to its own regional monetary institution, thus making more acceptable its minority voice on the smaller contributions assigned to the IMF.

Advantage might be taken of the adoption of the SDR system to help initiate such regional monetary cooperation by allowing members to pool for this purpose the SDR's allotted to them, as suggested by the Latin American countries before, and at, the Rio Conference.

IV. Other IMF Amendments

Finally, I feel we should examine with an open mind the proposals which some countries—particularly the EEC—will present for other amendments in IMF rules and policies.

Some of them may be both innocuous and reasonable, even if sometimes irritating to us. This would be true, for instance, of expected suggestions for a more logical definition of par values. It is very curious that the French themselves now insist on making changes in par value more difficult by subjecting them to the 85-percent rule.

We should also examine sympathetically the request for the application of uniform rules regarding the maintenance of gold value on SDR's and on other IMF assets and liabilities, and for fairer arbitration rules in the event of conflicting views between the Fund and a member concerning the interpretation of the Articles of Agreement.

The EEC claim for a veto power on major issues, if and when it succeeds in harmonizing the votes of its members, is by no means unreasonable. We enjoy, if I may use that word, such a veto power ourselves, even though we are now net borrowers of the Fund, while the EEC countries contribute—as of last August—more than 60 percent of the Fund's loans and investments, and must be expected—should be expected—to finance even a larger proportion of the total in future months and years.

The same purpose, however, could be achieved, in different ways.

The first way to do it is by raising from 80 to 85 percent the qualified majority defined by the present Articles of Agreement. That was the solution suggested at Rio.

A second solution would be to distribute an adequate portion of the total voting power pro rata of members' net claims, that is, lending to the Fund.

A third solution, and the one which I would undoubtedly prefer, would be to raise to 20 percent the combined quotas of EEC members. But all three would achieve, in fact, the same objective.

While agreeing—for the sake of reaching agreement without undue delays—with the first of these techniques, if it is insisted upon, I hope that future negotiations should explore more fully the other two as providing better solutions to a real problem. The last—and least objectionable one—an increase of the EEC combined quotas to 20 percent—could, in fact, be easily implemented by incorporating a mere fraction of the present GAB commitments of large creditor members of the Fund into their regular quota.

V. Conclusion

In brief, I would urge Congress:

(*a*) To accept the results of the present negotiation and ratify the agreement that will be submitted to it;

(*b*) To urge our officials to seek through further negotiations the amendments required for the following purposes:

(i) To adjust the future creation of all forms of credit-reserves—foreign exchange as well as SDR's—to the overall reserve requirements of feasible, noninflationary, growth in world trade and production, without waiting for the solution of our own—or of the British—balance-of-payments difficulties, but also without expecting the world monetary system to solve these difficulties for us, through the automatic or bilaterally negotiated incorporation of our I O U's into the world reserve pool;

(ii) To avoid destabilizing shifts between reserve currencies and gold metal;

(iii) To use the lending power derived from the creation of credit reserves for the support of internationally agreed policy objectives, including particularly IDA, as I mentioned before;

(iv) To encourage the development of regional—as well as of worldwide—monetary cooperation through the regional pooling of SDR's by members of regional economic groups; and

(v) To adjust other IMF rules to a realistic appraisal of members' legitimate concerns and interests in the management of the resources contributed by them to the Fund.

I might add that I would find it difficult to approve the Rio agreement if I felt that its rejection would lead quickly to a better agreement rather than to the chaos which the lack of any agreement would entail.

Most of all, I am convinced that agreement is urgently needed to preserve the necessary framework for an orderly evolution of the world reserve system in the future. This evolution will not be stopped by the mood of the Rio negotiators as of September 1967. The creation of a truly international reserve asset by international agreement would break the old nationalistic and conservative taboos that have repeatedly brought us to disaster in the past, and to the brink of disaster today.

Once these taboos have been broken, the evolution of our institutions and policies will be determined by the logic of events far more than by the passing convictions of our officials, no matter how strongly held—or expressed—today.

The puzzling gyrations in the Group of Ten negotiations should reassure us as to the flexibility of mind of our official experts and statesmen.

For instance:

(*a*) All the officials strongly resisted, until 1962 or 1963, the opening of any official debate on international monetary reform, but they initiated this debate in 1963.

(*b*) The creation of a new international reserve asset was rejected by our most brilliant and responsible negotiator, as late as 1962, as a utopian and dangerous dream in the absence of a world government, but the same proposal was strongly endorsed by him less than 2 years later.

(c) The same official foresaw also in 1962 the direst consequences from any expression of interest by the United States in international monetary reform, as long as our balance of payments was in deficit. One year later, these fears had apparently vanished, even though our deficit has increased further in the meantime and was later to be regarded as beyond remedy as long as we remained embroiled in the Vietnam war.

(d) We initially opposed the French proposal for reserve units and preferred to develop instead the traditional techniques of the IMF. By last March, however, a breakdown of the negotiations seemed imminent because of the French rejection of their initial reserve unit technique in favor of IMF drawing rights, and of our belated endorsement of reserve units as preferable to drawing rights.

Further lessons might be drawn from these bizarre quirks in incompatible and ephemeral "national negotiating positions" often as far removed from our true national interests as from those of the international community itself. But this should be reserved for another, and more leisurely, occasion.

Thank you, Mr. Chairman.

Chairman REUSS. Thank you, Mr. Triffin.

Let me ask first of Sir Roy Harrod his attitude on two of the propositions contained in Mr. Trifflin's paper which were also discussed by Mr. Bernstein, the so-called questions 3 and 4 put to you earlier, question 3 being whether starting rather promptly after the activation of SDR's it would make good sense to initiate discussions in the World Bank and in the IMF looking toward the possibility of allocating some portion of the new SDR's to international economic development possibly through the purchase of IDA securities, and thus to link foreign aid and reserve creation.

Then the fourth question, which is whether the pooling of SDR's by regional groupings of countries in order to marshal their new drawing rights most effectively should be permitted and encouraged.

Would you address yourself, Sir Roy, to those two points?

Sir ROY HARROD. Yes. There may be an opportunity later for me to seek elucidation on one or two of the points that Professor Triffin has just made.

Chairman REUSS. Yes.

Sir ROY HARROD. I do not think I really have much to say about 3 and 4. I am in favor of 3, and I think it would be a good thing to do.

The trouble has been that there is very strong prejudice at the official levels against any such scheme, against linking aid and monetary questions.

I suppose basically, I think, it is because there is prejudice on the part of bankers, top bankers, against the kind of things they understand being mixed up with aid questions.

The traditional arguments used are that you might have a scheme in which you had conflicting pressures. You might have, for instance, the use of IDA funds for certain projects in less developed countries. Such schemes very often last over a period of time. You might be committed to issuing a certain number of monetary units to these countries at a time when it might be that the world needed deflationary monetary policy, and when for a given year or two you did not want to issue any monetary units, so then the countries benefiting from these projects would be left stranded.

Chairman REUSS. If I may interrupt, the proposition was not really to link specific batches of SDR's to a specific dam or irrigation project. It was to make them fungible, to so speak, to use SDR's as a method of adding to the total lending power of IDA, and if for reasons of retrenchment in SDR's in a given period or for reasons of budgetary retrenchment in IDA overall, there had to be an on-again off-again end result in certain development projects in certain countries that would be too bad, of course, but it would not be particularly the fault of linking it with SDR's, would it?

Sir ROY HARROD. I quite understand that the proposal is not for the use of particular batches of SDR's for particular projects.

Nonetheless, IDA has got to budget; if it is to be careful, it ought not to engage in some projects of considerable duration, unless it sees from where the funds are coming.

Unfortunately, the funds available to IDA seem to be somewhat precarious; thus it might come to rely on this source of funds, namely, SDR's the value of an issue of new units, when it was undertaking longer range projects, since its other sources of funds might dry up because legislatures refused to vote replenishment. So it would come to rely on SDR's at a time when the high monetary authorities thought that none should be issued, owing to world inflationary tendencies.

Chairman REUSS. As it is now, IDA gets what reliance it can out of the commitments of its consitutent governments to contribute, usually over a 3-year period, a certain amount each year out of general budgetary processes of the constitutent countries.

I should not think there would be any reason why SDR's cannot be made available with substantially equal certainty.

After all, SDR's are going to be programed over a 5-year period, and we are just talking about a marginal amount of them here, 10 or 20 percent.

Sir ROY HARROD. I do not attach great importance to this argument. I was only trying to give expression to what——

Chairman REUSS. Some of the hazards.

Sir ROY HARROD (continuing). What I think the bankers are apt to argue.

I think that, if allotment of SDR's to IDA were a small proportion, something like 20 percent, that would be pretty safe.

Chairman REUSS. So that on balance you would favor the initiation of discussions on the linkage of SDR's and economic aid as soon as the first activation has occurred, so that you do not distract the activators by other things?

Sir ROY HARROD. After activation and on the basis of a proportion.

I would not go so far as the original plan of Max Stamp who thought in terms of the whole of the new units going to the less developed countries.

Chairman REUSS. Yes.

How about the other point, the pooling of SDR's by regional groupings? Does that seem to you a valid use of the new SDR's?

Sir ROY HARROD. Yes, it does, I think. It sounds like a good scheme.

I am not quite sure how it is related to the outline agreement; that is, I am not yet quite clear how far countries will have the liberty to switch their own holdings of SDR's to the other countries otherwise than through the specific machinery laid down. But if they are to have such liberty under the agreement, there seems no reason why they should not also be able to switch them to the pool.

Chairman REUSS. You had some additional points that you wanted to present to Mr. Triffin. Would you proceed now to put them?

Sir ROY HARROD. I was not quite clear—I am happy, very happy, to support his formula which he put out in the first instance, of creating whatever number of SDR's would be needed to fill the gap between a possibly desirable increase in the total world reserves and the accruals of gold and reserve currencies to those reserves. That seems to be an excellent formula, and it would meet the arguments of some who say, "We cannot start activating now because everything is so uncertain."

It is true, of course, that it is uncertain what the accretions of gold and dollars would be in the first 5 years. Well, I feel that that uncertainly will always remain, but it would be met by Mr. Triffin's formula, and then you would not have to do crystal gazing to discover what the gold accretions or dollar accretions are likely to be.

We would be in the position of saying this uncertainty does not matter, because, if the gold accretions are more, the SDR accretions will be less, by the formula. The only crystal gazing you would have to do would be about what total you think should be added to world reserves.

Further, under the scheme itself there is provision for making a change during the course of 5 years.

I was intrigued by the fact that it was unsymmetrical as between inflation and deflation.

If people think that the reserve creation proposed for a 5-year period is inadequate, it takes an 85-percent majority to have an increase during the course of the 5-year period. But if it is thought that the issues are excessive, a simple majority can authorize a decrease. That seems to imply a slight bias in favor of deflation. Well, I do not bother about that.

Then, I did not—I have had the privilege of reading Professor Triffin's submission—but I did not quite follow his "garbage can" argument. Certainly there is a problem in regard to old dollars and sterling that countries accumulated in the past, and have now changed their view about. They may have felt in the 1950's that the dollar was very good reserve currency to hold, but some countries, anyhow, have now altered that attitude of mind and, therefore, there is the danger of their just cashing in their holdings previously acquired, as one country has done already.

There is some safeguard, I think, in the SDR scheme that you cannot use SDR's, in order to alter the composition of your reserve holding, and it may be that that problem could be solved in that way. But it seems to me rather a tricky one, and difficult.

Chairman REUSS. Could we interrupt——

Sir ROY HARROD. Yes.

Chairman Reuss (continuing). At that point, Sir Roy, and ask Mr. Triffin to respond.

I have a little difficulty in seeing the garbage can horror myself. I would have thought that the two provisions in the outline plan against changing the composition of one's foreign exchange reserves will prevent the garbage can syndrome from occurring.

Mr. TRIFFIN. Mr. Chairman, I think all those difficulties about activation as well as the ones I have mentioned about the distribution, the allocation of SDR's among various countries, spring really from a single source, and it is the fact that we pretend to create a reserve creating machinery and to direct it rationally by addressing ourselves only to one of the three pieces of the machine.

The world reserve pool, after all, is made up of gold, dollars and sterling, and some IMF liabilities to be expanded now by the new SDR system.

We say we are going to direct rationally the evolution of the world reserve pool by directing rationally the creation of SDR's. But in the absence of any inkling as to what may happen to gold and to dollar and sterling reserves, we are unable to do that.

It is quite clear, for instance, that if foreign countries continue to be willing to take large amounts of gold and sterling in future years it might very well be that——

Chairman REUSS. Dollars and sterling?

Mr. TRIFFIN. Yes.

Chairman REUSS. Large amounts of dollars and sterling?

Mr. TRIFFIN. Large amounts of dollars and/or sterling. If they take large amounts, well, there will be no worldwide shortage of reserves. You might even have inflationary problems in this case.

Chairman REUSS. But can't you adjust as you go along if this turns out to be the case?

Mr. TRIFFIN. Create fewer SDR's.

Chairman REUSS. Turn the other needle valve.

Mr. TRIFFIN. No, that is where I am not quite sure that the shoe is not on the other foot than what Sir Roy was saying.

If too many reserves emerge already from the traditional reserve sources, creating no SDR's does not fully solve the problem. There still may be too much reserves, and you cannot really destroy the SDR's already created by asking for their repayment since 70 percent of them are nonrepayable.

Chairman REUSS. True. But is this really a danger that the world will be drowned in reserves, that central banks will hold so many——

Mr. TRIFFIN. Probably not.

Chairman REUSS (continuing). Dollars?

I do not really think it is serious.

Mr. TRIFFIN. No. Surely I agree with you that the likelihood may be the other way.

Chairman REUSS. They will grab gold and fracture the reserves.

Mr. TRIFFIN. They will even get rid of old dollars and sterling, and this is what I want to protect us against. As you know, I have been arguing for this since 1959, the first time I appeared before the committee on this subject, and I think we have disregarded that danger.

Now, what I mean by the "garbage can" is this, really: That you have on the one hand gold reserves which, for some absurd reasons, they are always willing to take. They do not question that.

But then you have alongside of that a second form of reserve which is "credit reserves": reserves that are also credits either to the IMF or to the United States and the United Kingdom. Both forms are credit reserves.

Now, suppose that at a certain time those credit reserves are used by the borrowers to finance policies with which the lenders disagree.

Now, I find it very difficult to believe that you could ask them the following kind of advance commitment: "Well, at the moment in the last few months, for instance, you have been willing to take more dollars, more sterling. Therefore, we need not create any SDR's.

"But if tomorrow you change your mind and refuse to take dollars and sterling or try to liquidate those that you have been willing to accumulate in the past months, then at that point world reserves would contract because of the destruction of the dollar and sterling balances converted into gold. This will legitimately call for SDR creation to prevent such a contraction, and one-third of every SDR created will be allotted to us. Thus, if you refuse to finance us directly by holding to your dollars and sterling, you will finance us, anyway, through the SDR's created."

Chairman REUSS. At the time when, in your model, foreign central banks are not willing to accept further dollars, we, the United States, are not going to be rescued by SDR's.

Mr. TRIFFIN. No, the amounts are too small.

Chairman REUSS. The amounts are just not enough.

Therefore, when that fell day comes we are in a pickle, or not in a pickle, depending upon your views of the effect of large scale gold withdrawals from the United States, it could well be that we could sit quietly by and see our gold withdrawn, and then when it is all gone, have the dollar float, and it might float quite well, it might float upward, because I think the dollar is sounder than gold.

But in any event I do not quite see that SDR's come to grips with this problem or why we should view it as a defect of the outline plan, that it does not, always assuming that I have an understanding of what you have just been saying.

Mr. TRIFFIN. Well, as you know, I am extremely worried, I have been for a long time, about this probability that at some point central banks will create a deflationary pressure upon world reserves, not only by refusing to hold new dollars and sterling, but even by cashing their old ones, and I think that the first thing that should be in the U.S. interest in that respect would be to see that reserves, dollar reserves, dollar balances which they have been accumulating for 50 years past under the gold exchange system, should not be converted or liquidated overnight into gold metal.

This introduces into the system a source of instability which is totally unreasonable from the world point of view as well as from the U.S. point of view.

Chairman REUSS. Such a standoff agreement might be very advantageous.

Mr. TRIFFIN. To us.

Chairman REUSS. To us; yes.

Mr. TRIFFIN. Yes, I agree.

Chairman REUSS. And to, indeed, the whole world. But you would not want to delay the ratification and activation of the SDR's pending such an agreement, would you?

Mr. TRIFFIN. Oh, no, certainly not.

All I have been suggesting here again are directions in which we should think in order to correct past mistakes because this is a kind of agreement we could have obtained a long time ago if we had showed ourselves more receptive to some suggestions made by the Italians, supported by the Germans, exactly for such a solution.

We have always refused to do so through a total misinterpretation, I think, of the U.S. interests. We have rejected all suggestions to protect our mounting dollar I O U's to control banks against sudden conversion into gold, because such a negotiation would obviously require some agreed limitation—by multilateral agreements—on our ability to finance future deficits through further accumulation of dollar reserves by our creditors. We hoped—rightly—that some countries would be willing, or could be persuaded, to accumulate more dollar balances in their reserves, but only if they felt assured that such balances would remain fully liquid, that is, that they could be drawn upon, at any later date, either to acquire gold, or to settle deficits with other countries as well as with the United States. We preferred in fact to leave our $16 billion of outstanding I O U's to foreign central banks exposed at all times to gold conversion, than to give up the chance of obtaining a few hundred million dollars of short-term financing for our deficits through further—and highly precarious—accumulation of our dollar I O U's by some of them.

It would have been wiser, I think, to recognize that this process was bound to come to an end, and to seek instead multilateral agreements, with at least all major reserve holders, protecting against wanton gold conversions of the dollars acquired by them in the past and those that they might still agree to incorporate into world reserves in the future.

Chairman REUSS. Sir Roy, would you proceed?

Sir ROY HARROD. I am still slightly hazy in my mind, but it is slightly clearer.

Mr. TRIFFIN. Could I add one point which would make it clearer, because it will refer to an old negotiation in which you were very much involved?

A few months before the final agreement was reached on the European payments agreement, Britain presented a project which was very much along those lines also. Britain said, "Countries which want to cash their sterling for gold will have to accept EPU settlements in lieu of gold. But as long as some countries, Italy at that time, or the Scandanavian countries, are willing to take our sterling and finance us directly in that way, those operations should not go into EPU. If they change their mind they should."

What other countries said at that time was that this would make the new European Payments Union the "garbage can" of the failures of the sterling area, and it is the same objection that we are confronting today.

I believe very much, Mr. Chairman, let me be clear about this, I believe very much in the proposal which I have indicated and with which we are all in agreement, that we should create SDR's to fill whatever gap develops between a targeted increase in world reserves and the actual evolution of world reserves. I agree, but to make this negotiable you have to think about the second point which I have brought before you. Otherwise, the negotiation is just hopeless.

Sir ROY HARROD. May I go on to the next point that I do not understand, the proposal in regard to the distribution of SDR's?

This is not a proposal of anything immediate but for something that we might work to.

Mr. TRIFFIN. Yes.

Sir ROY HARROD. Distribution is proposed to be according to quotas. How you should distribute these units has been much dis-

discussed, and to my own mind this seems about the best way of doing it, subject, of course, to the quotas being revised from time to time.

Mr. TRIFFIN. To give more to the Europeans in that case.

Sir ROY HARROD. Yes, to give more to the Europeans.

But you seem to have proposed quite a different method of distributing the SDR's. There were five points.

Now, one of the points was that some might be distributed to IDA. Well, we have agreed upon that, and that one understands.

But I do not understand how equity is satisfied, for instance, if these new units are allotted to support domestic stabilization programs. How can you use some of the annual increment of SDR's to support domestic stabilization programs from the equitable point of view?

The great thing then would be for a country to have a very upset system, and it would then get some money to stabilize itself, to finance its stabilization program, so that it would get a disproportionate share of the SDR's in that year. But how is it equitable that such countries should get a disproportionately large share of SDR's as compared with countries whose monetary systems have not got upset? It seems difficult.

Mr. TRIFFIN. Yes.

From the equity point of view, of course, the solutions which I prefer are those which use the SDR's for agreed international purposes and, particularly, for assistance to development through the IBRD, the IDA, and so on.

What I meant by the monetary stabilization is nothing different from what the Fund is already doing, and it means *agreed* monetary stabilization programs which the Fund members are ready to support.

After all, SDR's really are a commitment of prospective surplus countries to lend to the Fund, that is what it means.

Sir ROY HARROD. I would draw a distinction there. Is that true? I mean, of course, the Fund allows drawings to support domestic stabilization programs, but those are *repayable*.

Mr. TRIFFIN. Yes.

Sir ROY HARROD. I mean that the repayment obligation involves that there is no lack of equity. It may be there are quite a small group of countries that get drawing rights for stabilization programs. But then they have to repay that.

There is no lack of equity there, because, if some countries never have disorders in their monetary systems, and never get any drawing for the purpose, the other countries which do get such drawings will have to pay. But these SDR's are more like gifts, and to give a larger quantity of them to people who have gotten into a financial upset, seems inequitable somehow.

Mr. TRIFFIN. But, Sir Roy, when I make this proposal I would not apply necessarily to that particular piece of the proposal the technique which is used now in the Rio agreement for a completely different purpose.

Very obviously, the financing of monetary stabilization programs which have been agreed to with the Fund would continue to have to be repaid. That portion of SDR financing would be reconstituted, if you like.

Sir ROY HARROD. Yes.

Mr. TRIFFIN. This would meet the equity argument that you have mentioned. To me this is just another way of financing very much-needed Fund operations at times.

Sir Roy HARROD. Don't you feel it is rather desirable to draw the line between the old-type drawings which are credits, which are repayable, which are according to the need of each country, and the new type drawing which is basically not repayable and is distributed, around the world, on an equitable basis?

Mr. TRIFFIN. What I suggest is that a growing portion of future SDR's would not be allotted as a free gift to any specific country or countries, but would be used instead to purchase bonds of the IBRD, debentures of the IDA, et cetera, I would hope further that, like the famed British "consols," these obligations would not involve any fixed repayment obligation, but could be carried on indefinitely, subject only to regular interest payments.

Chairman REUSS. As a practical matter, Mr. Triffin, is not the proposal to use a fraction of new SDRs to somehow come to the aid of IDA?

Mr. TRIFFIN. A very good way to start.

Chairman REUSS. Isn't that far and away the best of the four or five you have assembled there in terms of world need?

Mr. TRIFFIN. I agree.

Chairman REUSS. And also, far out though it is, more politically realizable than to, say, use SDR's to pay a U.N. peacekeeping force or bailing out countries with domestic disequilibrium.

Mr. TRIFFIN. I mentioned the latter only as a very long-term and hypothetical possibility.

Chairman REUSS. So I think so long as Sir Roy agrees that the IDA solution is worth exploring, and since you agree that is the most meritorious on the list——

Mr. TRIFFIN. Yes.

Chairman REUSS (continuing). There really is a substantial area of practicable agreement between you two on that.

Mr. TRIFFIN. I quite agree that is the way to start certainly. That it is the best and most feasible way, I think, to start right now.

I hope that in the longer run we may then expand the idea further, but I think it is the best way to begin, and I would apply to whatever we discuss today the same disabused remarks which I apply to the mood of the negotiators in Rio in September 1967.

I think that the international monetary system will continue to evolve in the future, as it has in the past.

Sir ROY HARROD. The next point—and I apologize for these points—but there has been discussion this morning also about the equity of allowing the Common Market to have a veto power, and Mr. Triffin has argued that rather strongly this afternoon, and in a broad way, of course, one has great sympathy with the idea—if their trade and GNP are of sufficient magnitude, why should the United States be the only country to have a veto?

But yet I do think there is a difference which I cannot get away from because "the Six" are not really *one* country, and yet it has got this EEC which, in a certain sense, binds them together without really making them one country.

I do see a difference between the EEC and the United States.

Now, supposing the position of the United States was that it consisted of almost independent groups of States, say New York State, California, the Middle West, et cetera, and that all these regions had practically independent governments, but had only arranged, perhaps, to have no tariffs between them. Well, then, wouldn't you have to say about these countries—these are really not *one* country, and ought not to have, by some unanimity rule, a veto on new projects in the world. They are not entitled to a veto any more than the whole of Latin America is entitled to a veto. That is where I see a difference between the United States and the Common Market.

After all, the United States is really one country, and it is a very big one, and in relation to its size, it has an appropriate quota. Of course, all this argument depends on the voting procedure within the Common Market.

If we can have a guarantee that they would have fair majority voting, and that there could be absolutely no pressure on EEC as a whole, say, by France or by Belgium or by Germany or by Holland, or whatnot, if it were absolutely assured that there would be no pressure in the voting but that each country would vote independently, then I would not mind the group as a whole having a veto.

If there is to be some unanimity rule within the Six, then there does seem to me to be a grave danger in allowing "the Six" in its turn to have a veto, because it really does give one country a veto as against the whole world. I cannot help feeling that there is a danger there.

Taking the corresponding case over here of the United States, it would be like giving California a veto over the whole world.

Mr. TRIFFIN. Mr. Chairman, I think that the case is perfectly similar if we followed the assumption of Sir Roy and said there are 50 states in the United States, each one free to act as it wishes, just as every one of the Six at the moment is free to act as it wishes, and it is still true that if these 50 voted the same way they would have 26 percent of the vote, and they would have a veto.

It is only insofar as the Six act together, that they would have the same kind of situation, and we must not forget that there is something—one may regret it really from a moralistic or maybe utopian point of view—but it is very hard to believe that countries which put at the moment 60 percent, and tomorrow certainly more, of the total financing in the Fund, would agree to have less votes really than half the votes of the two countries which are now the largest debtors of the Fund, which are borrowing the money.

It is regrettable, but it is the fact that it would be impossible to get large contributions if they know that they have not, they do not have an adequate voice on the funds which they put in.

In any case, I mean this is something which has been agreed at Rio, and I doubt very much whether it would be, it could be, changed very easily.

But what I was arguing was that we should try to induce them to accept the present rules of the Fund, the 20 percent, they would have a veto if they had 20 percent of the total quotas, and we should induce them to try to raise their combined quotas to 20 percent rather than to have a veto with 15 percent.

But in any case, as you know, Mr. Bernstein made the point this morning, I think, in fact, they already have more than 20 percent in the decisions of the executive directors. They do not in the decision of the governments. But in practice, in the executive board of the Fund, some European countries are exercising the voting power of small nations which they are representing in the Fund, and that gives them already more than 20 at the moment.

Sir ROY HARROD. Can't these unfortunate small nations say, "We don't agree until the executive director"——

Mr. TRIFFIN. No. The executive director is compelled by the rules of the Fund to express only one vote, and if he has the votes of Israel, for instance, whether Israel says yes or no does not matter. The director cannot split his vote, even though he represents countries having different views on the matter under discussion.

Sir ROY HARROD. This is an abuse which one day will have to be looked into.

Mr. TRIFFIN. That is why I think some rules of the Fund may have to be looked into.

Sir ROY HARROD. Perhaps they will come in these amendments that are proposed.

But in connection with this same point, as a digression, I notice Mr. Triffin referred in regard to countries contributing to GAB, and I have seen this referred to also in the press, that the Common Market countries should be given more voting power because they have contributed, not only their quota of gold and their own currencies up to quota obligations, but also because they have contributed sums by way of the GAB, as creditor countries.

This seems to me most fundamentally wrong in principle. If you are going to "plow in," so to speak, the GAB contribution—there is a case arguable for that—you could say that the voting should depend not on quotas but quotas plus GAB contributions. OK.

But this extra voting right must not relate to the contributions of the particular countries that they have made under the GAB because they have been creditor countries in particular years. If you are going to bring in the GAB, as regards the voting conditions in the IMF, it must be on the basis of the amount of standby in the GAB that each country has provided.

The United States provided $2 billion. It is true that those $2 billion have not been used in this particular run of years.

Well, it is true that the German and French contributions have been used in these years because they happened to have been creditors. But they are not going to be creditors forever, and at another time the United States is going to be a creditor. What should be the criterion for any extra voting power granted to a country owing to its GAB participation, should be in proportion to the standby contributed. I am sure that is absolutely an essential.

Mr. TRIFFIN. Could I discuss that point, Mr. Chairman? I think again we are talking here about hardheaded central bankers, and if we applied simply the principle of standby or willingness to contribute, then we would be led to say: Well, Brazil could acquire a much larger voting power in the Fund by offering a standby agreement under the General Arrangements to Borrow, to lend to the Fund 500 billion cruzeiros.

Sir ROY HARROD. Excuse me; I am not talking in the slightest degree of other countries who are not parties to the GAB and might offer cruzeiros, or whatever. I am talking about GAB, and the offers that have been made and accepted.

The United States is under a standing obligation under GAB to provide $2 billion when it is asked for, subject to certain conditions, of course.

GAB is a credit system, and certain countries were asked to contribute to it, because their currencies were deemed worthwhile. That is why they were asked. Nobody asked Brazil to contribute to the GAB, and for the time being nobody will. But it is absolutely clear, in equity, that if you are going to do anything on this, it must be on the basis of the original standby contributions.

I mean you might just as well say that the voting rights in relation to quotas should be proportionate to the country's creditor-debtor position in the last 3 years. You might say, "Well, the United Kingdom is a debtor, and it has therefore lost all its voting power in the Fund because it has been a debtor or that some other temporary creditor country has increased its voting rights."

You could not run a system on the basis of the votes of each country depending on whether it happened to be in credit or in debit. That would be a very unstable system and the same applies to GAB.

Mr. TRIFFIN. I quite recognize that you cannot base the voting power simply on passing, ephemeral, creditor positions in the Fund, and that you have to have a system in which certain countries are assured of a stable minimum bloc of votes simply because of their importance in the world. I quite agree with that.

But even the Fund agreement recognizes that for certain decisions countries which are creditors will see their vote increased by a certain proportion in reaching a voting majority. It is certainly unrealistic and unreasonable in principle to say that the total amount of voting power should be governed by either one of two criteria: how much you are committing yourself to lend and how much you are being given the right to borrow.

You should not reward with the same voting power both the willingness to lend and the right to borrow. Yet, at any point in time the bankers about whom we are talking know very well that an increase in quotas for a certain country means an additional promise to lend, and that for another country at a certain point in time—but which may last for a very long time in the case of some countries—an increase in quota means an additional right to take money out, and you should not have the same voting power rewarding both decisions.

Sir ROY HARROD. I cannot agree with that principle at all.

It seems to me that the Fund is supposed to last maybe for a century, and maybe for many centuries, and to say that the voting powers in the Fund are to depend on whether a nation is in credit or in debit——

Mr. TRIFFIN. I quite agree with that, but it has to be influenced by it.

Sir ROY HARROD. I would not agree with that.

Mr. TRIFFIN. It is already in the Articles of Agreement of the Fund.

Sir ROY HARROD. In what sense?

Mr. TRIFFIN. This is in the Articles of Agreement for a number of decisions where the voting power is augmented by a certain proportion of the creditor position of the country concerned, or decreased by a certain proportion of its net debt to the Fund. It is not a new principle.

Sir Roy Harrod. I am all in favor of the Common Market countries being given larger quotas on the basis on which the other countries were given quotas originally, namely, the value of their foreign trade and GNP.

Chairman Reuss. And seeing their voting power come to a veto level by reason of that increase in quotas, is that correct, Sir Roy?

Sir Roy Harrod. That makes me worried because I want to explore more deeply the voting procedures within the Common Market.

It frightens me, the idea of giving one country in the Common Market alone an effective veto, resulting from the Common Market having a unanimous voting procedure. That, I think, ought to be thrashed out.

Chairman Reuss. But wouldn't you, whatever you found out as to the internal voting procedures in the Common Market, still want Common Market countries to have more representative and modern quotas, than they do now?

Sir Roy Harrod. Well, but it is a question of how much quota. Yes; I think they ought to have bigger quotas, but not so big as to give them a veto.

Chairman Reuss. Well, they have got 16½ percent of the voting power now, based on their present quotas. Most people seem to think that they are more than 3½ percent shy on what they ought to be putting in quotas.

Sir Roy Harrod. I quite agree.

Chairman Reuss. If so, then is not your quarrel with the Treaty of Rome in 1958 rather than with a proposal for forms of the quota today?

Mr. Triffin. What you are suggesting, Sir Roy, would change the Articles of Agreement of the Fund to say that even if a certain number of countries vote against a decision, and have together 20 percent of the votes, the decision must go through anyway. What you are proposing is a revision in the present Articles of Agreement.

Sir Roy Harrod. You might reduce the qualified majority to 75 percent. That would take away the American veto, would it not?

Mr. Triffin. No. I think we have about 26 percent.

Sir Roy Harrod. Well, suppose you made the qualified majority of 70 percent; then no one will have a veto, and you would get away from all these difficulties.

Chairman Reuss. It would be nice if the Common Market, I must say, did tell the rest of the world how they vote. You know, they have conned us into giving them trade preferences, and everything else.

But, Mr. Triffin, you are a great Common Marketer. What about that, shouldn't your friends in Brussels let us in on the secrets?

Mr. Triffin. The secrets?

Chairman Reuss. The secret.

Mr. Triffin. I think there is no secret, really. The voting rules are well known.

Chairman Reuss. What are they?

Mr. Triffin. I cannot remember offhand to quote it for the record. But I know that it gives a somewhat larger vote to France, to Germany, to Italy, some lower one to Belgium, and the Netherlands, and a still lower one to Luxembourg.

In practice, what it means is that a qualified majority must take at least two of the largest countries, plus one of the smaller ones. No single country can exercise a veto right on the decisions.

Sir ROY HARROD. This is not decisive because that is on those questions where the decision is based on a majority, qualified or otherwise. But then there are other decisions which require unanimity.

Mr. TRIFFIN. Yes; but they have never agreed so far that decisions about this sort of issue would require unanimity. They are trying to, some of them would like to, have such a decision that they must have, express their views, in the Fund with a single vote, but this is not something which has been so far accepted by the Common Market countries.

Chairman REUSS. Let me ask this specific question: Suppose five of the six Common Market countries, everybody but France——

Mr. TRIFFIN. Yes.

Chairman REUSS (continuing). Wanted to have a general quota increase in the regular IMF, which would markedly increase their quotas, and suppose France demurred. Would that or would it not be an effective veto of Common Market action?

Mr. TRIFFIN. I would like to make two points on that, Mr. Chairman, but I would ask you for permission to make the second off the record.

Chairman REUSS. Yes.

Mr. TRIFFIN. But the first one is quite simple. Legally, they could make the decision without the participation of France, according to the present rules of the Common Market.

That does not mean that they would not hesitate quite a lot before doing so. I recognize there are some political implications here and that some countries might not wish to provoke another crisis in the Common Market, even by doing something that they are legally authorized to do, so I do not think that the legal answer is decisive. I do not think that voting decisions would actually be taken on the basis of the legal provisions of the Treaty of Rome.

The second thing which I would like to say off the record——

Chairman REUSS. Off the record.

(Whereupon, there was a short discussion off the record.)

Chairman REUSS. Back on the record again.

Let me ask this question, Mr. Triffin. You have said that, with respect to the parallel proposed changes in the regular IMF procedures, you would regard it as vastly preferable to have quota increases and let the Common Market, so to speak, earn its veto that way.

Mr. TRIFFIN. Yes.

Chairman REUSS. Suppose, however, that the Common Market negotiators in months to come are intransigent and stick to the proposition which has been advanced that they should be given a veto without a quota increase by the device of raising the requisite majority to 85 percent.

Mr. TRIFFIN. Yes.

Chairman REUSS. Would you think that as the price of getting the ratification of the SDR agreement we should go along with such a change in regular IMF voting procedures?

Mr. TRIFFIN. Mr. Chairman, I would again say that I would hope that our negotiators could, in fact, reach the other solution with the Common Market people.

But if they were unable to do so, I would, I think, regretfully still suggest that we should not really "break the egg", because then we would have nothing.

After all, it is true that as of the moment they do contribute nearly two-thirds of the total lending power of the Fund. It is further true that the creation of SDR for some time to come is expected essentially to come 100 percent from them in terms of real resources, and if we break the egg we just get nothing.

If there is a way to have this agreement signed with the present 80-percent rule in the Fund, I would certainly prefer that, but if there is no way of getting it signed without going to 85, I would still prefer that to no agreement at all.

Chairman REUSS. How about you, Sir Roy, if confronted with that?

Sir ROY HARROD. I am sorry to bore you, sir, with my old point. I do not think that it is feasible to break the egg and unscramble the omelet or undo the package at this point. I think we have got to take it as a whole, and that is why I go back to my own point that I feel that what we could do is say we accept it as a whole, but that we are not going to ratify it until activation is guaranteed. Now, that is not altering the general package. It is merely saying that it is deferring it, and that the date of ratification by Congress is going to be the date when activation is agreed on.

Then, of course, you do not give them anything and you are not spoiling the package. They do not get the 85-percent majority rule until activation, and an activation date, is agreed to.

I would not mind trading a date in the rather distant future for a fixed date. It is the fixed date which seems more important to the question.

Mr. TRIFFIN. It is an empty threat, really, because those countries which are most reluctant to sign this agreement are not going to be frightened if we say we won't sign it until something else happens. I do not think it is a real weapon in the negotiation.

Sir ROY HARROD. Yes, it is a weapon. It is not a question of their being frightened. We do not want to "frighten" anyone.

Let us suppose, rather pessimistically, as things could turn out, that they will be willing to think the world is ripe for this in 5 years' time, and that in the next 4 years they won't think the world is ripe.

Well, the agreement would not be ratified according to my proposal. As soon as they think that the time is ripe for activation then the agreement will be ratified at once. There is no threat at all. It is simply saying we entirely agree, only we do not happen to think it is good constitutional procedure to sign the agreement, to ratify the agreement, without the date being put on it. You never normally sign an "agreement" before the date is there.

You do not sign to pay $10,000 a year for a house when the date on which you enter it is unspecified.

Mr. TRIFFIN. Sir Roy, you create a bank before it can make its first loan.

Chairman REUSS. Would either of you gentlemen have any further comments or questions to put to each other?

Sir ROY HARROD. Thank you very much.

Mr. TRIFFIN. Thank you. We are tremendously grateful.

Chairman REUSS. Have you explained that chart?

Mr. TRIFFIN. No, I have not explained it. Maybe I should explain it in a few words.

Chairman REUSS. Do you have a copy of it for the record here?

Mr. TRIFFIN. I could send you one or this could be, maybe, photostated—photostats could be made here.

Chairman REUSS. If not, may we keep it and send it back after we have reproduced it?

(Chart referred to follows:)

U.S. Net International Investments, Monetary Reserves and Liquid Liabilities, 1913 – 1967

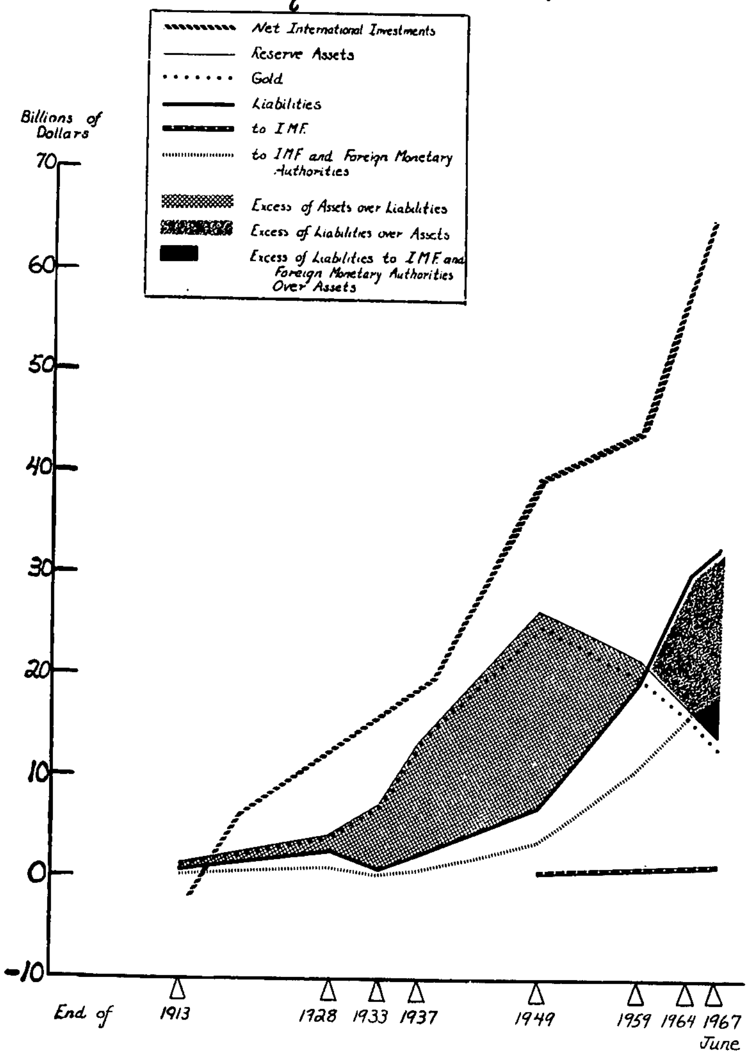

Chart 3

Mr. TRIFFIN. Could I turn it halfway, please?

Chairman REUSS. Yes. I will come sit around here, then.

Mr. TRIFFIN. It is not very visible from afar, I am afraid. I think some of you might come closer, possibly, to look at what it is.

This shows—I always like to take a longrun perspective—this shows the evolution of our reserve position since 1913, and the gold line here represents the amount of our gold stock, with a maximum of about $25 billion in 1949.

Then, the line declines, as you note, to something around $13 billion today.

The black line includes in addition to the gold, our foreign exchange and our net claims on the IMF or gold tranches in the IMF.

The other line, on the other end, the red line here, shows the dollar balances held abroad, private and public, and I showed with black lines here the excess of our monetary reserves over our short-term dollar liabilities, and the line was crossed shortly after I testified here in 1959. I presented a chart like this, but much more graphic, to Congress in 1959, showing the two lines coming very close to each other.

Well, they crossed about a month or two later, and the red dots mean, if you like, the excess of our liabilities over our total monetary assets, and I blocked in solid red something else, which is only the excess of our liabilities to central banks, to monetary institutions, over our total monetary reserves.

I have a similar chart—Chart 3, in my set—for Great Britain showing how this occurred at a much earlier stage in the British case. I think it is something that is unavoidable for a country whose currency is used as a reserve currency.

It is, of course, the reason why no country in Europe is very anxious—there have been some suggestions of this sort—but no country in Europe is very anxious to see its own currency used as reserves by other countries, because they consider it as hot money. The money comes in when the weather is good, it flows out when the weather is bad, like the famous umbrella of the bankers.

But now, to make this less alarming, I put on the same chart this green line, which is our total international net worth, including long-term investments abroad and our long-term liabilities abroad.

You see that throughout that period in which our monetary reserves passed from a net surplus of about $23 billion to a net shortfall of about $3 billion our total international net worth has continued to increase by leaps and bounds, and reached at the end of 1966 close to $65 billion. I wish that when people publish charts or comment on the enormous deterioration of our monetary reserves they should at the same time keep in mind the other aspects of our international position.

Chairman REUSS. I think it is a very good point, and I would like to see something like that in our system of accounting.

Mr. TRIFFIN. Accounting, yes.

Chairman REUSS. Another thing that to me would make some sense in our system of international accounting—and this thought was suggested to me recently by a very distinguished business friend—is that after all the strength of the dollar is dependent in only minor degree on the $13 billion worth of gold we now hold. It is dependent in very large measure on the long-term international investments which your line depicts.

To a person, foreign or domestic, who wonders whether to keep dollars or not, are there not two other relevant factors, one, the general state of the U.S. economy, our gross national product and the valuation of all assets; and, secondly, and part of that, the valuation of U.S. governmental assets, which is a not inconsiderable portfolio?

Mr. TRIFFIN. Our internal net worth as well as our external net worth.

Chairman REUSS. Aren't those factors of some relevance?

Mr. TRIFFIN. I think this is a good point, although it suggests an unfortunate simile which is the French assignats which were supposed to be backed up by the mortgages on the properties which had been seized by the French Government, and people will make jokes about that.

So I think that the case is eloquent enough already by having only our international assets, without counting also all kinds of domestic assets which some people would undoubtedly assimilate to the former backing for the assignats.

Chairman REUSS. What caused the assignats to collapse?

Mr. TRIFFIN. Because the Government of France at that time became more and more inflationary. They put out more and more money, and the more money they put out, of course, the more prices increased, and the greater the French franc value or the assignat value of the land and other real assets which the Governmend had; the price increases increased the value of the backing in one word. You see what I mean?

Chairman REUSS. Yes. The hitch was that you really do not have a lien or a mortgage on the chateau or you would have been all right.

Sir ROY HARROD. They had a lien, but these assignats were not convertible; that was the point. They were not convertible. I mean, the chateaux were there, but they were not convertible into——

Mr. TRIFFIN. They were convertible, but at an increased price. The more assignats they put out, the more the prices increased, and the higher the chateau costs were, and so they could put out more assignats against the chateau.

Chairman REUSS. The analogy of the assignat could be met by a policy of avoiding inflation.

Mr. TRIFFIN. Of course.

Chairman REUSS. Because if you could avoid inflation, an assignat was a good thing. You could have bought a condominium in that chateau.

Mr. TRIFFIN. Yes.

Chairman REUSS. Well, thank you both very much. I also thank in absentia Mr. Bernstein, who was so helpful this morning.

We now stand in adjournment,

Mr. TRIFFIN. Thank you very much, Mr. Chairman.

(Whereupon, at 3:30 p.m., the subcommittee adjourned.)

O