449

LINKING RESERVE CREATION AND DEVELOPMENT ASSISTANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-FIRST CONGRESS

FIRST SESSION

MAY 28, 1969

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
30-668 WASHINGTON : 1969

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price 50 cents

JOINT ECONOMIC COMMITTEE

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

WRIGHT PATMAN, Texas, *Chairman*

WILLIAM PROXMIRE, Wisconsin, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	JOHN SPARKMAN, Alabama
HALE BOGGS, Louisiana	J. W. FULBRIGHT, Arkansas
HENRY S. REUSS, Wisconsin	HERMAN E. TALMADGE, Georgia
MARTHA W. GRIFFITHS, Michigan	STUART SYMINGTON, Missouri
WILLIAM S. MOORHEAD, Pennsylvania	JACOB K. JAVITS, New York
WILLIAM B. WIDNALL, New Jersey	ABRAHAM RIBICOFF, Connecticut
W. E. BROCK 3D, Tennessee	JACK MILLER, Iowa
BARBER B. CONABLE, JR., New York	LEN B. JORDAN, Idaho
CLARENCE J. BROWN, Ohio	CHARLES H. PERCY, Illinois

JOHN R. STARK, *Executive Director*

JAMES W. KNOWLES, *Director of Research*

ECONOMISTS

DOUGLAS C. FRECHTLING (*Minority*)
RICHARD F. KAUFMAN
ROBERT H. HAVEMAN
FRAZIER KELLOGG
JOHN R. KARLIK
LOUGHLIN F. MCHUGH

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

HENRY S. REUSS, Wisconsin, *Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	WILLIAM PROXMIRE, Wisconsin
HALE BOGGS, Louisiana	STUART SYMINGTON, Missouri
WILLIAM S. MOORHEAD, Pennsylvania	JACOB K. JAVITS, New York
WILLIAM B. WIDNALL, New Jersey	CHARLES H. PERCY, Illinois
W. E. BROCK 3D, Tennessee	

CONTENTS

WITNESSES AND STATEMENTS

	Page
REUSS, Hon. HENRY S., Chairman, Subcommittee on International Exchange and Payments: Opening remarks	1
Announcement of hearing	1
DELL, SIDNEY, Director, New York office of UNCTAD	3
Prepared statement	5
Annex to prepared statement: Memorandum by Dr. I. G. Patel	12
JOHNSON, HARRY G., Professor of Economics, University of Chicago, and the London School of Economics and Political Science	16
Prepared statement	19
PREBISCH, RAUL, former Secretary-General of UNCTAD, and Director-General of the United Nations Latin American Institute for Economic and Social Planning	29
Prepared statement	30
SCITOVSKY, TIBOR, Professor of Economics, Yale University	31
Prepared statement	32
TRIFFIN, ROBERT, Professor of Economics, Yale University	34
Prepared statement	37

AFTERNOON SESSION

JOHNSON, BYRON L., Professor of Economics, University of Colorado	82
Prepared statement	94

ADDITIONAL SUBMISSIONS

DELL, SIDNEY:	
Table: Development Assistance Committee members—Net flows to less-developed countries of financial resources and net official transfers, as a percentage of GNP, 1960–67	15
JOHNSON, HARRY G.:	
"The International Monetary Problem: Gold, Dollars, Special Drawing Rights, Wider Bands and Crawling Pegs," a lecture in the University of Calgary Distinguished Lecture Series: April 7, 1969	21
TRIFFIN, ROBERT:	
Table: Financing of United States and United Kingdom Capital Exports, 1968	36
Article: "The Thrust of History in International Monetary Reform," from *Foreign Affairs*	43
Table: Maximum impact of a conversion account, Dec. 31, 1968	114
JOHNSON, BYRON L.:	
Article: "Financing Expanded U.N. Economic Aid," from *War/Peace Report*, February 1968	87
Article: "Let's Stop Calling it AID," from *War/Peace Report*, November 1966 (with accompanying letter)	103
REUSS, Hon. HENRY S.:	
Letter from Professor Benjamin Cohen, Princeton University, outlining views	111

LINKING RESERVE CREATION AND DEVELOPMENT ASSISTANCE

WEDNESDAY, MAY 28, 1969

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

The Subcommittee on International Exchange and Payments met, pursuant to notice, at 10 a.m. in room S–407, the Capitol, Hon. Henry S. Reuss, (chairman of the subcommittee) presiding.

Present: Representatives Reuss, Moorhead, and Widnall.

Also present: John R. Stark, executive director; John R. Karlik, economist, and Douglas C. Frechtling, minority economist.

Chairman REUSS. Good morning.

The Subcommittee on International Exchange and Payments will be in order for a hearing to consider a new facility for increasing financial assistance to developing nations.

While the proposals under discussion today are new in the sense that they are not now in being, the idea of using the multilateral creation of reserves not only to ease the liquidity problem but also to finance real transference to developing countries has been discussed for almost ten years.

Today we hope to consider the arguments for and against the so-called "link," what the form of such a mechanism might be, the advantages and disadvantages of alternative mechanisms, and the benefits that the less developed countries might potentially get from such a facility.

Inasmuch as today's hearing was announced last month I will place in the record at this point the original release.

(Release follows:)

WEDNESDAY, APRIL 16, 1969.

CONGRESS OF THE UNITED STATES: JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

REUSS ANNOUNCES PLANNED HEARINGS ON LINK BETWEEN RESERVE CREATION AND ASSISTANCE TO DEVELOPING COUNTRIES

Representative Henry S. Reuss (D-Wis.), Chairman of the Joint Economic Committee's Subcommittee on International Exchange and Payments, today announced that hearings are planned for late next month on proposals to use reserve creation, such as the distribution of Special Drawing Rights (SDR's) by the IMF, as a means of increasing financial assistance to developing countries. "Given the prospective distribution of SDR's later this year," Reuss said, "the idea of linking reserve creation and development assistance now deserves serious examination."

Reuss observed, "Suggestions for this type of link have included both voluntary and, what might be called, integrated mechanisms. As an example of the voluntary approach, Emilio Colombo of Italy suggested at the IMF meetings last September that industrial nations receiving SDR's contribute funds equivalent to a portion of their SDR allocations to the International Development Association or to other forms of development aid. Two types of integrated mechanisms have also been mentioned. First, new reserves, such as SDR's, could be distributed directly to less wealthy nations for subsequent expenditure. Alternatively, new reserve assets could be sold to industrial countries for their own currencies or acceptable foreign exchange. In the latter case, the proceeds from these sales would then be turned over to developing countries."

"Arguments have been advanced both for and against a link," Reuss noted. "Most favorable arguments have been based essentially on humanitarianism and on the idea that reserve creation offered the possibility for achieving two goals simultaneously, i.e., providing an adequate quantity of international liquidity and increasing financial assistance to developing countries."

"However," he said, "economic arguments have also been offered. A Princeton University professor has maintained that developing countries bear a disproportionately large share of the costs of international payments disequilibria; consequently, these nations are entitled to a similarly large share of reserve-assets created through multilateral agreement." Reuss also called attention to a recent Subcommittee Staff Study which argues that the supply of SDR's to be made available through general distributions will most likely be inadequate. A supplementary increment of SDR's linked to development assistance would help provide an adequate amount of international liquidity.

In discussing opposition arguments, Reuss commented, "The critics contend that while the objective of reserve creation is to ensure an adequate amount of liquidity, the goal of development assistance is to speed economic growth. These critics maintain that each problem should be solved according to its own facets and that linking them would only complicate matters. But," Reuss continued, "perhaps the more substantial opposition lies in the fears of government officials that any link would tend to create pressures for additional reserve creation and so lead to the debasement of these new assets."

In addition to re-examining the desirability of linking reserve creation and development assistance, the Subcommittee hearings will appraise the potential of this mechanism. Its potential would be governed by the proportion of all new reserve assets that could be linked with development assistance and by the size of this additional aid in comparison with the unfulfilled financial requirements of impoverished nations.

We have an exceptionally distinguished panel of witnesses to participate in our discussion this morning. Starting at your right we have Mr. Sidney Dell, Director of the New York Office of UN Conference on Trade and Development, who appears here in his private capacity. Next, Prof. Harry G. Johnson of the University of Chicago, who has been so helpful to this committee on may occasions in the past. Raúl Prebisch, formerly Secretary-General of UNCTAD and currently Director-General of the U.N. Latin American Planning Institute, and finally, two professors from Yale University, Prof. Tibor Scitovsky, and very shortly Prof. Robert Triffin.

All of you gentlemen have prepared most valuable statements which under the rule and without objection will be admitted into the record and made part of the proceedings in full.

I would like each one of you, starting with Mr. Dell, to give or summarize the points that you wish to make, and then I would hope that we can have some discussion not only among members of the subcommittee but also among members of the panel on this most important question.

Mr. Dell?

STATEMENT OF SIDNEY DELL, DIRECTOR, NEW YORK OFFICE OF UNCTAD

Mr. DELL. Mr. Chairman, among the indispensable conditions for a healthier world economy is a willingness on the part of the industrial countries to assist in the development of the less-developed countries.

It is generally recognized that, as the World Bank has lately reaffirmed, the current flow of capital to the less-developed countries is well below the capacity of these countries to make effective use of it. Among the reasons frequently cited by donor countries for curtailment of aid programs is the fear of losing reserves, and if action is taken to increase the world level of reserves, it is to be presumed that one of the deterrents to an enlargement of aid would be pro tanto reremoved.

It cannot, however, be taken for granted that restrictions on aid, once imposed, will be readily relaxed. Such limitations on aid have by now acquired a life of their own, and all kinds of reasons have been found to justify them. There is therefore no assurance that an easing of the world's liquidity position will be accompanied by an increase in the flow of resources to the less-developed countries, unless specific steps are taken to insure that this occurs.

This is the basic rationale for a link between liquidity creation and the provision of aid to less-developed countries. Such a link would enable donor countries to respond to the need for more aid, without running the risk of incurring any loss of reserves, and without having to increase taxes for this purpose, although not of course without increasing the transfer of real resources.

One contention commonly advanced against the link is that liquidity creation is not designed to effect a permanent transfer of real resources from one group of countries to another, a contention that would apparently rule out the gold standard as well, since countries acquiring gold for their reserves have always had to transfer real resources to the gold producing countries in exchange. This argument would also rule out the newly established system of SDR's, which allows participating countries to maintain as little as 30 percent of their net cumulative allocation of SDR's, and use the balance to acquire real resources from other participants.

Another objection is that linking liquidity creation with the provision of assistance to less-developed countries may tend to generate pressures for excessively large amounts of SDR creation in relation to world liquidity needs.

It is important to note, however, that throughout the discussion of this matter by both industrial and less-developed countries in UNCTAD, the point has never been questioned that the amount of any new reserve creation should be determined by the monetary requirements of the world economy, and not by the need for development finance.

In any case, there is very little risk of excessive creation of SDR's in circumstances in which a mere 15 percent of the total vote in the International Monetary Fund suffices to prevent a proposed act of liquidity creation.

Finally, it has been suggested that if the industrial countries are not prepared to expand their aid by direct means, that is by direct contributions to bilateral and multilateral aid programs, they are not likely to be willing to do the same thing indirectly, that is through the link.

Now although the real burden of aid is the same, whether the transfer takes place by conventional methods or through such methods as the link, governments may see some advantages in the latter method.

As I have already mentioned, two advantages of this method are that it avoids any risk of reserve losses, and that it makes it possible to expand aid programs without having to increase taxes.

The possibility that introduction of the link would tempt governments to reduce other forms of aid cannot be entirely dismissed. It is, however, unlikely that the opening up of new channels of aid adds nothing at all to the total flow. The net increase in the total level of aid resulting from the link may turn out to be less than the direct allocations of SDR's or their equivalents in national currencies for lending to less-developed countries, but there would probably be some net increase, and my own impression is that the net increase would be considerable.

We come finally to the question of the most suitable form for the link. Although there are important advantages in establishing the link as an integral part of the mechanism through which SDR's are distributed, we have to face the fact that in the immediate future this has been ruled out by the terms of the new amendment to the articles of agreement of the International Monetary Fund, which preclude the holding of SDR's by any such agency as the World Bank group.

There is therefore a strong case for considering a voluntary form of the link, as suggested by Professor Triffin, and by Dr. I. G. Patel, economic adviser to the Ministry of Finance of India and one of the members of the UNCTAD expert group on international monetary issues. The full text of the proposal in Dr. Patel's version will be found in the annex to my paper submitted to the subcommittee. (See p. 12.)

What Dr. Patel suggests is that every act of international liquidity creation should be accompanied by voluntary contributions to IDA by all the Part One member countries of IDA, the size of the voluntary contribution being a certain uniform proportion of the share of every Part One country in international liquidity creation.

Most of the objections to the link in its organic form do not apply to this alternative version. From a legal standpoint, there is nothing in the amendment to the articles of agreement of the IMF that would preclude such an arrangement, and from the standpoint of economic and banking policy, this alternative version of the link would provide for a clear separation between liquidity creation and development assistance as recommended by the critics of the organic link.

The proposal in this form not only commands widespread approval among the less developed countries, but has received the specific endorsement of a member of the Group of Ten, namely Minister Colombo of Italy. It might also win the approval of France, whose representative in UNCTAD at one time suggested the need for a link as, in his words, "a relation in time between various measures rather than a functional relation between them."

As to the possible ratio of IDA contributions to the newly created reserves, this is a matter for discussion and negotiation just as the obligation to reconstitute 30 percent of cumulative SDR allocations was a matter for discussion and negotiation.

Ideally one would like to see IDA contributions equal to the value of the newly created reserves, but one might have to settle for less than this.

In United Nations circles the proportion 50 percent has been considered as a serious possibility, but I cannot say that there is any particular virtue in that proportion as against some other. It is simply a question of how much additional aid one wants to provide.

If, for example, total SDR allocations to all countries were at the rate of $2 billion a year, and if the Part One member countries of IDA contributed to IDA in an amount equivalent to 50 percent of their SDR allocations, were adopted, this would add $680 million to the total annual flow of aid, of which $243 million would be supplied by the United States.

This compares with the total public and private flow, according to OECD sources, of $11.3 billion in 1967, and with $7 billion in official flows alone. It is of course a much more significant figure in relation to the total flow to multilateral agencies, which amounted to just over $1 billion in 1967.

The additional aid would be modest, but it would represent a useful supplement to other channels of aid. Moreover, as experience is gained, that ratio of aid allocations to new reserve creation might be raised. All in all, the link would significantly increase the efficiency of new reserve creation in improving the international economic environment.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Dell follows:)

PREPARED STATEMENT OF SIDNEY DELL

THE CASE FOR THE "LINK"[1]

If all goes well, an important step forward is about to be taken in the evolution of international monetary cooperation. For the first time, an attempt is to be made to regulate the supply of international reserves through a deliberate collective decision. If the new approach is successful, the total supply of world reserves will henceforward be adjusted to world requirements for reserves and not to such haphazard factors as the current flow of newly mined gold into official coffers or the deficits in the balances of payments of the reserve currency countries.

The creation of a new form of international liquidity is obviously not an end in itself, but one means among others of establishing a better framework for international economic cooperation within which countries may pursue rational economic policies, particularly policies for promoting higher living standards.

A key element in any improvement in the international environment must necessarily be an increase in the flow of assistance to the less developed countries. It is now generally accepted at the national level that the community as a whole has a responsibility towards every one of its members, and that active measures are required to provide all members of society with minimum standards of social security and even, perhaps, of income.

Although it is not yet generally accepted that similar considerations apply on a world-wide basis, and that the logical next step after the welfare state is the welfare world, most people in the industrial countries would now recognize the need to provide assistance to the less developed parts of the world

---

[1] This paper is presented by Mr. Sidney Dell in his personal capacity and does not necessarily represent the views of the United Nations secretariat, in which he serves.

as well as the importance of seeking to narrow the growing gulf between incomes in the richer countries and in the poorer countries.

At the second United Nations Conference on Trade and Development held in New Delhi in 1968, the industrial countries accepted a commitment to provide assistance to the less developed countries equivalent to one per cent of their gross national product. It proved impossible, however, to agree on a date for the achievement of this target largely because certain countries under balance of payments pressure did not feel able to commit themselves to an early expansion of foreign aid. The result is that the current flow of resources to the less developed countries averages only seven-tenths of one per cent of the gross national product of the developed countries as a whole; and in the case of the United States the latest available figure is two-thirds of one per cent of the gross national product. We nevertheless have it on the authority of the World Bank that "the developing countries could now absorb productively new external resources at least equal to what would correspond to the one per cent of gross national product of the developed countries as a group".[2] In other words, the current flow of resources to the less developed countries is considerably below the amount which they could utilize effectively for increasing productive capacity and growth potential.

If the creation of a new type of international reserve takes place side by side with action to secure a better adjustment in international transactions, and if countries are thereby encouraged to liberalize their trade and aid policies, we might expect the flow of aid to increase without the need for providing a specific "link" between liquidity creation and the flow of assistance. It is not at all clear, however, that action will indeed be taken to remove the various obstacles to aid that have arisen during the past few years. Concern over the balance of payments and over the war in Vietnam have led to a questioning of the fundamental validity of aid programs as such; and many have sought to rationalize their doubts by pointing to cases in which aid has been wasted or misused. It is therefore no accident that we are now going through a period of profound disillusionment with aid programs, in the course of which much of the perspective has been lost, and impatience for quick results has caused people to forget that centuries of economic backwardness cannot be overcome within the span of a single decade.

Given the current mood of pessimism regarding aid prospects, it cannot be taken for granted by any means that an improvement in balance of payments positions, and a reversal of the factors which led originally to the curtailment of aid programs will necessarily be accompanied by a revival in such programs. Restrictions on aid once applied tend to perpetuate themselves and it is therefore only through a deliberate effort that an increase in the flow of resources to the less developed countries will be achieved. It is for this reason that the possibility of a deliberate "link" between reserve creation and development assistance is worthy of consideration.

The principal advantage of the "link" is that it makes it possible to step up the flow of assistance to developing countries without involving individual developed countries in any risk of losing reserves. The fact that potential loss of reserves has become a major factor affecting the volume, terms and conditions of aid programs is clear from the progressive increases that have taken place in the tying of bilateral aid as well as from the efforts made to introduce elements of tying into the operations of the International Development Association (IDA) in connection with the current replenishment. The "link" would relieve governments of the anxiety that resources supplied to less developed countries might result in a weakening of their reserve positions.

A number of governments, while not necessarily concerned about their balance of payments or reserve positions, have found it difficult at a time of generally high taxes to propose increases in taxes for the purpose of expanding foreign assistance. On the other hand, at a given level of government revenue, it may be equally difficult to reorder social priorities in such a way as to make more room within the budget for an enlarged program of foreign aid. Since governments have accepted the one per cent assistance target, it is to be presumed that they would welcome a way out of this impasse, and the advantage of the "link" is that it may enable them to respond to the need for more aid without having to raise taxes for this purpose.[3]

---

[2] United Nations, Comments by Member States and Organizations Concerning International Development Strategy for the Nineteen Seventies, document E/AC.56/L.1, page 13.

[3] This would not, of course, relieve the countries concerned of the need to make larger transfers of real resources.

But the "link" might well also make a significant contribution to an improved international monetary system. It is a characteristic feature of the present situation that all developed countries would like to maintain surpluses in their balances of payments. Yet the only way in which all these countries could simultaneously succeed in achieving such surpluses would arise if, as a group, they maintained a sufficiently large export surplus with the less developed countries.

As matters now stand, the sum total of the surpluses which the industrial countries would like to maintain in their external accounts is considerably larger than the aggregate surplus with the less developed countries which they are currently prepared to finance through the flow of public and private capital. This means that in so far as any particular developed country succeeds in its objective with respect to its own externl surplus, it does so only by frustrating the corresponding objectives of other developed countries. This conflict in turn tends to generate growing competition for available reserves as well as a serious danger of competitive protectionism and exchange depreciation.

The problem is therefore to find a means whereby the industrial countries as a group could finance an adequate surplus with the less developed countries as a group. The conditions for a satisfactory equilibrium in this respect are first that the aggregate surplus with the less developed world as a whole should be large enough in relation to the sum of the individual surpluses that each developed country would consider desirable in its own particular circumstances; and that the method of financing the surplus should be such as to contribute to an improvement in the international monetary situation and not to a deterioration. From this standpoint, if the developed-countries give away the surpluses in the form of grants, this does not yield any benefit to the balances of payments of those donor countries that are currently in deficit. If they provide the resources in the form of loans, they acquire long-term claims on the developing countries, but these too are not generally regarded as providing a source of strength for the balance of payments, at any rate in the short run.

There would therefore be great advantages in an arrangement whereby export surpluses with less developed countries would be made to yield usable assets in the form of internationally accepted reserves. If it were possible for developed countries to earn additional reserves by enlarging their export balances with developing countries, they would probably be inclined to take a quite different view of such surpluses from the view which they take at the present time. In that case, they would see the same advantage in transferring real resources to less developed countries in exchange for additional reserves as in the traditional exchange of real resources for additional gold.

The question may be asked why the industrial countries should saddle themselves with the burden of having to earn the new reserves through transfers of real resources to the less developed countries: under the new arrangements for Special Drawing Rights (SDRs) as they stand, they can obtain additional reserves without any cost at all.

This point is well grounded: there is no compulsion at all on the industrial countries to adopt a "link" between liquidity creation and development assistance. If they did accept the idea of a "link," it would be an entirely voluntary act of economic statesmanship. Indeed, it might even be suggested that once the industrial countries find that they are able to acquire SDRs costlessly, they will no longer be as concerned about running balance of payments surpluses as they are now.

It may, however, be doubted whether countries would in fact lose their proclavity for balance of payments surpluses even if they were able to add to reserves by other means. For one thing, the employment-creating effect of such surpluses should not be overlooked. But even aside from that, it is doubtful whether a country could for long command confidence in the stability of its currency if it were adding to its reserves solely by virtue of the periodic receipt of SDRs, and was otherwise in balance of payments deficit. Rightly or wrongly, the currency of a country in such a position would probably be regarded as vulnerable and hence would be subject to speculative attack.

But even if this were not so, it would remain an important advantage of the "link" that it provides a unique method of tying together and reconciling a number of objectives which might otherwise tend to conflict. Since the industrial countries do, at the presnt time, all prefer to run balance of payments surpluses, the advantageous way of dealing with the potential inconsistency of these aims is not to find methods of doing away with the surpluses or making them unnecessary; but rather to channel the surplus resources thereby generated to the coun-

tries that stand in need of them. And insofar as the current flow of public and private capital to the less developed countries is inadequate to finance surpluses in the amounts desired by the industrial countries, individually and collectively, the creation of opportunities to earn reserves would make it possible to finance the remainder.

One particular advantage of the "link" is that it would raise the flow of resources to the multilateral lending institutions authorized to participate. Since there is a growing measure of agreement that the multilateral institutions should continue to increase their share of the total flow of resources to the less developed countries, this would represent a step in the right direction.

Various objections have been raised against the idea of the "link." The Ossola Study reported that most of its members believed that the provision of capital to developing countries is quite distinct from the creation of reserves and should be achieved by other techniques. Yet it is difficult to see why the fact that a particular measure may achieve two different types of results at the same time should be regarded as invalidating it. A devaluation of currency has the effect of simultaneously cheapening exports in terms of foreign currency and of raising the prices of imports in terms of domestic currency. It therefore tends to increase the volume of exports at the same time as it tends to restrain the volume of imports. No one, however, would suggest that devaluation is an improper device because it deals simultaneously with exports and imports and thus kills two birds with one stone. Similarly, a high tax on tobacco tends to restrain a harmful form of consumption at the same time as it adds to government revenue; and the fact that two objectives are thereby achieved rather than one is not generally regarded as an argument against such a tax.

However, the Ossola Study Group advanced a more serious objection when it expressed the fear that if the creation of new reserve assets were mixed up with the provision of development finance, there would be a danger that the requirements of the latter would begin to take priority over those of the former. This, it was felt, would introduce an inflexibility into whatever new monetary arrangements were introduced, and would thus impair the monetary quality of the new asset. The Ossola Group conceded that if the amount of reserve creation associated with development finance were kept at a modest fraction of the total creation of reserves the difficulties might not be insuperable. But the Group felt it would be difficult to resist demands from developing countries, and even internal pressures in the industrial countries themselves, to give aid in this form.[4] It is noteworthy that in a recent statement before the Italian Parliament, Mr. Emilio Colombo, Minister of the Budget and the Treasury, in supporting the idea of a "link", conceded that he had encountered some difficulties in securing the agreement of other industrial countries to this proposal, on the grounds that decisions on the amount of SDRs to be created might thereby tend to be influenced by "non-objective" factors.

It is a perfectly valid point that liquidity creation should respond to world liquidity needs and not to aid requirements. As the UNCTAD expert group on international monetary issues put it:

"We are quite clear that the amount of any new reserve creation should be determined by the monetary requirements of the world economy and not by the need for development finance. But once the need for additional reserves has been demonstrated and the amount of the addition determined on the basis of monetary requirements, the introduction of a link with development finance is entirely proper and desirable."[5]

It should also be borne in mind that under the arrangements for the creation of SDR's in the International Monetary Fund, an 85 per cent majority of the voting power of participants is required. It will be apparent that a majority as large as this is likely to err on the side of excessive caution rather than of excessive adventurousness: for it would take only a small minority of the industrial countries to block a proposal for adding to reserves at any particular time. Under the conditions the danger foreseen by the Ossola Study Group does not seem to be a serious one.

A third objection to the "link" was voiced by the Deputies of the Group of Ten when, in their report of July 1966, they stated that "We are agreed that delib-

---

[4] Report of the Study Group on the Creation of Reserve Assets, paragraph 138.

[5] UNCTAD, *International Monetary Issues and the Developing Countries*, Report of the Group of Experts, New York 1965 (U.N. Sales No.: 66.II.D.2).

erate reserve creation is not intended to effect permanent transfers of real resources from some countries to others".[6]

It is odd that this particular objection has been raised, because the traditional gold standard took precisely this form. In other words, under the gold standard, countries wishing to add to their reserves transferred real resources to the countries where the gold was mined, in the form of an export balance of goods and services. Similarly, countries wishing to acquire dollars or sterling may do so by transferring real resources to the United States or Britain, respectively. Thus the Deputies were, in effect, proposing an entirely new approach to reserve creation. It is difficult to understand why they should have felt it appropriate for industrial countries to earn gold by transferring real resources to the gold producing countries, but inappropriate for them to earn the new reserve asset by transferring real resources to the less developed countries.

Whatever may have been said by the Deputies of the Group of Ten in 1966 about not using liquidity creation to effect transfers of real resources from one group of countries to another seems to have been rendered obsolete by the character of the SDR scheme adopted subsequently. Under that scheme a participant's use of SDR's during any five year period shall not exceed 70 per cent of the average net cumulative allocation of rights during that period. In other words, a participating country may draw down its holdings for as long as it wishes, provided that the average level of such holdings in any five year period is equal to at least 30 per cent of its net cumulative allocations of SDRs. And any participating country that draws down its holdings in this way is obviously absorbing real resources of a corresponding magnitude from other participants. Moreover the 30 per cent level may be maintained from one five-year period to the next, so that the transfer may be of indefinite duration.

A fourth objection has been put forward by Professor Harry Johnson, who has suggested, by way of analogy, that the establishment of the Federal Reserve System would have been indefinitely postponed if the new central bank had been required to invest most of its assets in loans to poor people.[7] The implication is that the establishment of the system of SDRs might be prejudiced if SDRs were used for investment in the less developed countries.

It is not entirely clear what Professor Johnson had in mind in making this comment. But in any case it would be wrong to suppose that what is involved here is an effort to misuse SDRs by making potentially unsound loans to less developed countries. The suggestion is rather that SDRs should be directly or indirectly used to provide additional resources for the World Bank group. And the financial standing of the World Bank is hardly comparable with that of "poor people".

The fact is that World Bank obligations have the highest standing in the financial community—a standing which is as strong as that of the joint and several guarantees by the major financial powers of the world on which it is based. Even if it were not the case (which it is) that there has never been a default on a World Bank loan to a less developed country, the fact that the Bank is supported by the guarantees of the big powers means that its credit standing is, in effect, virtually as high as that of the big powers themselves. Thus the use of SDRs to augment the resources of the World Bank could not be regarded as prejudicing the new reserve asset in any way.

It is also noteworthy that throughout the discussion of this matter in UNCTAD, the governments of the less developed countries have always accepted the point that the primary objective is to have the new system of SDRs accepted and activated, and that the question of the "link" should not be raised in such a way as to prejudice this primary objective.

Two other objections to the "link" are frequently encountered. On the one hand, it has been suggested that it would not be worth complicating and encumbering the already difficult process of international monetary reform for the sake of an addition to the flow of aid which would in any case be relatively small. On the other hand, it is also argued that the utilization of new money to increase the flow of resources to the less developed countries would add to the danger of inflation.

---

[6] Group of Ten, *Report to Ministers and Governors by the Group of Deputies*, July 7, 1966, paragraph 40.

[7] Harry Johnson, review of Triffin's *Our International Monetary System* in Book World, August 11, 1968.

Now it will be obvious that these two suggestions cannot both be valid, at any rate at the same time. Either the flow of real resources engendered by the "link" would be small, in which case their inflationary effect would also be small; or if the inflationary effect is appreciable, then the flow of resources must also be appreciable.

However, it seems that the danger of inflation is in any case rather exaggerated. Even if the additions to world reserves in a single year amounted to as much as $5 billion—a higher figure than is likely—and even if the whole of this sum were used to purchase World Bank bonds—which is scarcely conceivable—this would add less than one third of one per cent to the demand for output in the OECD countries, which amounted to about $1,700 billion in 1968. This could hardly generate an inflationary problem of major concern to the developed countries.

But even if the resulting pressure on resources were substantial, it surely ought not to be assumed that it is the needs of the less developed countries that should be cut first, and that aid to these countries has no priority in the disposition of resources by the developed countries. In a potentially inflationary situation it would be odd to argue that it is only the additional assistance to the less developed countries that would be responsible for inflation, and not, say, the much larger volume of resources devoted to defense or space travel.

In any case, the developed countries have assumed a solemn commitment to provide assistance to the less developed countries in an amount equivalent to one percent of their gross national products. And this means that they have undertaken to make room for assistance of this magnitude within their overall national expenditure. So long as the "link" does not take the donor countries beyond the one percent assistance target—and there has been no suggestion that it should [8]—the prevention of inflation should be sought through curtailment of other elements of national expenditure.

Finally, it has been suggested that if the industrial countries are not prepared to expand their aid by direct means—that is, by direct contributions to bilateral and multilateral aid programs—they are not likely to be willing to do the same thing indirectly—that is, through the "link." Alternatively, insofar as they do agree to the "link," they may simply make offsetting cuts in other aid programs.

There is, of course, no magic about the "link." Like other forms of assistance, it would be effective only in so far as it brought about a transfer of real resources from the industrial countries. To put the matter in another way, the real burden of aid is the same whether the transfer takes place by conventional methods or through such methods as the "link."

On the other hand, it would be wrong to suppose that institutional obstacles play no part in preventing an expansion of aid programs. For eample, as noted earlier, governments may be unwilling to raise taxes for the purpose of expanding aid programs, but may have much less difficulty in contemplating an increase in aid through a device such as the "link," even though they know that the total real burden on the community may be the same.

The possibility that introduction of the "link" would tempt governments to reduce other forms of aid cannot be entirely dismissed. Indeed problems of this type arise whenever new channels for aid are being considered. Thus, for example, it is always possible to argue that there is no point in replenishing the resources of IDA because the amount involved will be cut out of bilateral aid programs. Or, again, one can maintain that whatever resources are provided to the regional development banks, such as the Inter-American Development Bank, are only at the expense of the funds that would otherwise be available for the World Bank.

It is, however, unlikely that the opening up of new channels of aid adds nothing at all to the total flow. The net increase in the total level of aid resulting from the "link" may turn out to be less than the direct allocations of SDRs (or their equivalent in national currencies) to IDA would lead one to suppose. But there would probably be some net increase, and my own impression is that the net increase would be considerable.

We come finally to the question of the most suitable form for the "link." Hitherto, in this paper, the discussion has taken place in terms of what might be called an "organic" link—that is to say, a link in which SDRs are themselves

[8] There would thus be a case for exempting from operation of the "link" those countries which are, at any particular time, fulfilling their obligations under the one per cent assistance target.

used, directly or indirectly, for the channelling of resources to the less developed countries. This would happen if, for example, SDRs were allocated to the World Bank and corresponding loans (either in SDRs or in national currencies) were made to less developed countries.

It would be possible to envisage a number of possible variants of the "organic" link, and consideration could be given to the technical advantages and disadvantages of each variant. However, one major consideration is that the amendment to the Articles of Agreement of the Fund currently in process of ratification by the Fund's member governments in effect rules out the holding of SDR's by multilateral institutions engaged in development assistance.[9] It hardly seems likely that governments which have brought themselves to the point of ratifying a major new departure in the Articles of Agreement of the Fund would, in the immediate future, act to reverse themselves on a salient feature of the new amendment.

There is therefore a strong case for considering an alternative "link" proposal originally put forward independently by Professor Triffin, and by Dr. I. G. Patel, Economic Adviser to the Minister of Finance of India and one of the members of the UNCTAD expert group referred to above. The full text of the proposal in Dr. Patel's version will be found in the annex to this paper. The essence of the latter proposal is that every act of international liquidity creation should be accompanied by voluntary contributions to the International Development Association by all the Part I member countries of IDA—the size of the voluntary contribution being a certain uniform proportion of the share of every Part I country in international liquidity creation.

Most of the objections to the "link" in its "organic" form do not apply to this alternative version. From a legal standpoint, there is nothing in the amendment to the Articles of Agreement of the International Monetary Fund that would preclude such an arrangement. And from the standpoint of economic and banking policy, the alternative version of the "link" would provide for a clear separation between liquidity creation and development assistance, as recommended by the critics of the "organic" link

What is involved, essentially, is the acceptance of parallel and simultaneous commitments to increase aid by developed countries benefiting from allocations of SDRs. Since one of the objectives of new reserve creation is presumably to encourage more liberal trade and aid policies, the assumption of such parallel obligations would be in the spirit of the reform, while maintaining the separate and independent character of the two processes—liquidity creation and the provision of development finance.

In the alternative form proposed by Professor Triffin and Dr. Patel, the "link" appears to be gaining a measure of acceptance among certain members of the Group of Ten. In his address to the 1968 annual meeting of the Board of Governors of the International Monetary Fund. Mr. Emilio Colombo, Minister of the Treasury and the Budget of Italy made the following statement:

"The new facility, being the outcome of a very difficult compromise aimed at reaching a general consensus, is not perfect. The main deficiency, according to some, is the lack of a link between reserve creation and the provisions of resources for development needs, a link which, on the contrary, exists in the present system. An improvement which could be carefully studied and eventually made, without modifying the text of the Amendment, could consist of a pledge by the main industrial countries to use the part of their reserves corresponding to a portion of their Special Drawing Rights allocations for the replenishment of IDA or for subscription to World Bank bonds".[10]

It is also noteworthy that as long ago as February 1966 the representive of France in UNCTAD suggested that the "link" was indispensible but that it should be "a relation in time between various measures rather than a functional relation between them." [11]

---

[9] Article XXIII, Section 3, entitled "Other holders" provides that the Fund by an 85 per cent majority of the total voting power may prescribe as holders, nonmembers, members that are nonparticipants, and institutions that perform functions of a central bank for more than one member.

[10] Statement on October 1, 1968 at the joint annual meeting of the International Monetary Fund and the World Bank.

[11] United Nations, Report of the Committee on Invisibles and Financing related to Trade on its special session, 1966, TD/B/57/Rev.1, paragraph 10.

The advantages of the "link" in the Triffin/Patel version may be summarized as follows:—

1. It has the advantages of the "organic" link in permitting industrial countries to increase the flow of real resources to less developed countries
   (a) without incurring any loss in reserves
   (b) probably without having to raise taxes
2. It meets some of the principal objections of the Deputies of the Group of Ten by establishing a clear separation between reserve creation and development assistance, and by avoiding a direct use of SDRs for a permanent transfer of real resources.
3. It also avoids the danger that aid requirements might determine the amount of additional SDRs created by providing for assistance only as a parallel and voluntary process, which would itself always be subject to review.
4. It assists in channelling the export surpluses universally desired by industrial countries towards the countries most in need of additional resources.
5. It directs the increased flow of assistance to a multilateral institution, namely the International Development Associaiton

The above proposal will be examined later this year by a second expert group convened by the Secretary-General of UNCTAD under a mandate of the Trade and Development Board. It is a proposal worthy of serious consideration by the Subcommittee on International Exchange and Payments.

In the longer run, and once experience has been gained in the operation of a voluntary "link", it might prove to be more generally acceptable to governments than it is at the present time to build the link process integrally into the system of liquidity creation itself. In that case it would become possible to negotiate a further amendment to the Articles of Agreement of the Fund to provide for such an arrangement.

ANNEX: Memorandum by Dr. I. G. Patel[1]

THE LINK BETWEEN THE CREATION OF INTERNATIONAL LIQUIDITY AND THE PROVISION OF DEVEVLOPMENT FINANCE

1. In chapter IV of their report, the UNCTAD Group of Experts on International Monetary Issues[2] attempted to demonstrate at some length that it was both feasible and desirable to establish a link between the creation of international liquidity and the provision of development finance, without detriment to either process. The feasibility of the link was demonstrated in terms of a specific proposal which was based on the assumption that the creation of additional international liquidity would take the form of the issue of Fund Units against deposit of national currencies. It was suggested that a sizable part of the currencies of the developed countries so acquired by IMF could be made available to IBRD and its affiliates against IBRD Bonds. The additional currencies thus acquired by IBRD could be utilized in the normal course of its operations to finance developmental loans.

2. It was recognized that investment of national currencies obtained as a counterpart to Fund Units in IBRD Bonds would represent an eventual transfer of real resources from the developed countries taken as a whole to the developing cuntries. The share of each of the developed countries in the transfer of real resources would depend on its willingness and ability to obtain expert orders against IBRD loans. Thus, those whose share in the orders was larger than their share in the original liquidity creation (among the developed countries taken as a whole) would have to bear a higher share in real terms in the transfer of real resources. But to the extent that their share were more in the orders (and consequently in the transfer of real resources), they would gain reserves at the expense of those who failed to match their share in the original liquidity creation by correspondingly obtaining orders against Bank loans.

3. The report of the UNCTAD Group of Experts took special care to emphasize that the link between international liquidity and development finance must be so established as to give primary attention to the need for additional liquidity. Thus, unlike some of the earlier schemes envisaging such a link (e.g. by Mr. Maxwell Stamp), the UNCTAD Group of Experts envisaged the creation and

---

[1] Extracted from United Nations document TD/B/115/Add.2, dated August 14, 1967.
[2] *International Monetary Issues and the Developing Countries—report of the Group of Experts* (United Nations publication, Sales No.: 66.II.D.2).

distribution of international liquidity first and channelling a part of the national currencies mobilized for this purpose towards development finance only as a next step so that the original liquidity created would at no time be immobilized. Indeed, the timing, amount and distribution of the initial liquidity creation was to be governed solely by the needs of the international monetary situation and not by the needs of development finance which in any case had to be met primarily in other ways.

4. A number of possible objections to the proposed link were also examined in the report.

5. Since the publication of the report of the UNCTAD Group of Experts, considerable progress has been made in arriving at a better general understanding of the real issues involved in any scheme of international liquidity creation. As already mentioned, there is now a more general appreciation, for example, of the fact that a new reserve asset does not really require the "backing" of national currencies or the like. Criticisms of a link on the ground of the superiority of national currencies over IBRD and IDA bonds as a form of backing for international reserve assets need, therefore, no longer be refuted. Nor is there any need to meet the argument sometimes advanced that it would not be appropriate for the IBRD to sell bonds to IMF as envisaged by the UNCTAD Group of Experts as this might affect adversely the marketability of any other bonds issued by IBRD during its normal operations.

6. As a matter of fact, if the reform of the international monetary system is in terms of a reserve unit scheme without any backing or in terms of a drawing rights scheme patterned on the present practices of the IMF, the simplest way of establishing a "link" between the creation of international liquidity and development finance would be by means of a convention or an agreement whereby each act of international liquidity creation would be followed by voluntary contributions to IDA by all the Part I member countries of IDA—the size of the voluntary contribution being a certain uniform proportion of the share of each Part I country in international liquidity creation. In short, fundamentally, what the "link" proposes to establish is merely the principle that since one of the main reasons for the creation of international liquidity is to sustain liberal and rational policies of trade and aid, it is not inappropriate that each act of international liquidity creation should mark an advance towards more liberal and rational policies. The provision of larger contributions to multilateral aid agencies, whose aid is untied to any particular source of procurement and has, therefore, the most beneficial effect not only on development in the short-run but also on the long-term promotion of world trade on the most efficient lines, represents an advance which is most in keeping with the objectives of the two Bretton Woods institutions—the IBRD and the IMF.

7. Unfortunately, as pointed out in the IMF *1966 Annual Report*, this proposal for a link has not thus far found favour in the discussions between the Group of Ten and IMF. The reasons for this are seldom spelt out explicitly but can perhaps be inferred from paragraph 40 of the *Report to Ministers and Governors by the Group of Deputies of the Group of Ten*, which says:

"We are agreed that deliberate reserve creation is not intended to effect permanent transfers of real resources from some countries to others."

8. It is difficult to see what particular objection is intended to be conveyed by the statement just quoted. As envisaged by the UNCTAD Group of Experts, it is not reserve creation which leads to a transfer of real resources from some countries to others. It is the decision, if such a decision is taken, to provide development finance along with the creation of international liquidity which leads to the transfer of real resources. In other words, to say that there should be no transfer of real resources as part of the scheme of deliberate reserve creation, amounts merely to saying that the provision of development finance should not be linked with the creation of international liquidity. A statement of this kind does not say anything about why such a link should not be welcomed.

9. Any genuine apprehensions regarding the link can only be based on the feeling that (a) despite every attempt to recognize the priority to be given to considerations relevant to international liquidity creation, the establishment of the link might introduce in practice some extraneous considerations when it comes to decisions on the timing, quantum or distribution of the liquidity creation; or alternatively, (b) that whereas the advanced countries are not opposed to the provision of development finance, they would prefer to give it in different forms from those envisaged in the link.

10. It is difficult to see why a scheme of international monetary reform administered by an institution like IMF should be in any real danger of being

30-668—69——2

vitiated by excessive concern for development finance. As for the question of initiative in regard to provision of development finance, there is nothing in the proposed link which would detract from the freedom of the developed countries as a group to decide on the quantum of development aid they should give from time to time. The link merely reiterates the claim that development finance must also have the right quality—of being mobilized as an act of international will and of being usable with maximum freedom consistent only with the requirements of sound development.

11. In fact, developments that have taken place since the publication of the report of the UNCTAD Group of Experts have made it all the more clear that something in the nature of a link between development finance and international liquidity is essential both for development as well as for a smooth functioning of the international monetary system.

12. The recent discussions on IDA replenishment, for example, have clearly brought out that concern for the balance-of-payments difficulties of individual countries is likely to make a serious impact on the quality as well as the quantity of what has hitherto been perhaps the most effective form of development finance. However, if an opportunity were to be taken in the future to replenish IDA as a special gesture whenever additional international liquidity has to be created, it would be possible to secure generous replenishments for IDA from time to time without any fear that some countries might stand to lose reserves as a result of their contribution to IDA. At worst, a country, whose share in the initial liquidity creation is higher than its share in IDA orders, will not be able to retain a part of its initial acquisition of additional liquidity. But by the same token, a country which might succeed in adding to its initial share in the liquidity created would not be able, nevertheless, to convert this source of strength for itself into an embarrassment for others by an attempt to change the composition of its reserves.

13. Again, much of the current difficulties in adjusting balance-of-payments positions arise from the fact that practically all developed countries are anxious to prevent a loss of reserves and, indeed, to add to their reserves if at all possible. If even surplus countries feel obliged to take remedial measures as soon as the surplus begins to diminish, it naturally makes it almost impossible for the deficit countries to get back into balance. The only way in which the industrially advanced countries could have a surplus as a group would be for them (a) to acquire gold by exporting real goods and services to gold producing countries or (b) to transfer real resources to the developing countries as a whole. Quite clearly, the second alternative is the more rational. If it is still not preferred by the industrially advanced countries, one reason, at any rate, is that an export surplus to the developing countries yields an asset in the form of the indebtedness of the developing countries themselves; and such an asset is not very acceptable to the richer countries. If, in part at least, this export surplus could be made to produce an asset in the form of internationally accepted reserve units, the richer countries would be able to satisfy their normal desire to have an export surplus or at least to avoid a loss in reserves without making the "adjustment process" almost impossibly difficult for those among them who might be experiencing payments difficulties at any given time. A link between international liquidity and development finance is thus not just a matter of wresting some gain for the developing countries out of every act of additional liquidity creation. It is at least arguable that the principle that the richer countries should earn their right to retain their share in the initial liquidity creation by sharing in the provision of additonal multilateral aid is likely to contribute, given the behaviour pattern of the richer countries, to a smoother functioning of the international monetary system.

14. It would not, of course, be desirable for the time-table for the liquidity exercise to be put off merely because of lack of a satisfactory decision on the question of the link. But it is important that the door should be kept open for the introduction of a link at a later stage. The question of a link between international liquidity and development finance has a vital bearing on the successful evolution of the two Bretton Woods institutions—IBRD and IMF; and it is most important that a hasty and final decision against the link should not be taken without allowing time for a proper assessment of the considerations raised here in further elaboration of the report of the UNCTAD Group of Experts on International Monetary Issues.

(The following table was received subsequently from Mr. Dell to supplement his testimony:)

DEVELOPMENT ASSISTANCE COMMITTEE MEMBERS—NET FLOWS TO LESS-DEVELOPED COUNTRIES OF FINANCIAL RESOURCES [1] AND NET OFFICIAL TRANSFERS,[2] AS A PERCENTAGE OF GNP, 1960-67

[In percent]

	1960	1961	1962	1963	1964	1965	1966	1967
Australia:								
Net official and private flows	0.39	0.43	0.41	0.49	0.54	0.60	0.55	0.68
Net official flows	0.30	.43	.41	.49	.48	.53	.51	.63
Net official transfers	(3)	.42	.41	.49	.48	.53	.51	.63
Austria:								
Net official and private flows	.09	.30	.43	.08	.25	.51	.49	.45
Net official flows	(4)	.03	.19	.03	.17	.37	.36	.36
Net official transfers	(3)	.03	.19	.02	.17	.36	.34	.34
Belgium:								
Net official and private flows	1.59	1.35	.91	1.26	1.05	1.30	.97	.78
Net official flows	.88	.76	.54	.57	.46	.60	.44	.51
Net official transfers	(3)	.74	.52	.56	.45	.58	.44	.50
Canada:								
Net official and private flows	.39	.24	.29	.33	.32	.35	.50	.44
Net official flows	.20	.17	.14	.24	.29	.26	.39	.37
Net official transfers	(3)	.16	.14	.24	.28	.24	.38	.36
Denmark:								
Net official and private flows	.64	.50	.20	.13	.35	.15	.22	.21
Net official flows	.09	.12	.10	.12	12	.13	.23	.23
Net official transfers	(3)	.12	.10	.12	.12	.13	.23	.23
France:								
Net official and private flows	2.19	2.17	1.93	1.55	1.54	1.38	1.30	1.23
Net official flows	1.40	1.46	1.35	1.06	.94	.80	.73	.76
Net official transfers	(3)	1.43	1.32	1.03	.91	.76	.70	.74
Germany, Federal Republic of:								
Net official and private flows	.88	1.03	.73	.64	.68	.64	.61	.94
Net official flows	.49	.76	.53	.46	.41	.42	.40	.45
Net official transfers	(3)	.75	.51	.44	.37	.37	.35	.39
Italy:								
Net official and private flows	.88	.69	.93	.66	.45	.47	1.03	.43
Net official flows	.31	.21	.25	.22	.09	.15	.20	.30
Net official transfers	(3)	.19	.23	.19	.06	.12	.16	.27
Japan:								
Net official and private flows	.58	.73	.49	.40	.37	.57	.68	.73
Net official flows	.26	.21	.15	.21	.15	.29	.29	.34
Net official transfers	(3)	.20	.14	.20	.14	.27	.27	.31
Netherlands:								
Net official and private flows	2.11	1.61	.85	.92	.69	1.25	1.23	1.00
Net official flows	.31	.45	.49	.26	.29	.36	.45	.50
Net official transfers	(3)	.43	.47	.24	.27	.35	.44	.48
Norway:								
Net official and private flows	.23	.55	.13	.38	.36	.55	.23	.36
Net official flows	.22	.18	.13	.36	.27	.17	.17	.19
Net official transfers	(3)	.18	.13	.36	.27	.17	.17	.19
Portugal:								
Net official and private flows	1.46	1.63	1.41	1.65	1.82	.81	.97	1.75
Net official flows	1.46	1.63	1.41	1.65	1.82	.56	.60	1.04
Net official transfers	(3)	1.52	1.28	1.49	1.62	.39	38	.88
Sweden:								
Net official and private flows	.38	.37	.24	.32	.36	.36	.49	.50
Net official flows	.05	.06	.12	.14	.18	.19	.26	.25
Net official transfers	(3)	.06	.12	.14	.18	.19	.26	.25
Switzerland:								
Net official and private flows	1.82	2.22	1.53	1.76	.87	1.45	.74	.78
Net official flows	.04	.25	.05	.05	.07	.02	.02	.03
Net official transfers	(3)	.24	.04	.05	.07	.02	.01	.02
United Kingdom:								
Net official and private flows	1.23	1.17	.93	.84	.99	1.03	.89	.81
Net official flows	.57	.60	.52	.49	.53	.48	.50	.46
Net official transfers	(3)	.54	.46	.42	.46	.41	.42	.39
United States of America:								
Net official and private flows	.75	.86	.77	.76	.75	.79	.66	.69
Net official flows	.54	.65	.62	.62	.54	.52	.48	.46
Net official transfers	(3)	.63	.59	.59	.50	.50	.45	.43
Total DAC countries:								
Net official and private flows	.89	.96	.82	.77	.75	.80	.73	.74
Net official flows	.54	.63	.57	.54	.48	.47	.45	.46
Net official transfers	.52	.60	.55	.52	.45	.44	.42	.42

[1] Net of amortization, and capital repatriation in the case of private flows.
[2] Net of amortization and interest payments received (official).
[3] Not available.
[4] Nil or negligible.

Sources: OECD, "The Flow of Financial Resources to Less-Developed Countries," 1961-65; "Development Assistance Efforts and Policies, 1968 Review"; United Nations Monthly Bulletin of Statistics, various issues.

Chairman REUSS. Thank you, Mr. Dell.
Mr. Johnson?

STATEMENT OF HARRY G. JOHNSON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO, AND THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Mr. JOHNSON. Thank you, Mr. Chairman.

The proposal of the link does have a lot of attraction at the present time for two reasons, one being that the balance of payments deficits for the United Kingdom and the United States have been used as justifications for reducing the flow of aid. The other is that the developing countries have become much more capable of absorbing aid, just at a time when the flow of aid relative at least to the capacity to bear the burden has been falling.

Nevertheless, it seems to me that there are fairly strong arguments against the general proposal to link international reserve creation and development assistance. One which I have advanced in the past is that development assistance and the creation of international reserves are separate issues, each with its own economics and, more important, with its own politics.

One can argue that the linkage of these two problems in policy discussions is really a matter of willingness of governments to link them, and that perhaps at the present time this possibility is greater than it has been in the past, and that is a matter on which I am not competent to pass a judgment.

The more fundamental argument against the proposal, I think, is that contrary to widely held views the creation of international reserves does not need to involve the generation of a pool of resources which have to be allocated somehow and on which the less developed countries have a moral claim.

Perhaps some years ago this view was more plausible, in the sense that plans for international monetary reform at that time were generally modeled on the concept of a bank, with liabilities which would constitute the reserve assets, being backed by assets in the form of loans and securities, but it has come to be understood in the course of the discussion that what is required of international reserves is acceptability to those who have to hold them, and that the quality of acceptability does not require that there be assets to back the reserve instrument. And that principle is in fact embodied in the SDR scheme which from that point of view constitutes a considerable advance on earlier discussions.

The fact that it is embodied in the SDR scheme makes it much more difficult to disguise the fact that linking reserve creation to development assistance does demand a deliberate choice to transfer real resources from the developed countries which want to hold larger stocks of reserves to the less developed countries which would benefit either by initially receiving the reserve assets or by receiving the funds paid in exchange for them.

Now the real transfer involved is entirely unnecessary from the standpoint of creating new international reserve assets, and you could only justify it either on the political feasibility argument, which I

have already mentioned, or else by creating some sort of fiction to the effect that it is more desirable that countries earn their additional reserves than that they simply create them.

Creating reserves is a costless procedure, at least in economic terms. On the other hand, giving reserves away and then earning them back does involve a very substantial real cost in terms of transferring real resources and it seems to me that countries would be unlikely to accept that unless they already had a strong desire to increase their transfers of resources to the promotion of the economic growth of the less developed countries, and in that case the question is whether the linkage is the best way of doing this.

Well, the specific proposal before the subcommittee is for the linkage of creation of SDR's in addition to those created under the present agreed scheme to the financing of the development of the less developed countries.

Now the basic argument for that proposal has to rest on the assumption that under the agreement, the creation of new reserves in the form of SDR's will promote the healthy development of the international economy and that the creation that is prospective will be insufficient to the needs of the international economy. Otherwise the proposal to create additional SDR's is really a proposal for financing economic development by world inflation, and the policy of promoting development by inflation is not usually regarded as a good policy in the context of single nation's policies.

Well, the whole thing has to rest then on the assumption that reserve creation would otherwise be inadequate, and this raises two problems. The first is to establish that in fact it will be inadequate by some kind of economic standard, and this raises difficulties, because in spite of the alleged seriousness of the international liquidity problem, the world economy has been characterized by a mild but marked inflation of prices since World War II.

That inflationary trend of world prices has been much more resented on the European Continent than it has been here and in the United Kingdom, and the assertion that the reserve creation will be inadequate could simply be the assertion that United Kingdom and United States views on inflation versus unemployment are correct, and that the world would be better off being forced to accept those views than it would be if it had less inflation with less reserve creation.

The second difficulty, while it is a political one, is one which I do feel competent to discuss, and that is that if the developed countries having negotiated the present scheme then negotiate a sizable increase of reserves in the form of SDR's, then even if it is true that those new reserves will be inadequate and will prove to be inadequate, I do not see the countries involved accepting a renegotiation of their decision in the form of extra SDR's. Rather I expect them to insist on seeing what happens with the reserves they create, and if necessary correcting their decision in the event of experience.

Well, these considerations suggest that in the light of the questions posed by the subcommittee for these hearings, that aid-linked SDR's would virtually have to be and should be created as an integral part of the decision to create new international reserves, and that they would not constitute a net addition to the total of SDR's created, only a redistribution of a predetermined quantity of SDR's.

Now in connection with the proposal that creation of extra SDR's should be on a voluntary purchase basis there is I think a real question of how many might be purchased. As reserve assets, SDR's will be significantly inferior to U.S. dollars, and though I am not very confident at the moment, they might even be inferior to sterling, because the SDR's carry a very low rate of interest on accumulations additional to a country's quota.

The development of the use of SDR's as an international reserve asset will depend on the establishment of a central bank preference for them, and it is not altogether clear that such a preference will in fact be established. It is possible that the rest of the world will get used to the present de facto dollar standard, and that the use of dollars as reserve assets rather than being terminated as is assumed in many of these discussions, may in fact revive.

Another consideration is that it would be perfectly possible for countries, if they want to accumulate reserves and also want to have the accumulation of reserves matched by contributions to the less developed countries, to do that entirely apart from the SDR scheme itself. It is possible, as I suggest in my statement, that this could be done simply by purchasing World Bank bonds, and using them as reserve assets.

They would be less liquid, obviously, than SDR's. On the other hand, they would offer a rate or return substantially superior.

Now, this consideration—and I had not read Mr. Dell's paper before I came this morning—but the proposal that you should couple the creation of SDR's with contributions to IDA, for example, really accepts this point, and I do not see that to say that that is a proper procedure really amounts to accepting any link at all other than some sort of moral obligation to contribute to the developing countries.

If we accept my argument that aid linked SDR's would simply be a redistribution of a predetermined total of SDR's, it is obvious that the benefit of aid linking to the developing countries is going to depend on the total size of the SDR's created and the proportion of them which are linked to aid. This is an answer to another one of the subcommittee's questions which is how much benefit the developing countries would get from this.

Insofar as SDR's are decided on the basis of how much extra money the world needs, then the amount of them created would have to depend among other things on how much use of the dollar as a source of additional reserves is made, and also on the estimate of how many extra reserves the world needs.

Again I would say that it is not all that clear that the dollar is finished as an international reserve asset. Some of my colleagues have argued on the contrary that the dollar is going to be the currency of the future, and in that case, the amount of SDR's required will be rather substantially less than current estimates indicate.

As to the proportion of SDR's to be aid linked, this depends very much on the scheme of linking, but it seems to me very unlikely that the developed countries would really make a major proportion of the SDR subject to the linkage. I have a very rough estimate here that taking 25 percent as a sort of token contribution, and applying that to the highest figure for the possible creation of SDR's that I have seen, $3 billion, this would amount to $750 million a year financial transfer. That works out rather higher than Mr. Dell's estimate,

though he uses 50 percent and a $2 billion basis. But I would point out in conclusion that while one could talk about the size of the financial flows, the real resource transfer is typically substantially very much less than the financial transfer. Insofar as the money is made available in the form of loans rather than grants, then you have to take as the value of the resource transfer the difference between the present value of the loan repayments, discounted at the actual rate of interest, and the present value of a loan of the same amount made at commercial rates of interest, and when these calculations are made, they typically show that the real resource transfer is very substantially less than the financial transfer. So that that $750 million estimate I made is going to be on the high side.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Johnson follows:)

PREPARED STATEMENT OF HARRY G. JOHNSON

RESERVE CREATION AND DEVELOPMENT ASSISTANCE

The proposal to link the creation of new international reserve assets with the provision of increased aid to the less developed countries has been a popular one ever since the need to increase international liquidity came to be recognized. Since the balance-of-payments deficits of the United States and the United Kingdom have been adduced as justification for progressive reductions in the development assistance provided by these countries, it is at least superficially attractive to argue for proposals by which development assistance would enable countries to earn foreign exchange reserves rather than entail the risk of loss of reserves. Moreover, it can be argued that, considered as a group, the developing countries have become increasingly able to absorb and put to good use any external aid they get, at the very same time as the aid provided them has been declining, no only relative to the capacity of the developed countries to bear the burden of aid-giving and to the needs of the less developed countries for such aid, but also absolutely in terms of real purchasing power. In these circumstances, there is a strong argument for providing incerased aid by whatever means can be made to seem plausible. And the provision of aid linked to reserve creation is a plausible solution, especially when it can reasonably be argued that the provision of new international reserves through the S.D.R. scheme is likely to be inadequate in scale.

Nevertheless, there are cogent arguments against the general proposal to link international reserve creation and development assistance. One, which I have advanced in the past, is that development assistance and international monetary reform are separate issues, each with its own economics and, more important, its own politics. That argument is subject to the counter-argument, which may have gained in force in recent years, that if governments are prepared or can be persuaded to accept a linkage of additional reserve creation to development assistance, and if by this means they will agree to create an adequate amount of additional reserves whereas otherwise they would not, both the world in general and the less developed countries in particular will benefit and no one will be harmed. This is an issue of political feasibility and acceptability on which I am not competent to form a judgment.

A more fundamental argument is that, contrary to widely held views, the creation of international reserves need not involve the generation of a pool of resources which must be allocated somehow and on which the less developed countries have a moral claim. Those views were perhaps more plausible some years ago, when plans for international monetary reform were generally modeled on the concept of a bank, with liabilities backed by assets in the form of loans and securities. As has come to be understood more recently, what is required of international reserves is acceptability in settlement of international indebtedness, and that quality need depend in no way on there being assets behind the reserve instrument. This principle is embodied in the SDR scheme; and that fact makes it much more difficult to disguise the fact that linking reserve creation to development assistance involves a deliberate choice to transfer real resources from the developed countries that wish to acquire increasing

reserve holdings to the less developed countries that would benefit either by initial receipt of the reserve instruments themselves or by gift or loan of the national currencies paid for increases in reserves by the developed countries. That transfer is entirely unnecessary to the creation of new international reserve assets, and could only be justified either by the political feasibility argument mentioned earlier, or by the establishment of a fiction concerning the desirability of developed countries "earning" their reserves rather than creating them (and correspondingly, of less developed countries not "earning" their reserves.) In view of the costs to the developed countries involved in earning rather than creating additional reserves, it seems unlikely that they would agree to such a scheme unless they already had a strong urge to contribute external resources to the promotion of the economic growth of the less developed countries; and in that case the question would arise whether this would be the most attractive form in which to give development assistance.

The specific proposal before the Subcommittee is for the linkage of creation of SDR's additional to those to be created under the existing agreement, to financing the development of the less developed countries. The basic argument for this proposal has to rest on the assumption that under that agreement insufficient new reserves will be created for the healthy development of the international economy. Otherwise the proposal would amount to financing the development of the less developed countries by world-wide inflation—a development policy which is usually disapproved when followed by one country.

The assumption that reserve creation will be inadequate raises two major difficulties. The first is to establish its plausibility. Despite the alleged seriousness of the international liquidity problem, the world economy has been characterized by a steady if mild inflationary trend of prices over the postwar II period. This trend has been resented more on the European Continent than in the United States and the United Kingdom, and the assertion that creation of SDR's is likely to be inadequate may merely reflect a one-sided assumption that inflation at a rate determined by U.S. fiscal and monetary policy is better for the world (or at least for the U.S.) than would be the lower rate of inflation required by a less rapidly growing total of international reserves. The second difficulty is that if the developed countries have negotiated a rate of increase of SDR's under the main scheme that will in fact prove inadequate, they are even so most unlikely to allow their decision to be re-negotiated by the creation of additional aid-linked SDR's, on either a compulsory or a voluntary basis. Instead, in all likelihood they would want to leave the correction of under-estimation of reserve needs to subsequent negotiations among themselves in the light of experience.

These considerations suggest, in the context of the questions posed by the Subcommittee for these Hearings, that the aid-linked SDR's would virtually certainly have to be, and further should be, created as an integral part of the mechanism for determining the total amount of new reserves in the form of SDR's to be created, and that they would not constitute a net addition to the total of new SDR's, but only a redistribution of a predetermined quantity of SDR's.

In connection with the proposal for the creation of aid-linked SDR's on a voluntary purchase basis, the proceeds being channeled to the less developed countries, there is a real question of how much if any of them would be purchased. As reserve assets, SDR's will be financially far less attractive than U.S. dollars (and sterling too, if the pound ever recovers), owing to the low rate of interest earnable by accumulating them in excess of a country's quota. The development of the use of them will depend on the establishment of a central bank preference for them over dollars, which will take time to emerge which may not even emerge at all, if the rest of the world gets used to the present *de facto* dollar standard and the United States develops a deeper sense of world responsibility in managing its domestic fiscal and monetary policies.

A further consideration, relevant to either the voluntary or the compulsory scheme, is that it would be perfectly possible in principle for countries that wished to accumulate international reserves and at the same time transfer real resources to the less developed countries to do so through existing capital markets. Such countries could for example accumulate portfolios of World Bank bonds. This would of course involve some risk of capital loss when the bonds had to be sold to finance deficits; but the superior liquidity provided by SDR's would be obtained at a heavy cost in foregone yield.

On the assumption argued for above, that aid-linked SDR's would constitute a redistribution of a predetermined total of SDR's, it is obvious that the benefit of aid-linking to the less developed countries would vary directly with the size of that total and the proportion of it linked to aid. The total of SDR's created each year would depend not only on the agreement reached as to the desired global increase in international reserves, but also on how far increasing holdings of dollars were meeting the need for additional reserves. On this point I would merely comment that it is not clearly established that the dollar has reached or passed its limit as an international reserve currency; on the contrary, the international monetary use of the dollar may expand substantially in future, in spite of contemporary official agreement that creation of SDR's should supplant further reliance on the dollar. As to the proportion of SDR's to be aid-linked, I would expect that concern to validate SDR's as an international reserve asset would prevent agreement on more than a token proportion being aid-linked. I would be surprised if as much as 25 per cent of SDR's were aid-linked; and on the most generous estimate of the total of SDR's that might be created ($3 billion) this would provide a flow of financial aid to $750 million a year. The actual financial flow would be likely to be very much below this outside estimate. The real resource transfer to the less developed countries entailed in such a financial flow would depend on the terms of the corresponding financial transactions, and would probably be substantially smaller. If the money were given as a gift the real transfer would equal the financial transfer. But if, as financial respectability would be likely to require, it were lent at concessionary interest rates through the World Bank, the real transfer would be substantially less than the financial one.

(The following material was also submitted for the record by Professor Johnson:)

THE INTERNATIONAL MONETARY PROBLEM: GOLD, DOLLARS, SPECIAL DRAWING RIGHTS, WIDER BANDS AND CRAWLING PEGS*

By HARRY G. JOHNSON, Professor of Economics, The London School of Economics and Political Science and The University of Chicago

Our present international monetary system is a system of fixed exchange rates, that is, a system within which the price of each national currency is kept fixed by national economic policy in terms of the currencies of other countries. (Actually, a small margin of variation in the foreign exchange values of national currencies is permitted, but the principle is that exchange rates are fixed.) Such a system is generally believed to be conducive to freedom of international trade, to international economic integration, and to the steady growth of the international economy. Judging by the unprecedented quarter of a century of steady and rapid world economic growth that has ensued on the termination of the second world war, the system may be said to have served these objectives very well so far. But a series of increasingly severe international monetary crises in recent years, most notably three occurring within the past year and a half—the sterling crisis and devaluation of November 1967, the gold crisis and the establishment of the two-tier gold price system in March 1968, and the franc-mark crisis of November 1968, which produced no change in the status quo—have called the attention of the average man to the fact that there is something seriously wrong with the international monetary system. It is my purpose in this lecture to explore and explain what has gone wrong with the system, and to comment on the alternative courses of action available to change and possibly improve it in the future.

I begin with some remarks on the remarks on the requirements that the international monetary system must meet, if it is to facilitate growth of the international economy, the maintenance of high employment along with reasonable stability of prices, and the preservation of a relatively liberal and competitive system of international trade and payments—the policy objectives of most governments in the western world today. First, the International monetary system must provide a steadily growing supply of "international liquidity"—that is, of some form of internationally acceptable and usable money which nations can use in settlement of deficits and surpluses on international balances of payments.

*A lecture in the University of Calgary Distinguished Lecture Series: April 7, 1969.

Under a fixed exchange rate system, nations are obliged to stabilize the values of their currencies in the foreign exchange markets; to do this they must be able to buy up surplus supplies of their currencies by disposing of international reserves; and as their economies and their international commerce grow over time, they will need growing stocks of international reserves in the aggregate for this purpose. If reserves do not grow as fast as the value of world trade and payments, at stable or rising prices, either there must be deflationary pressure on prices and incomes, as nations compete for the limited additions to the global stock of reserves, or—as in the more likely alternative in the contemporary world—nations will be driven increasingly into interventions in and restrictions on international trade and payments, designed to confine balance-of-payments deficits and surpluses to the magnitudes permitted by the available stocks of international reserves.

Second, there must be a "mechanism of adjustment" of international imbalances—an internationally accepted way or ways of insuring that a country's domestic price level and/or its exchange rate is so adjusted that the goods and services it produces remain sufficiently competitive with those produced by other countries, in the domestic and foreign markets, for its receipts and payments in transactions with other countries to remain broadly in balance. Otherwise, countries in deficit would have to resort either to intolerable deflation of their domestic economies, or to extensive and ever escalating interventious in international trade and payments.

There is obviously a "trade-off" between the provision of liquidity and the provision of an adjustment mechanism, in the sense that the more liquidity a deficit country commands, the slower the adjustment mechanism can be allowed to operate, and conversely. In the longer-run context of a growing world economy, it follows that the more adequate the provision for the growth of international liquidity, the less the need to work to improve the adjustment mechanism.

The third requirement for the international monetary system is the maintenance of confidence in the international values of the national currencies that are linked together through the fixity of exchange rates. This requirement would be largely met, or at least occasional failure to meet it would not cause serious trouble, if the other two requirements were met.

These three requirements the international monetary system has progressively failed to meet, as evidenced by the recurrent and deepening crises of recent years. The international monetary system has increasingly manifested three problems technically described as the liquidity problem, the adjustment problem, and the confidence problem. That this should have occurred is one of the great paradoxes of modern economic history, and an ironic reflection on man's capacity for economic planning. For these very problems were resposible for the collapse of the international monetary system, which centers on the International Monetary Fund, was deliberately designed to prevent the problems of the 1930's from recurring.

The collapse of the 1930's was associated with a shortage of gold; the use in place of gold of the pound sterling, and overvalued currency vulnerable to loss of confidence, and the inability of domestic policies, especially in Britain, to adjust domestic wages and prices to the fixed foreign value of the currency. Under the International Monetary Fund system, the liquidity problem was to be solved by the the creation of a pool of national currencies, on which nations could draw to supplement their gold reserves; provision was also made for increasing the price of gold by international agreement, if this proved desirable. The adjustment problem was to be handled by permitting nations in "fundamental disequilibrium" to alter the international values of their currencies by international agreement; provision was also made—through the "scarce currency" clause, which has in fact never been used—for the disciplining of chronic surplus countries by permitting the others to discriminate against their exports. The confidence problem was to be dealt with by allowing nations to exercise control over international short-term capital movements—which had been the medium in the 1930's through which losses of confidence had operated to disrupt the system. This last provision has proved unworkable, for the simple reason that short-term capital flights are typically the result of precautionary actions of businesses and individuals fearful of loss, rather than of speculative actions of a few rich people or institutions hopeful of a quick profit; but the fundamental hope was that the system would work well enough to avoid engendering unmanageable crises of confidence.

Why, in spite of so much careful advance planning in the light of disastrous previous experience, have the problems of the 1930's returned to plague the world economy, albeit under much more prosperous conditions than in the 1930's? The basic reason is to be found in the inadequacy—as to both quality and quantity—of the provision made through the International Monetary Fund for supplementing international liquidity in the form of gold with international credit facilities, and particularly the inadequacy of the provisions made for the growth of international liquidity. As to quality, where Keynes had proposed the creation of a genuinely international credit money, the Fund provided for the deposit of national currencies on the basis of which countries could withdraw the currencies of other countries in exchange for their own when these foreign currencies were required to finance balance-of-payments deficits. These drawing rights were conditional after a point, and provided a second line of defense not as good as gold or direct holdings of foreign currency. As to quantity, the volume of drawing rights created was niggardly to begin with; moreover, the real purchasing power of gold and drawing rights together was more than halved by the postwar inflation; and subsequent increases in countries' quotas of drawing rights at the Fund have not kept pace with the growth of world trade and payments.

Instead of being met by increases in international credit money provided through the International Monetary Fund, the needs of an expanding international economy for an expanding supply of international reserves were met by a growth in holding of other nations' currencies as substitutes for gold. Initially, a supply of such currency, in the form of the sterling balances, was provided as an accidental by-product of the methods by which Britain financed her was expenditures in colonial and some Dominion territories. Subsequently, and for quite natural reasons, there was a rapid growth in holdings by other countries of United States dollars as a substitute for gold in their reserves. This development meant the re-establishment of the gold exchange standard that had broken down so disastrously in the 1930's, with the dollar increasingly assuming the role that sterling had previously played, and sterling dwindling into a relatively insignificant—though still potentially dangerous—relic of its former glory.

Any system of fixed exchange rates will generate problems of confidence in the stability of the various national currencies, once it has been learned that exchange values are not immutable, and especially when, as under the International Monetary Fund system, a change to another level of the fixed exchange rate is a legitimate last resort. However, a gold exchange standard generates special problems of confidence with respect to the reserve currency. First, if private individuals can buy gold from the monetary authorities at the fixed official price, any lack of confidence on their part in the reserve currency will be reflected in speculative private purchases of gold, which purchases will in turn generate further speculation by draining official reserves. While private individuals are not in most western countries legally allowed to buy gold from the monetary authority, the "gold pool" arrangements initiated in the late autumn of 1960, by which the major countries collectively pegged the free market price of gold to the official price, enabled private speculators in fact to buy official gold; and it was a speculative run on gold through the medium of the free gold market that precipitated the gold crisis of March 1968 and the termination of the "gold pool". Second, while private speculation moving funds from one currency to another can always be countered by co-operation among the central banks involved, the banks receiving funds lending them back to the baks losing them, such co-operation is likely to be strained, in the case of a run on a reserve currency, because of jealousy on the part of other nations of the "imperial role" that a country acquires through the use of its currency by others as a reserve currency, and resentment of the fact that the willingness of other nations to hold its currency enables it to run deficits with apparent impunity.

These problems of confidence derive their force from the more fundamental fact that, by its inherent nature, the gold exchange standard must eventually arrive at a crisis. For this there are two reasons; they are analytically independent, but in practice closely connected.

The first concerns the role of gold, on which the system is based. The gold exchange standard, and specifically its growth, is a means of satisfying a demand for international reserves that is growing faster than additions of new monetary gold can supply. Expanding use of the dollar as an international reserve currency

has permitted rapid world economic growth to occur, along with liberalization of international trade and payments and a mild inflationary trend in world prices. But general world growth implies growing demands for gold for non-monetary purposes—industry, the arts, and what is commonly called "traditional hoarding"—and the flexity of the monetary price of gold in a general context of price inflation both encourages the substitution of gold for other materials and reduces the profitability of gold production and of prospecting for new deposits of gold. The non-monetary demand for gold will creep up on and eventually overtake the supply of it, the process being accelerated by speculation on the possibility that the monetary price of gold will eventually have to be raised. At this point, the relation of the monetary authorities to the private gold market changes dramatically: from being supporters of the price of gold they become suppressors of its price, and from being net purchasers they become net sellers of gold. They then face a dilemma: whether to continue to sell while their stocks last, which means abandoning gold as the basis of the international monetary system and will require the development of a credit substitute for gold; or to raise the price of gold sufficiently to ensure a continuing net inflow of new gold into monetary reserves. As it happens, when the crisis came in March 1968 the world's monetary authorities, under the leadership of the United States, opted for a compromise solution; to retain the $35.00 an ounce price of gold for transactions among monetary authorities, but neither to sell gold to nor buy gold from the private market. This solution is a contradiction in terms, even though it has held so far—because a refusal to sell gold to private purchasers at the official price implies that gold is really worth more than $35.00 an ounce to the monetary authorities, while a refusal to buy at that price implies that the authorities have no further use for gold.

The second reason why the gold exchange standard is doomed to crisis concerns the role of the reserve currency country. If the international reserves of the rest of the world are to grow more rapidly than new supplies of monetary gold permit the liabilities of the reserve currency country to the others must grow more rapidly than both gold and total reserves; and if the other countries are to preserve a balance between gold and the reserve currency in their growing holdings of international reserves, let alone increase the gold component, they must absorb not only all the new monetary gold but also gold from the reserves of the reserve currency country. Thus the international liquidity position of the reserve currency country must steadily deteriorate, with reserve liabilities rising and gold reserves falling. As it happened, by the end of the second world war the bulk of the world's monetary gold reserves had become concentrated in the hands of the United States, and the United States authorities were pleased enough to see some of it redistributed to other countries; but that was necessarily a transitory state of affairs which could not survive the continuing deterioration of the United States liquidity position.

The only way of avoiding a continuing deterioration of the liquidity position of the reserve currency country would be for the other countries in the international monetary system to reduce their gold holdings steadily, in return for larger holdings of the reserve currency. But this would mean deliberately moving off gold and onto the reserve currency as the basic reserve asset of the system, that is, it would mean making the national currency of the reserve-currency country the basic international money, and endowing its central bank with the powers, but without the world responsibility, of a world central bank. Instead, the deterioration of the international liquidity position of the reserve currency country will make the others increasingly reluctant to hold additional amounts of its currency and increasingly anxious to hold gold instead. Again, the system arrives at a dilemma: to raise the price of gold, to accept replacement of gold by the reserve currency, or to invent a new international credit money to substitute for both gold and the reserve currency. In fact, the termination of the "gold pool" and the adoption of the two-tier gold price system has put the world for the time being on a United States dollar standard; and political and economic events since March 1968 have temporarily restored confidence in the dollar and made it scarce enough to be willingly held by other countries. But the dilemma has probably only been postponed for a short while.

The need to devise a new and genuinely international reserve asset to take over the role of the dollar and sterling as credit supplements to gold was agreed on among the major countries as long ago as 1963. But negotiations were protracted by bickering between the United States and the United Kingdom on the one hand, and the Continental European countries on the other, over whether the

new asset should be brought into being before, or only after, the United States balance-of-payments deficit had been corrected. The analysis presented earlier suggested that, in the absence of a new international reserve asset, and given a scarcity of new gold, some country or countries must necessarily run a deficit in order to provide for the growth of reserves demanded by the rest. Experience strongly suggests that the United States, and probably also the United Kingdom, is the logical candidate—so that the European demand that the United States deficit be remedied before the initiation of the new reserve asset amounted to denying the existence of the liquidity problem. Agreement was finally reached in the autumn of 1967 on a contingency plan to create a new reserve instrument in the form of Special Drawing Rights at the International Monetary Fund. This plan is now in process of ratification.

The Special Drawing Rights plan is very complicated in technical detail, but fairly simple in principle. Essentially, the nations will create and distribute among themselves reserve certificates, which they will accept from one another in settlement of balance-of-payments deficits; additional certificates will be created from year to year on an agreed scale, to provide for the growth of international liquidity. From a theoretical point of view, the scheme is superior to what many observers had expected—some type of pooling of national currencies—since it gets away from the fallacious notion that money has to be backed by tangible assets, and bases itself on the fundamental principle that what makes money money is its acceptability as such. But the Special Drawing Rights are unlikely to solve the liquidity problem of the international monetary system, for two reasons. First, European acceptance of the plan was conditioned on changes in voting rights in the International Monetary Fund which gives the Common Market countries a veto power, so that the amount of new reserves created in this form is likely to be too small. The recently-achieved United States surplus, precarious as it is, may last long enough to make the European countries more amenable to United States pressure for creation of Special Drawing Rights on an adequate scale. Second, and more important, the Special Drawing Rights carry a gold guarantee, so that gold remains at least the ultimate accounting unit of the system, and, moreover, so long as there is any prospect of an increase in the official price of gold, the Special Drawing Rights are likely to be hoarded rather than used freely for international settlements: countries in deficit will obviously use their holdings of dollars first. For these reasons, international monetary experts agree that more drastic change is needed, and they have produced a variety of schemes for pooling gold and the reserve currencies in a new set of accounts at the International Monetary Fund, these accounts to be used for international settlements and their total amount to be increased over time by Fund lending and invesment operations.

The logical long-run solution to the international liquidity problem is obviously to convert the International Monetary Fund into a world central bank, whose liabilities would replace gold as the basic international reserve, just as paper money and central bank deposits have replaced gold as the base of national monetary systems. Such a world central bank would be operated by international co-operation in the interests of the international economy as a whole; its functions would include providing for the steady growth of international liquidity, and acting as a lender of last resort to countries in balance-of-payments difficulties.

Unfortunately, the logical solution from a cosmopolitan perspective is not likely to be achievable in today's world of nation-states jealous of their economic sovereignty and differing in their policy priorities, particularly with respect to the relative weights they give to preventing unemployment and preventing inflation. To operate the International Monetary Fund as a world central bank would require either international collaboration and international agreement on precisely those issues which have been the subject of profound international disagreement under the present system, particularly the division of the burden of adjustment of international imbalances among deficit and surplus countries respectively; or else it would require a surrender of national sovereignty in the monetary sphere to an international body with governmental powers, a major change which seems very unlikely to be accepted.

That leaves the other two possibilities already mentioned still open. One would be a deliberate agreement to raise the price of gold, in order to restore a major role for new monetary gold in the provision of new international liquidity and provide more freedom and autonomy for national policy-makers. This solution has always been strongly resisted by United States Administrations, including

the present one. But most of the economic arguments against it are really very weak, while the political argument for it, as an alternative to the strained and tense international collaboration necessary to keep the present system functioning, or to the unpopularity of a full-blown United States dollar standard, are fairly strong. The potentially inflationary consequences of a rise in the price of existing gold reserves could be readily avoided by sterilizing the paper profits; nations that lost because they had agreed to hold dollars instead of gold could be compensated; the "gift" to Russia and South Africa entailed by a higher gold price would be trivial compared with the benefits; and the waste of resources entailed in the physical production of money that could be created by a stroke of the pen would be negligible. The main argument against raising the gold price stems from American pride in the one-thirty-fifth-of-a-gold-ounce dollar. But it should be remembered that that dollar is less than thirty-five years old; and if Roosevelt could be twice re-elected after saving the nation by raising the United States official price of gold from $20.67 to $35.00 an ounce, it is not outside the bounds of possibility that a contemporary President could pull off the same trick. Too much should not be made of the fact that Congress, not the President, has authority over the official United States price of gold; for Congress could be faced with a *fair accompli* on the part of the President which it could not reverse.

The other alternative would be a change from the present *de facto* dollar standard to a full-blown dollar standard, through the demonetization of gold. This could be accomplished very simply, through unilateral American action, by imposing an embargo on sales of American gold to official monetary authorities in other countries. The rest of the world would then individually have the choice of remaining pegged to the dollar, as they technically are under the present international monetary system, or letting their currencies float against the dollar. This might involve considerable disruption of the international monetary system, probably accompanied by a proliferation of trade and payments restrictions such as occurred in the 1930's; and there might emerge a Continental "gold bloc" such as emerged after the suspension of sterling convertibility in 1931, a bloc with a common currency and an exchange rate fluctuating against the dollar. In the longer run the outcome might be the same as in the 1930's—a return to fixed exchange rates at a higher price of gold.

What appears most likely actually to occur, at the present time, is that the United States Administration will use the latent threat of is power to demonetize gold and put the world on a dollar or floating exchange rate standard, to press for large-scale activation of Special Drawing Rights than was originally contemplated, and for more lively motion towards a world central banking role for the International Monetary Fund, along with reforms of the system designed to improve the adjustment mechanism—all this, perhaps, to be promoted by the convening of the secretly-held international monetary conference that was suggested as desirable after the failure of the Bonn meeting of officials last November.

This brings us to the other major problem of the international monetary system, the inadequacy of its mechanism of adjustment. Under a regime of absolutely rigid exchange rates, a country must adjust its aggregate demand in the short run, and its domestic price level—under the pressure of aggregate demand—in the long run, so as to maintain its international competitiveness. This unfortunately requires that deficit countries be willing to tolerate unemployment, and surplus countries be willing to tolerate inflation. Countries are usually adverse to both unemployment and inflation; and it so happens—not altogether accidentally—that the chronic deficit countries of recent years, the United States and the United Kingdom, have special historical reasons dating from the 1930's for being strongly averse to unemployment, while the chronic surplus country, Western Germany, has special historical reasons dating from the 1920's for being averse to inflation. Consequently, the traditional mechanisms of adjustment through deflation in deficit countries and inflation in surplus countries has been very seriously impaired—it has become a "mechanism of reluctant adjustment."

The International Monetary Fund system was intended to provide a way around this conflict between domestic policy objectives and the requirements of international equilibrium, by allowing exchange rate adjustment by international agreement in cases of "fundamental disequilibrium." But governments have proved themselves very reluctant to resort to this solution, too: the foreign value of the currency has become a symbol of national prestige, a devaluation a symbol of political defeat by, and in appreciation a symbol of political sur-

render to, foreign governments. In the case of sterling and the dolllar, reluctance to devalue has been reinforced by the presumed obligation on a reserve currency country not to defraud its creditors—even though those creditors have been paid handsome interest to take the risk. Political resistance to exchange rate changes has been manifest in the prolonged struggle of the British government to avert the devaluation that ultimately came in November 1967, and most recently and dramatically in the failure of the franc-mark crisis to produce the expected devaluation and revaluation of those currencies, owing to governmental refusals to accept the solution agreed by the officials. The result particularly of this last experience has been to convince many experts of the need to introduce more automatic flexibility of exchange rates into the international monetary system—a subject to be discussed later.

The unwillingness of countries to apply either the classical mechanism of adjustment (deflation by deficit countries, inflation by surplus countries), or the International Monetary Fund mechanism of adjustment (changes in exchange rates), has meant that they have been driven to resort instead to a variety or expedients involving governmental interventions in trade and payments. The rule of the General Agreements on Tariffs and Trade prohibit export subsidies generally, and the use of tariff increases to correct deficits; and the method these rules allow—the imposition of import quotas—is clumsy and inefficient. Consequently, governments have resorted to such measures as sophisticated tax-relief subsidization of exports allowable under the rules of the General Agreement on Tariffs and Trade; measures to restrict private foreign investment, including the Interest Equalization Tax, voluntary and mandatory "restraint" programmes, and tax discrimination against foreign investment; measures such as tying of foreign aid and discrimination in governmental procurement in favor of domestic suppliers, measures which because they fall on government and not private trade escape the G.A.T.T. rules; and special intergovernmental financial transactions designed to disguise balance-of-payments disequilibria by moving them out of the statistical deficit or surplus.

These policies, though often officially described as "adjustment" policies, generally are not so in fact. Some would be better described as "financing policies, in the sense that they aim at generating financial movements which offset the deficit that would otherwise appear in the accounts. Others, while appearing to be policies of adjustment when viewed in the context of partial equilibrium, are not so when viewed in the larger context of general and monetary equilibrium. This point may be illustrated by reference to the use of import restrictions to correct a balance-of-payments deficit. Nothing would seem more natural than to assume that, if a country is "importing too much", restriction of imports will remedy the situation. But in a diversified industrial economy with high employment, while restrictions may temporarily succeed by way of inducing postponement of consumption or the running down of stocks of imported goods, in the longer run they will tend to divert resources from exports, or demand to other imports, thus reducing efficiency without helping the balance of payments. Further, if monetary policy is slack or permissive, wages and prices are likely to rise, rendering the economy less competitive than previously. (The same remarks apply, of course, to a devaluation that is not adequately backed up by deflationary policies.)

The increasing resort to interventions of these various kinds has been accompanied by reiterated expressions of surprise as their failure to work as expected; and typically this failure has been taken as evidence of the need for still more stringent restrictions. An alternative view is that these measures have failed because the theory underlying them is fallacious—it is a partial equilibrium theory—if a theory at all, rather than superficial arithmetic—which ignores the general equilibrium nature of the balance-of-payments problem, and especially the monetary aspects of the problem of adjustment. The monetary factor is important in two contexts: that of an individual country in deficit, and that of the system as a whole in disequilibrium.

From the point of view of a deficit country, the deficit necessarily involves an excess of total purchases from domestic and foreign sources over total sales in the domestic and foreign markets, and hence implies that the public as a whole is running down its cash balances. The essence of the classical theory of the mechanism of adjustment concerned the consequences of the depletion of the public's cash balances in producing monetary stringency and thus putting downward pressure on demand and prices. It follows that one should not expect adjustment policies to be effective unless they are backed up by proper restraint on the money supply, or in more old-fashioned terminology on effective demand.

If, instead, governmental policies permit continued excess spending to be financed by continued money creation, the adjustment policies should not be expected to be successful: efforts to prevent money from spilling out of the economy in one direction will simply cause it to spill out in another.

This point I believe to be an important factor in understanding the long exercise in futility commonly described as United States balance-of-payments policy. The significance of the recent turn-around in the United States balance-of-payments position is that it has been caused in part by monetary stringency in the United States relative to Europe; unfortunately, that stringency has been brought about by the effects of inflationary exceptions in raising money interest rates, and the consequent improvement of the United States position cannot be regarded as the result of a normally functioning adjustment mechanism. The same point helps to explain the apparent failure of the devaluation of sterling to work, at least this far. While the British Government has tackled aggregate demand directly through increased taxation, it has continued its long practice of using monetary policy to favour the Government with low interest rates, thus guaranteeing monetary expansion in a period of rising interest rates. The general equilibrium approach also suggests that the official view—that devaluation has been working well to expand exports, but unfortunately has been failing to work to restrain imports—is nonsensical: if aggregate demand is held constant, and exports rise, imports must rise too to fill the resulting gap in supplies to meet domestic demands.

Turning to the viewpoint of the international monetary system as a whole, in disequilibrium, the analysis presented of the liquidity problem implies that if the growth of demand for reserves exceeds what is made available from new monetary gold supplies and international credit arrangements, the system will attempt to obtain the desired reserves from inside itself. In other words, countries will compete for what reserves there are, and this will almost inevitably mean that someone will wind up with a deficit. That someone will be the country or countries with the slackest monetary and fiscal policies. This is an important point in understanding the prolonged weakness of the pound and the dollar: in a real sense there has been a demand from the rest of the world for the United Kingdom and the United States to run deficits so as to feed the rest of the world with international reserves.

It is also an important point in relation to current proposals for introducing more automaticity into exchange rate adjustments. The chief contenders in this respect are the "wider band" proposal and the "crawling peg" proposal. Under the "wider band" proposal, the present narrow margin of allowed variation of exchange rates around their gold parities of one per cent (in practice usually less) would be widened to, say, five per cent, so that a maximum of ten per cent of appreciation or depreciation could occur automatically. Under the "crawling peg" proposal, the par value of a currency would be adjusted, automatically or at government discretion, on the basis of an average of the actual values of the exchange rate over some previous period, the band of variation of the actual market rate about the parity either remaining the same or being widened. Under this system, if the balance of payments were weak the actual exchange rate would be consistently below the parity and on the averaging principle the parity itself would gradually drift downwards; and conversely if the balance of payments were strong. From the point of view of increasing automaticity of adjustment, the "crawling peg" is superior to the "wider band", since the latter would give only a once-over increase in the extent to which the exchange rate can be adjusted. The "crawling peg" might, however, raise more difficult problems than the "wider band" in the eventuality that might occur under either system, or a disequilibrium so great that it became certain that the parity itself would have to be changed. There are many technical problems with either proposal. But the main point implied by the monetary analysis is that the superimposition of either proposal onto the present international monetary system would not necessarily resolve its problems. Th reason lies in the unresolved problem of international liquidity: so long as there is a demand for international liquidity in excess of what the system generates, there will be pressures for some country or countries to have a deficit; and these pressures may well force exchange rates to the limit of the permitted range of flexibility without producing adjustments, thereby recreating the problems of the system as it now exists. Only a system of fully floating exchange rates would permit, and in fact ensure, full adjustment; this is because, under a system of freely floating exchange rates, there is no need for international liquidity.

Chairman Reuss. Thank you, Mr. Johnson.

Mr. Prebisch.

STATEMENT OF RAUL PREBISCH, FORMER SECRETARY-GENERAL OF UNCTAD, AND DIRECTOR-GENERAL OF THE UNITED NATIONS LATIN AMERICAN INSTITUTE FOR ECONOMIC AND SOCIAL PLANNING

Mr. PREBISCH. Thank you, Mr. Chairman.

Undoubtedly, international monetary reform and the transfer of resources to developing countries are two different things, and we should not mix them. However, this does not mean that they cannot be combined. What we are trying to do, therefore, is take advantage of the reform in order to add more resources to developing countries.

But it is obvious that the amount of new monetary resources to be created should be considered quite independently of any consideration as to the external financial needs of developing countries. This is essential in order to avoid monetary inflation in the use of this reform.

I think that, given the voting power of the different countries in the IMF, there is no risk of developing countries exercising a very effective pressure on developed countries. As you know, the latter have the real power to decide the amount of resources to be created. Indeed, I am afraid that if there is any risk of bias, this risk would be in favor of an insufficient rather than an excessive creation of resources.

The question of whether the link should be organic or not, as Mr. Dell already said, has been considered. The amendment of the articles of the Fund has not entailed an organic link, and in order to introduce an organic link, it would be necessary to amend the amendments. This could be a very serious difficulty. But it is perfectly conceivable to make a parallel agreement whereby developed countries receiving additional resources would put part of the equivalent of these resources at the disposal of the World Bank, or IDA, or regional banks, in order to increase the amount of their resource transfers to developing countries.

There is nothing unsound in the transfer of real resources in that way; this was the nature of the transfer of resources during the golden age of the gold standard. There is nothing new in this. Countries willing to capture part of the increment of gold supplies would exercise all their competitive power through their exports of goods and services to obtain a part of the new gold resources. The results of this SDR scheme, if the idea of a link was accented, would be the same. Instead of gold, countries could capture these new instruments which are representative of gold.

As to the proportion of resources to be transferred to developing countries, Mr. Chairman, I have suggested in my short paper that it be a 50-percent proportion. There is, of course, nothing dogmatic about this. It is a matter of negotiation, as Mr. Dell has said. But the final target should be 100 percent at some future date.

As to conditions of transfer, Mr. Chairman, I consider that it would be unfair to charge a rate of interest to developing countries in this operation, except in exceptional cases. On the contrary, I would like to see this new resource as an element to alleviate the already heavy load of services plaguing developing countries in the form of interest, amortization, and related capital remittances.

It is a well known fact that many developing countries are in a very critical situation in this matter of a substantial and still rising debt-

30-668 O—69——3

servicing burden. Especially in Latin America. This concerns me very much, not only in regard to the present, but also to the critical situations that would appear in the course of the next few years, if present tendencies continue, and worse yet, if they are aggravated, as seems to be the case.

There is, naturally, the risk that this new transfer of financial resources to developing countries would diminish in a parallel fashion the resources that are presently transferred and which are very scarce indeed. However, I would rather see this as part of the policy commitment accepted by developed countries at the UNCTAD Conference in New Delhi a year ago, whereby in principle they agreed to transfer 1 percent of their gross product to developing countries. I think that this new operation, through the link, can and should help developed countries achieve that target as soon as possible.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Prebisch follows:)

PREPARED STATEMENT OF RAUL PREBISCH

THE LINK BETWEEN RESERVE CREATION AND ASSISTANCE TO DEVELOPING COUNTRIES

Since the time when I was in charge of UNCTAD I have advocated the need to link the creation of additional monetary reserves with an increase in the transfers of financial resources to developing countries. A committee of experts appointed by UNCTAD made a recommendation to that effect in 1967 and later the same idea appeared in a report by a group of experts presented to CIAP, the Inter-American Committee for the Alliance for Progress.

It may be appropriate to stress at the outset that the amount of new monetary resources to be created should be based strictly on monetary considerations and not on the needs of developing countries for external financial resourcs. In any case, given the voting requirements provided for in the proposed amendments to the Articles of Agreement of the IMF, and within the IMF governing bodies, any decision would require the support of the major industrial countries and therefore there is no danger whatsoever that the creation of resources would be based on the financial needs of the developing countries.

As mentioned above, a group of experts appointed by UNCTAD recommended an "organic" link between the creation of new monetary resources and the transfer of part of these resources to developing countries. But considering the fact that at the time the international monetary reform was encountering strong obstacles, and following the prudent advice of some responsible authorities on this matter, the UNCTAD secretariat decided not to insist on the "link" until a decision was taken in relation to the fundamental elements of the reform. But now that these have been settled, it is timely to return to a discussion of the "link" and I welcome the initiative of the Subcommittee on International Exchange and Payments to deal with this matter.

Various possibilities are worth considering. The first would be to try to make a modification in the amendment to the Articles of Agreement of the Fund establishing the Special Drawing Rights. But if this involves insurmountable difficulties, it may be better to think in terms of a parallel agreement by which the developed countries would undertake a firm commitment to transfer a certain proportion of the addtional liquidity to developing countries. If the latter alternative is accepted I would not favour, however, a mechanism whereby every developed country would decide unilaterally and in isolation the amounts of its transfers to developing countries. I should also like to point out that in my view the transfer of resources should, as would be normal, based on an appraisal by the World Bank, IDA and the regional development banks of the needs of developing countries, taking into account their development plans and programmes, including their commitments to intensify the mobilization of domestic resources.

Let me deal now with the relationship between the amount of additional monetary resources received by developed countries and the transfer of resources to developing countries. The ideal solution would have been to follow the pattern

that had evolved in the world for the distribution of new gold in the golden times of the gold standard. In those years the countries of the world would strive to obtain additional monetary reserves by buying gold from gold producing countries with their exports of goods and services. It could have been conceived that new monetary resources created through the international monetary reform would have been transferred to developing countries according to the aforesaid process and that, through their exports, developed countries would have captured their share of the new monetary resources. The whole of the new monetary resources would have been distributed in this fashion, and this would have been fully consistent with the principle of multilateral trade and with the high degree of competitiveness that should prevail in world trade.

However, the balance-of-payments situation of important developed countries may make such a system impracticable for the time being. Let us then consider this mainly as a target to be achieved in due course. Meanwhile, the transfer of resources could amount to, say, 50 percent of the new monetary reserves, to be increased gradually, especially as the present balance-of-payments situation improves. This could constitute the proper way of correcting the possible consequences of a mechanical distribution of the new monetary resources.

A strong objection against the reform has been that such mechanical distribution would not stimulate countries with a balance-of-payments deficit to take international corrective measures but if deficit countries have to capture part of the newly created reserves by increasing their efforts to export to developing countries, they will be forced to adopt measures to increase their competitiveness in world markets. This should be an objective to be attained once the present difficulties are overcome.

From another angle, we have to recognize that the amount of new monetary resources to be created will have great influence on the success of the efforts to correct balance-of-payments deficits. It seems to me that in those good times of the gold standard, the down-swing of the cyclical movements was less intense and its duration was shorter when gold production was high than in periods of scarcity of gold. What happens now is that, due to a scarcity in the amount of new gold at the disposal of monetary authorities, the effort to put in order the balance-of-payments is much greater than it should be. If deficit countries could have access to new monetary resources created in response to the needs of world trade and would improve their competitiveness in order to capture part of these resources, they would be in better conditions to improve their balance-of-payments problems than during the current scarcity of new gold.

A further objection to the "link" has been that developed countries would diminish their present contribution to development financing in the proportion of their transfers of new monetary reserves to developing countries. This would be a real danger if developed countries had not committed themselves at the second UNCTAD Conference in New Delhi to effect transfers equivalent to one per cent of their gross national product to developing countries. Consequently, the possibility of using part of the new monetary resources for financial transfers to developing countries should in fact assist developing countries to attain this target as soon as possible.

Chairman Reuss. Thank you, Mr. Prebisch.
Mr. Scitovsky?

STATEMENT OF TIBOR SCITOVSKY, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. Scitovsky. Thank you, Mr. Chairman.

I believe I can be most useful to the subcommittee by limiting myself to a rather technical point, which I think is quite an important one.

In the prepared statement I submitted, I drew attention to the fact that one can and ought to distinguish between two kinds of links, one which may be called unconditional link will link the creation of reserves to development assistance available to developing countries unconditionally in the form of loans whose proceeds can be spent in any country, wherever the equipment or other goods on which these proceeds would be spent happen to be the cheapest.

The other and altogether different kind of link, which may be called the tied link, would link the creation of reserves to development assistance available only in the form of goods produced in the country or countries that receive the newly created reserves.

The distinction is important, I think, because the economic effects of the two kinds of links are totally different.

I, for example, am opposed to the unconditional link, because it might increase the inflationary pressures of SDR creation. It would increase the misgivings of surplus countries, the misgivings that surplus countries already have about reserve creation, and it would be likely therefore to restrain or to limit the vote in favor of increased SDR creation as well. It would minimize, as a result, the volume of SDR's created.

If this were the only kind of link available, then I should fully agree and side with those who are arguing against the link on the ground that it is undesirable and improper to link two altogether separate issues, reserve creation and development assistance.

At the same time, however, I am very much in favor of the tied type of link. This does not add to the inflationary pressures that reserve creation may put on surplus countries. On the contrary, it provides a safeguard against excessive inflationary pressures, by making the acquisition of SDR's by deficit countries subject to cost, which may be considered prohibitive, if these countries happen to be in an inflationary situation already.

The tied link therefore has an economic justification that is quite independent of whatever benefits the developing countries might derive from it. If development assistance in kind is a condition of acquiring SDR's, this will automatically limit SDR creation to times and to a rate at which it is safe to create SDR's without the danger of simultaneously creating world inflationary pressures.

To my mind, the question whether to have a link and what kind of link to have ought to be decided on the ground whether it would improve the mechanism of reserve creation, and quite independently of its benefits to developing countries.

These benefits are and should be considered a desirable by-product, and of course as Dr. Prebisch also argued, the rate of reserve creation should be completely independent of the need for such benefits. I feel all the more this way because development assistance that the link can produce would, even under the most favorable circumstances, be a very small part of the total need or total absorptive capacity of the developing countries for assistance.

So I do think it is a useful thing to make this distinction and to think of the link as something that in some cases might add to inflationary pressures, in others might be a safeguard against them. It is the second kind of link, which would be a safeguard against inflationary pressures, that I think has a real justification.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Scitovsky follows:)

PREPARED STATEMENT OF PROF. TIBOR SCITOVSKY

LINKING RESERVE CREATION AND DEVELOPMENT ASSISTANCE

I should like to limit myself in this statement to a single point, which I consider important, and which seems not to have been brought out in previous discussions of the link between international reserve creation and assistance to developing

countries. This is the distinction between a link likely to enhance the dangers of reserve creation and the antagonisms between its advocates and opponents, and an altogether different kind of link, which is likely to minimize these dangers and antagonism, because it is designed to guard against the excessively inflationary effects of reserve creation. Past discussions and arguments for and against the link have blurred the issues, because they failed to distinguish between the two kinds of link.

The creation of Special Drawing Rights (SDR's) or of any other form of international reserves is potentially inflationary, not because of any mechanical relation between the supply of reserves and the level of world prices, but because they enable deficit countries to run larger or longer deficits, and so to impose on surplus countries larger or longer surpluses, together with the inflationary pressures these generate at times—though only at times—when the surplus countries are already under inflationary pressures. This is why countries typically or chronically in surplus are anxious to limit the creation of SDR's; this is why Mr. Karlik's fear of "the strong probability . . . that globally the SDR distribution will be inadequate" seems well founded.[1]

The crucial questions therefore to ask about the link is how it would affect the actual or potential inflationary pressures on surplus countries, and how, as a result, it would affect these countries' votes in the IMF on the creation and distribution of SDR's.

The answer depends on the nature of the link. If the IMF were empowered to lend to the IBRD or the IDA part of the national currencies it held against SDR's; or if surplus countries were required so to lend part of their excess surpluses (this, I believe, is one of Professor Triffin's suggestions); or if any countries were so to lend in connection with their acquisition of SDR's (this, I believe, is Sr. Colombo's suggestion), this would almost certainly add to the surplus countries' surpluses and to the inflationary pressures these may create. The reason is that the proceeds of all project loans the IBRD and its subsidiaries make available to developing countries must be spent on goods produced by the lowest bidder in an international competition; and the lowest bidder is likely to be, for obvious reasons, a firm in one of the surplus countries. Such a link therefore would be likely to add to the surplus countries' surpluses and potentially also to the inflationary pressures weighing on them.

Such a link, I believe, is undesirable. It would aggravate the very problems that opponents of reserve creation are afraid of; it would strengthen the vote of those desiring to block or minimize the creation of SDRs; and if this were to restrict the rate at which SDR's are created, it would aggravate the crisis of international payments. Since the developing countries suffer the most from the unsatisfactory working of the international payments mechanism, they might well lose, as a block, no less or more than a few of them would gain from the development assistance provided under such a link.

There is, however, another form of the link, which avoids these drawbacks, because it would not add to inflationary pressures on surplus countries, and would, on occasion, even relieve such pressures. Such a link would consist in requiring industrial countries in need of additional reserves to pay for the SDR's (or part of the SDR's) issue to them, by making available development assistance, *which is tied to their own exports*. Since, as a rule, only a deficit country is likely to claim SDR's, the distinguishing feature of such a link is that the products bought by developing countries with the proceeds of such assistance would originate in the deficit country, add to *its* exports, and—if this country happened to be in an inflationary situation—add to *its* inflationary pressures. All these are advantages as I hope to show below.

It is true that the spending of the SDR's themselves by the industrial country in deficit can create inflationary pressures for the surplus countries; but these would be no greater than what they would be if the creation of the same SDRs were not linked to development assistance. On the contrary, they are likely to be smaller, because at times when deficit countries are under inflationary pressures themselves, they will be reluctant to claim SDR's if these add to their own inflationary pressures; and by not claiming *and not spending* SDR's, they relieve the inflationary pressures on the surplus countries. It is worth noting that these are the times when adding to the world supply of international re-

---

[1] John R. Karlik, "On Linking Reserve Creation and Development Assistance," a staff study prepared for use of the Subcommittee on International Exchange and Payments of the Joint Economic Committee, Washington, April 1969, p. 6.

serves is inflationary and undesirable for the world as a whole. Such a link therefore would provide a welcome safeguard against the creation of international reserves at the wrong time—that is, at a time of world inflationary pressures.

Since this kind of link involves the provision of tied aid, which is usually more expensive than untied aid, means would have to be found to make it acceptable to the developing countries. With this in view, I once proposed that development assistance linked to the creation of SDR's should take the form of grants rather than loans, since the objections to tied loans do not apply to tied grants.[2] Another way of dealing with the same problem might be to link the acquisition of SDRs to the making of tied contribution to the IDA. The U.S. contribution of $160 million p.a. now under discussion shows that tying is not an impossibility, although more tying would be desirable. Since the IDA can grant loans so soft as to be almost indistinguishable from grants, (e.g., interest-free, with long grace periods) the tying of such loans would not be too objectionable. A third and perhaps the best solution might be to link the acquisition of SDR's to development assistance in the form of tied loans; but with the deficit country's government bearing the excess cost of tying. In other words, the value of the lowest bid would determine the value of the loan, the developing country's repayment obligations, and the amount of SDR's made available to the deficit country; but the contract would actually be awarded to a firm in the deficit country, with the government paying the difference between its bid and the lowest bid. Such an arrangement would render the acquisition of SDR's by a particular country the more expensive, the more that country's price level exceeded the world price level—this fact might well be considered an advantage too.

To link the distribution of SDR's with development assistance along some such lines has merits quite apart and different from the humanitarian consideration of aiding the developing countries. The difficulty of international reserve creation is that it benefits one group, the deficit countries, at a possible cost to another group, the surplus countries. This is why international agreement on the subject is so difficult to achieve. A link of the first kind aggravates the difficulty by adding to the cost that may be inflicted on the surplus countries. A link of the second kind avoids or mitigates the difficulty. It creates no additional surplus, no additional inflationary pressures for the surplus countries; at the same time, it imposes a real cost and may create inflationary pressures on the deficit countries, which can act as a deterrent and limit the creation of SDR's and the consequent inflationary pressures on surplus countries. This last is an important and valuable function of such a link and, to my mind, its economic justification. It may seem paradoxical to use the creation of inflationary pressures in one country as the means of relieving those pressing on another; but the explanation is very simple. The second kind of link imposes costs and their pressures on the same country or countries that benefit from the creation of SDR's. There is much to be said for locating benefits and their costs in the same country, and making the same government weigh one against the other. This is a matter not only of social justice but of sound economic principle as well. It is my reason for favoring this kind of link at the same time that I am opposed to the first kind.

Chairman REUSS. Thank you, sir.

Mr. Triffin?

STATEMENT OF ROBERT TRIFFIN, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. TRIFFIN. Thank you, Mr. Chairman.

Following your own advice, I shall try to summarize only very briefly the highlights of my statement.

Three main objections have been raised against the link idea. The first is that reserve creation should be determined by reserve needs rather than by developmental needs. It seems to me that this objection is totally irrelevant to any link proposals that I know of, since most

[2] Cf. T. Scitovsky, "A New Approach to International Liquidity," *American Economic Review*, Vol. LVI, pp. 1212–20.

of them accept that very principle as their starting point, as Mr. Prebisch has just confirmed.

But given the fact that reserve needs may require $2 to $3 billion a year of SDR creation in the forthcoming years and more in the longer run, what purposes should this lending power serve? That question cannot be evaded.

The present answer is that they should be distributed automatically pro rata of IMF quotas and irrespective of the policies which such allocations will help finance. This to my mind would be morally repugnant, economically absurd, and, fortunately, also politically unviable, for the reasons which I have developed in my paper.

The lending power derived from internationally agreed SDR creation should serve *internationally agreed objectives* rather than purely national policies whatever they may be.

The link is one, even though only one, of the most respectable and agreed of those objectives. There is no reason to exclude it from consideration.

A second objection is that SDR's should not be distributed to persistent deficit countries but should be reserved for countries which, in the long run, are in equilibrium in their balance of payments.

If we followed that principle, the United States and the United Kingdom should not receive the lion's share of SDR allocation—36 percent—since those two countries have incurred the largest and the most persistent deficits in the world over the last 20 years. Their monetary reserves have declined by about $33 billion, from *plus* $17 billion in 1959 to *minus* $16 billion at the end of last year, while the reserves of the other countries have more than tripled, and those of the underdeveloped countries have increased by more than 50 percent.

So if we follow the principle affirmed by the Group of Ten, the SDR's should be distributed primarily to those countries rather than to the two reserve center currency countries.

The third objection is that the counterpart assets of SDR liabilities should be as liquid as those liabilities themselves. Professor Machlup was obviously right economically when he refuted that objection in arguments which are well known to you, where he shows that the only need for liquidity for a World Bank like the IMF would be to finance *interplanetary* statements. In any case, and whatever the economic merits of this argument, the present draft agreement makes 70 percent of the SDR potential gifts without specific repayment obligations.

If gifts are unobjectionable, investment in IBRD obligations, or other similar obligations, are certainly even more unobjectionable.

But to put the argument more positively, let me stress that the link would not be a revolutionary step forward. It would be a *conservative* step necessary to prevent a reactionary step backward.

Sterling and dollar reserves have traditionally helped sustain a larger capacity for foreign aid and development finance by the United States and United Kingdom than they could have sustained if they had had to pay their deficits in gold.

To the extent that dollar and sterling balances will largely be substituted by SDR's in the future, as affirmed by the negotiators, the same constructive function should be preserved in the new system.

Of the $75 billion of total gross reserves in existence today, about 40 percent or $30 billion was used in that fashion. The present treaty

agreement would break this link and substitute for it an invitation to the richer countries to accumulate reserves on each other, without being bound as in the past to earn reserves by transfer of real resources to the rest of the world.

The link proposal is all the more vital at this stage as the United States and United Kingdom, which were traditionally the two largest capital markets of the world, and should export capital to the tune of at least $10 billion a year, if the principle of UNCTAD—1 percent of the GNP—was accepted. These two countries, however, have been exporting last year on a net basis *zero* of real resources, while on the contrary pumping from the rest of the world $5 to $6 billion of earnings on their past investments.

I have distributed a table which summarizes these figures for the year 1968.

(The table referred to follows:)

FINANCING OF UNITED STATES AND UNITED KINGDOM CAPITAL EXPORTS, 1968

[In millions of U.S. dollars]

	United States	United Kingdom	Total
I. Current account surplus	806	−574	232
II. Capital exports	8,039	1,953	9,992
A. Foreign aid	4,246	463	4,709
B. Long-term private capital	3,793	1,490	5,283
Total Excess of II over I (−), financed by—	−7,233	−2,527	−9,760
A. Short-term capital, exchange adjustments, and errors and ommissions	520	852	1,372
B. Long-term foreign capital inflows (−)	−5,270	−1,342	−6,612
C. Settlements deficit (−)	−2,483	−2,037	−4,520
1. Official prepayments and waivers	−269	−86	−355
2. Private dollar and pound balances	−3,831	979	−2,852
3. Net monetary reserves	1,617	−2,930	−1,313

Mr. TRIFFIN. It is very striking that the gross capital exports of the United States and the United Kingdom last year approximated indeed the $10 billion figure which is suggested by UNCTAD. But only 2 percent of those capital exports were financed through surpluses; that is, through exports of real resources; 98 percent was refinanced by borrowing abroad and by reserve losses financed by various rescue operations with which we have become all too familiar.

It is quite clear that this situation cannot continue.

Finally, we should recognize that the present draft agreement can only be approved as it stands, and has already been approved in this fashion by the U.S. Congress.

The only thing that can be done at this stage is, first, to request that the U.S. Executive Director initiate new studies and negotiations aiming at restoring the link that the present agreement would break; second, that in the meantime the United States and other developed countries join in committting themselves to make supplementary contribution to IDA equal to all, or at least part, of the SDR's allotted to them.

Thank you.

Chairman REUSS. Thank you, Professor Triffin.

(The prepared statement of Professor Triffin follows:)

PREPARED STATEMENT OF PROF. ROBERT TRIFFIN

Linking Reserve Creation and Development Assistance

I would like, first of all, to congratulate this Subcommittee for its persistent attempts to re-open an issue on which the officials involved in the negotiation on international monetary reform have persistently—and wrongly, to my mind—tried to close the door.

PREVIOUS SUPPORT FOR A "LINK"

The idea of linking reserve creation and development assistance goes back at least more than ten years. It was forcefully presented and defended by two illustrious officals and practical bankers: Mrs. Maxwell Stamp in an article, "The Fund and the Future" published by the *Lloyds Bank Review* of October 1958 (pp. 1–20) and by Sir Oliver Franks in his annual statement to the shareholders of the same bank. In 1959, I integrated their suggestions in the articles later assembled in my book on *Gold and the Dollar Crisis* (Yale University Press, New Haven, 1960, pp. 118–119). I came back repeatedly to the same point in all my subsequent writings, and particularly in my appearances before this very body.[1]

Your response to these suggestions was most encouraging. Representatives Reuss and Ellsworth endorsed them, as early as 1965, in their Report to the J.E.C. entitled *Off Dead Center: Some Proposals to Strengthen Free World Economic Cooperation* (see particularly their recommendations on pp. 16–17), and your Subcommittee expressed unanimous support for their views in its December 1967 Report on *Guidelines for Improving the International Monetary System—Round Two* (pp. 7–10).

The same "link" proposal was argued at length, and unanimously approved by a high-level body of international experts in their 1965 report to UNCTAD on *International Monetary Issues and the Developing Countries* (pp. 26–31).

OBJECTIONS AGAINST IT

The link proposal never found favor, however, with the officials in charge of the negotiation on international monetary reform, and was indeed strongly opposed and soon discarded by the so-called Group of Ten. Their objections were summarized as follows[2] on pp. 69 and 70 of the *Report of the Study Group on the Creation of Reserve Assets* (May 1965) chaired by Rinaldo Ossola:

"137. A suggestion has been made for coupling the creation of reserve assets with the provision of development finance under the direction of an international investment institution, say, the IBRD. It was argued in favor of the idea that it would partly overcome the disadvantage of a group approach by providing benefits for countries not participating in the system. In the form in which it has been put forward, this technique would apply to only a modest fraction of the total reserves to be created, and would probably supply only a small amount of the total resources of the IBRD. The scheme would entail the Fund's investing currencies from its members' quotas or from special resources in an instrument issued by the IBRD, which would subsequently distribute the currencies according to its policies. The beneficiaries, being assumed to be in need of finance, would not retain the currencies received from the IBRD, but would use them for purchases from industrialised countries, and additional assets would thus find their way into the reserves of countries which were in surplus. The system could be applied to any type of scheme other than those relating directly to balance of payments' financing.

---

[1] See, for instance, p. 2944 of the October 1959 *Hearings* of the Joint Economic Committee on *Employment, Growth and Price Levels* (Part 9A), pp. 178–179 and 360–361 of the 1965 *Hearings* of the Subcommittee on International Exchange and Payments on *Guidelines for International Monetary Reform*, p. 139 of the same Subcommittee's 1966 *Hearings* on *Contingency Planning for U.S. International Monetary Policy*, p. 137 of its 1967 *Hearings on New Plan for International Monetary Reform*, and p. 145 of its 1968 *Hearings* on *Next Steps in International Monetary Reform*.

[2] See also the *Report* of the Subcommittee on International Exchange and Payments entitled *Guidelines for Improving the International Monetary System* (Washington, 1965), pp. 11–12, and the discussion in *International Monetary Issues and the Developing Countries* (New York: United Nations, 1965), pp. 30–31.

"138. Most members believe that the provision of capital to developing countries is a problem quite distinct from the creation of reserves and should be achieved by other techniques. They saw disadvantage in an attempt to combine objectives of long-term development finance with the needs of flexibility required for monetary management. From the point of view of international monetary management, full flexibility of decision is called for as to whether assets should be created or not. From the point of view of development, on the other hand, planning both by donors and by recipients requires firm commitments over considerable periods. This would introduce an inflexibility into the monetary aspects of the scheme and thus impair the monetary quality of the asset. The difficulties might not be insuperable if, as was suggested in paragraph 137 above, the amount of reserve creation associated with development finance were kept at a modest fraction of the total creation of reserves. But it would be difficult to resist demands from developing countries, and internal pressures in the industrialized countries, to give aid in this form, which appears to avoid a cost in real resources. There would be a risk that, over time, more of the assets might be created than surplus countries would be willing to acquire. Most members also hold the view that the character of an asset depends to some extent on its quality in case of liquidation of the scheme or of withdrawal of members. In case of liquidation of the scheme, participants would receive long-term IBRD bonds, which might not meet the requirements of liquidity demanded by a central bank.[3] For these reasons, therefore, the idea of combining asset creation with development finance was not widely favored."

It is of course true that the size and timing of the needs for reserve creation are quite different from—and much smaller than—those for development financing. Reserve creation should be decided entirely upon its own merits, and should probably range initially around 4% a year on the average (i.e., about $3 billion, while development financing could probably absorb three to four times as much. Yet, this does *not* mean that development financing should be ruled out as one of the several purposes to which the lending potential inevitably derived from fiduciary reserve creation should be assigned.

The fear has been expressed that developing countries might, if such a system were adopted, exercise pressure for reserve creation in excess of monetary requirements, thus imparting an inflationary bias to the system. Such a danger, however, is already more than adequately guarded against through the present voting rules requiring an 85% majority of the total voting power for the allocation of Special Drawing Rights. Indeed the real danger is one of excessive conservatism rather than liberality in the activation of SDR's. Moreover, the combined GNP of the more developed countries is now running, for the OECD group alone, at an annual rate of about $1.7 trillion, and increasing at a rate of about $120 billion a year. The inflationary impact of the most ambitious allocation of SDR's ever contemplated so far would be practically negligible in comparison with these figures.

Secondly, apprehensions have also been expressed about the contrasting needs for firm, long-term, commitments in development planning and finance, on the one hand, and for flexibility in the creation of new reserve assets, on the other. Opposite conclusions are drawn from this observation by the Ossola Study Group (p. 70) and by the UNCTAD experts (p. 31). While the Ossola Group fears that monetary flexibility would be sacrified to developmental needs, the UNCTAD experts expect that the latter will have to take into account the unpredictability of reserve creation. All agree, however, that the obstacle is not insurmountable since "even today, neither the IBRD nor IDA has any long-term assurance of additional funds" (UNCTAD *Report*, p. 31) and since "the amount of reserve creation associated with development finance [could be] kept at a modest fraction of the total creation of reserves" (Ossola *Report*, p. 70.)

Thirdly, the more conservative members of the Ossola Group argued that the new reserve asset should be distributed only among countries which could be trusted not to remain persistently in deficit and would be able, therefore, to honor their obligation for repayment in operation or, ultimately, in liquidation. This view was opposed by other members and the arguments *pro* and *con* are particularly worth re-reading today in the light of the provisions later adopted in the drafting of the present SDR Agreement:

"120. In favor of keeping the ownership and circulation of the asset within a limited group of industrialized countries, it was argued that an international

[3] Several central banks, however, including the Bundesbank, have taken a different view on this matter, and acquired long-term IBRD bonds.

asset must be based on credit and that the credit of those who back it must therefore be unquestioned. There must be no room for doubt whether the asset will, in practice, be honored in operation or, ultimately, in liquidation. Deliberately-created new reserve assets must, of their nature, initially be distributed without the recipients' having had to forego real resources in order to earn them, but will thereafter command real resources. Care is therefore needed in establishing the group in which they are to be used. A reserve asset is characterized by the expectation that, if it flows out, it should ordinarily be reconstituted in due time. Assets which are specifically created to fulfill the reserve function should, consequently, be distributed only to countries whose balance of payments is likely to move between deficit and surplus and which are, therefore, able to assume the obligations as well as the rights entitled in the convention and its working. More generally, a system which meets the reserve needs of the larger nations will, in practice, benefit all countries.[4]

"121. The other view here, while recognizing the logic of some of the points made, considers that the limited arrangement would be exposed to disadvantages which would outweigh the advantages claimed for it. For a group of industrially-advanced countries to increase, by a stroke of the pen, as it were, their own monetary reserves and appear to make themselves thereby the richer, would invite criticism from other countries, who would declare that their own need for more elbow room in their international payments was, proportionately, no less than that of the members of the group. A number of the smaller countries could show that they have maintained a good reserve position and that their balance of payments' record compares favorably with that of countries within the group. It would be arbitrary to deny participation to such countries. In any limited membership, the difficulty of borderline cases is likely to arise. For this reason, those who hold this view favor an approach that is not strictly limited in the width of membership. They prefer an approach that embodies a self-qualifying element and would therefore be more open than a grouping that is strictly limited to a small number of countries. They point out that many countries throughout the world feel, or will feel, a need for growing reserves; yet countries excluded from the group would be able to increase their reserves only by surrendering real resources or attracting capital inflow. To exclude these countries would risk creating a sense of discrimination which would hamper monetary co-operation and understanding and which might well lead to demand for compensation in other ways. As a technical matter, the more limited the group the more likely it is that individual members of the group will accumulate an undue amount of the new asset; this would occur if such members, even when in payments' balance with the entire world, had a surplus with the group and a deficit with the rest of the world."

The basic objection raised in paragraph 120 above of the Ossola report has often been expressed—more naively, but plausibly—in terms of the liquidity criterion of sound banking practice. Short-term indebtedness—such as liquid reserve deposits with the IMF—must be backed by short-term claims. Reserve deposits with the IMF might become "frozen" if they were used for the financing of long-term investments. I commented as follows on this point in my initial proposal for a "link," some ten years ago:

"A primary consideration in determining the pattern of Fund investments would be the need to preserve the full liquidity of its members' deposits. It should be noted, however, that the Fund would be in a particularly strong position in this respect as the total amount of its required deposits . . . could hardly decline in practice, but would on the contrary grow year by year with the increase of world reserves. Any withdrawals of deposits by members whose reserves are declining would be more than matched by increases in the required deposits of members whose reserves are increasing."[5]

Professor Machlup made the same point, in a more striking and wittier fashion, by observing that the amounts, quality, composition and liquidity of a bank's assets are irrelevant for payments among customers of the same bank, and become relevant only for payments to customers of other banks. A commercial bank must retain sufficient liquidity to finance interback payments, a national reserve bank only to finance international payments, and an international reserve

[4] This last argument calls back to mind the remark of one of our former Secretaries of Defense: "What is good for General Motors is good for the country."
[5] *Gold and the Dollar Crisis*, p. 118.

bank only to finance interplanetary payments to persons, banks or reserve banks on the other planets.[6]

In any case, the framers of the SDR agreement can no longer be suspected of entertaining any taboo against long term investments of liquid deposits. Under Article XXV Section 6 and Schedule G of the proposed agreement, 70 percent of the SDR's used by a participating country need not be "reconstituted"—i.e. repaid at any fixed time—and may be tantamount to a straight gift—or at least "consol"—as long as the country continues in deficit and remains a member of the system. The "freezing" of IMF claims under this provision would be greater, if anything, than under the "link" proposal.

Let us observe, finally, that, far from constituting a revolutionary innovation in international monetary practice, the "link" would merely preserve an essential feature of the gold-exchange standard. The accumulation of sterling balances as reserves by foreign central banks traditionally helped Britain finance a larger amount of capital exports particularly to less developed countries—than it could have sustained otherwise. The same was true of the dollar balances accumulated, in the same way, by foreign central banks, and particularly by the surplus countries of continental Europe since the end of World War II. We would have been unable to finance as large an amount of foreign aid and capital exports if surplus countries had cashed their dollar reserves for gold. In essence, the willingness of foreign monetary authorities to accumulate large reserves in the form of sterling and dollar balances enhance the ability of London and New York to provide long-term financing for economic development, private and official, to the countries of the Third World.

The basic assumption underlying the creation of SDR's is that they will have to substitute gradually, but increasingly, in the future for reserve currencies, as well as gold, as a source of increase for world reserves. The constructive role previously played by reserve currencies in development financing should certainly not suffer as a consequence of this shift. What would be revolutionary, but in a retrogressive direction, would be to terminate a "link" which has always existed in the past between the creation of fiduciary reserves and development financing.

THE PRESENT PROPOSAL

The present SDR Agreement will, in principle, distribute SDR's among all participants *pro rata* of their Fund quotas.

Such a system of allocation is, to my mind, morally repugnant, economically wasteful and politically unviable.

It is morally repugnant to assign the lion's share of SDR's—about 72 percent—to the 25 richest and most capitalized countries in the world—including 36 percent to the United States and the United Kingdom alone—leaving only the remaining 28 percent to be parcelled out among 86 least developed and neediest members of the Fund.

It is also economically wasteful, since any automatic distribution of this sort would contravene the cardinal principle, so often affirmed in previous Group of Ten discussions and reports, that "the process of adjustment and the need for international liquidity are closely interrelated."[7] The improvement of the present adjustment mechanism should indeed be an essential objective of the proposed reforms, and the distribution of the credits that are the unavoidable counterpart of any accumulation of fiduciary reserves should be determined in that light rather by any automatic, and arbitrary, formula. Would you ever think of setting up a new bank which would be committed by its very charter to allot its credits automatically among all prospective customers in strict proportion to their height, or to their waistline, so as not have to bother the Management about deciding on the comparative usefulness of alternative uses of the bank's lending capacity?

Since, however, moral and economic considerations do not always determine governments' policies, a third consideration may be deemed more realistic and relevant. The proposed automatic allocation of SDR's will soon reveal itself as *politically unviable* in fact. Prospective lenders will oppose desirable SDR activation decisions whenever they feel that such activation would automatically

---

[6] Fritz Machlup, "The Cloakroom Rule of International Reserves: Reserve Creation and Resources Transfer," *The Quarterly Journal of Economics*, August 1965, p. 343.

[7] *Ministerial Statement of the Group of Ten and Annex Prepared by Deputies*, August 1964, p. 4. For further discussion and references, see also my book on *Our International Monetary System: Yesterday, Today and Tomorrow* (Random House, 1968), pp. 139 ff.

commit them to underwriting in advance national policies of prospective borrowers in which they have no voice and with which they may fundamentally disagree. This problem is all the more acute as the plan envisages that the initial activation decision will be made for five years at a time. A presumptive guideline of a 4 percent annual increase in current reserve levels would entail a tentative commitment of more than $15 billion, of which more than $5.5 billion would be earmarked for the United States and the United Kingdom alone. Would the prospective surplus countries be willing to sign a blank check of $5.5 billion available to finance U.S. and U.K. policies if they felt, at the time, that this would entail a transfer by them of $5.5 billion of real resources—of which 70%, or close to $4 billion might be closer to a gift than to a loan—likely to be used for a resumption of war escalation in Vietnam, or other military or social expenditures which their Governments or Parliaments might regard as highly questionable, or worse?

The present allocation proposal calls to mind a system which this country found totally repugnant on the eve of its birth. "Taxation without representation!"

INTERNATIONALLY AGREED SDR'S SHOULD SERVE INTERNATIONALLY AGREED PURPOSES

Such a system will be no more viable tomorrow than it proved to be two centuries ago. If SDR's are to be created by collective agreement, the uses to which they should be put must be also collectively agreed. And it should not be difficult to define such collectively agreed uses which are now begging for resources and to which SDR's could make a significant—even though only partial—contribution. One of these would be the recycling of speculative funds such as contemplated in the "General Arrangements to Borrow" of the IMF. Another would be to supplement, if necessary, the funds available to the IMF to finance its traditional monetary stabilization assistance to members. A third would be to provide some of the resources that might be needed to implement international efforts to stabilize the prices of primary products, as envisaged in the second resolution *unanimously* adopted at Rio, together with the SDR Outline. A fourth would be to invest in the obligations of IBRD, IDA and other international or regional development institutions, or to enhance the capacity of major financial markets to finance overseas development. A fifth purpose, now that the principle of "non-reconstitution" has been accepted and embodied in the present Draft Agreement, could even be the support of United Nations peace-keeping and other agreed objectives.

A PRACTICAL FIRST STEP

The preservation of the "link" which the present SDR amendment would destroy will require, at an early stage, a renegotiation that will—if precedents are a guide—require many months, or years, to complete.

The U.S. Congress could initiate such a renegotiation by reviving, and broadening, the third recommendation unanimously approved by this Subcommittee on December 6, 1967.[8] The United States Executive Director in the IMF should call for studies and negotiations aiming at rechanelling toward the financing of internationally agreed objectives, such as those mentioned above, some or all of the SDR lending potential now automatically and blindly earmarked for the support of all and every national policies, no matter how economically maladjusting and politically distasteful to other IMF members.

In the meantime, and pending the outcome of such a re-negotiation, all countries, or at least the richest and most developed countries, should be urged to express their intention—or better their commitment—to make supplementary contributions, in their own or in other currencies, to the IDA or other similar institutions, equal to any amounts of SDR's allotted to them under the present Draft Agreement.

The United States should take the lead in issuing such a declaration, either unilaterally, or together with a number of other countries such as those now associated in the Group of Ten.

COMPLEMENTARY REFORMS

This is not the place to rehash other recommendations already endorsed by your Subcommittee. They should, however, be kept in mind and could usefully be reviewed and grouped together in a comprehensive and evolutionary program of international monetary reform. Let me merely list those which appear most crucial to me, with a few comments where necessary:

[8] *Guidelines for Improving the International Monetary System—Round Two,* pp. 7–10.

1. The present pre-requisite for activation is thoroughly absurd and should be replaced by a "Conversion Account" Agreement, merging recommendations 2 and 3 of the September 19, 1968 *Report* of this Subcommittee (pp. 4–6).[9]

2. Recommendation 4 of the same *Report* (pp. 6–7) should be amended along the lines suggested on pp. 488–491 of my article in the April 1969 issue of *Foreign Affairs:* "The Thrust of History in International Monetary Reform." (Particularly the "fork" proposal briefly summarized in the third paragraph of p. 490.)

3. Recommendation 4 of your December 1967 *Report* (p. 10) regarding the "marshaling of SDR's on a regional basis." [10]

4. Recommendation 1(c) of the same *Report* (p. 5), supplemented to the comments on pp. 2 and 3 of your September 19, 1968 *Report*, regarding the financing and correction of U.S. balance-of-payments deficits.

5. With proper revisions and up-dating, some of the other recommendations and comments of previous Reports of your Subcommittee which have not yet been acted upon and remain as relevant—or more—today as when they were initially issued.

CONCLUSION

I hope to have covered some of the main issues scheduled for today's hearings.

As far as the second half of your second question is concerned, I have made it clear that I would make "the link . . . an integral part of the mechanism through which SDR's are distributed." The voluntary scheme suggested by Mr. Karlik might possibly help balance the conservative bias which the present voting rules might impart to the decisions concerning the amount of SDR's to be activated. I am not fully confident that it would do so, as prospective lenders intent on minimizing their own transfer of resources would regard his proposal as likely to accelerate the actual use made of their contingent lending commitment. Moreover, the proposal remains far short of what I would, for the reasons developed above, regard as necessary to strengthen the adjustment process and preserve the traditional link between the creation of fiduciary reserves and development financing. Yet, I would not presume to prejudge the quirks of a difficult negotiating process, and would not be ready to discard lightly what might indeed prove a negotiable "second-best."

With regard to your third and fifth questions, it is clear that any proposal to determine the overall creation of SDR's in the light of developmental needs rather than monetary criteria would be a kiss-of-death for the negotiation suggested above. This is not to say, however, that the developing countries would not benefit from such a negotiation. The same amount of global SDR creation would transfer a larger amount of real resources to them in the form of development assistance rather than in the form of bullets, bombs, napalm and other military contributions to their freedom and security(!)

Finally, I feel that any answer to your fourth question would impose an arbitrary straitjacket on alternative uses of the SDR lending potential. I would apportion *all* of the newly created reserves among internationally agreed purposes and in internationally agreed proportions, reflecting the order of priorities entertained at any given time by the members of the Fund. No lone academic should presume to predict the outcome of this continuing negotiating and managing process, even though we shall all continue to participate in the debate and to express individual views which may, or may not, influence the decisons of the officials in charge.

Ten years of intense involvement in the marathon debate on international monetary reform have taught me to be despairingly modest about the short-term impact of unwelcome academic advice on the minds and actions of the officials in charge, but also to be cheerfully sanguine about its longer-run impact upon the same officials—or their successors.

(The following article was submitted by Professor Triffin to supplement his prepared statement:)

[9] See also my previous comments on pp. 142–147 of your September 9, 1968, *Hearing*, and—in Appendix to this paper—a revision and updating of pp. 146–147, facilitating a quick comparison of the relative impact of a worldwide Conversion Account and of a Conversion Account limited to the eight countries of the defunct Gold Pool.

[10] See also my testimony in your *Hearings* of November 22, 1967, pp. 128–157, particularly the penultimate paragraph of p. 132, and the Section headed "III. Pooling" on pp. 138–139.

THE THRUST OF HISTORY IN INTERNATIONAL MONETARY REFORM

By Robert Triffin

IS our international monetary system heading toward a sudden collapse as in 1931, or toward the fundamental reforms needed to cure its most glaring and universally recognized shortcomings? Or will it continue to drift precariously from crisis to crisis, each one dealt with by belated rescue operations and the spread of restrictions and currency devaluations? Judging from past history, official statements and even intentions are unlikely to provide reliable answers to these questions, for they are more often designed to reassure than to enlighten. The Governor of the Bank of England, Sir Leslie O'Brien, candidly confessed to a Cambridge audience last spring: "I am rapidly qualifying as an instructor on how to exude confidence without positively lying." Another reason is that major changes in the international monetary system have rarely been the result of conscious planning. They have most often been the by-products of broad historical forces or accidents, defying contemporary forecasts and official intentions.

Official negotiations on international monetary reform were launched, five and a half years ago, with a confident agreement "that the underlying structure of the present monetary system—based on fixed exchange rates and the established price of gold—has proven its value as the foundation for present and future arrangements." (Statement issued on October 2, 1963, by the Secretary of the Treasury of the United States on Behalf of the "Group of Ten" Members of the Fund.)

The snail's pace of these negotiations, however, and the recurrent and snowballing gold and foreign-exchange crises of recent years have spread mounting doubts regarding these two pillars of the gold-exchange standard. The disbanding of the famed Gold Pool and the introduction of the so-called two-tier gold market in March 1968 were not the planned and deliberate outcome of the negotiations in process, but rather the defeat of fourteen years of efforts to preserve the $35 price in the private as well as in the official market. The optimists—like myself—still hope against hope that these decisions will prove the first, and constructive, steps toward a gradual elimination of gold as the

ultimate and obviously absurd regulator of reserve creation and destruction. The speculators still choose to view it, however, as the harbinger of a further defeat of official policies and of an eventual and substantial increase in official, as well as private, gold prices. Few, if any, observers give much credence to the third interpretation professedly favored by the officials—namely, that the two-tier gold market is a lasting step toward the consolidation of the $35-an-ounce gold-exchange standard of yesteryear.

The second pillar of the Group of Ten policies, *i.e.* the fixity of exchange rates, is equally assailed today, not only by academics, but even by Congressional leaders and responsible officials, here and abroad. Various forms of exchange-rate flexibility[1] are seriously discussed and advocated as the only realistic cure for the recurrent foreign-exchange crises involving the major currencies of the Western world, and particularly for the persistent deficits of the United Kingdom and the United States, which both countries have repeatedly promised but failed to correct.

In brief, official intentions and pronouncements appear in retrospect a most unreliable guide to the recent evolution of the international monetary system, and are therefore widely mistrusted as a basis for confidence in its future stability. Far better clues and safer predictions can be derived, in my opinion, from analysis of a broader historical perspective and the persistent trends which emerge so clearly from it concerning the direction of changes in our national and international monetary institutions.

II

The first lesson that history teaches us is that these institutions have always been carried forward by an irrepressible evolutionary process, the strength of which was repeatedly misunderstood, underestimated or even totally overlooked by contemporary observers, academic as well as official. Even today, many people evoke with nostalgia the nineteenth-century gold standard, and

[1] The so-called "band proposal" would enlarge the margin between official buying and selling rates, leaving market rates free to fluctuate around a stable middle rate, or par-value. The "crawling peg" proposal would allow the par-value of a currency to depreciate or appreciate, in accordance with market forces, but by no more than 2 or 3 percent per year. The "crawling band" proponents would merge these two proposals, by allowing an enlarged band around a "crawling" par-value. Others would retain the facade of stable rates, but favor special tax and subsidy provisions tantamount to exchange-rate flexibility for merchandise imports and exports.

remain blissfully unaware of the fact that silver far outpaced gold in importance until the latter half or third of that century, and that paper money—currency and bank deposits—had largely superseded both gold and silver moneys well before the outbreak of the First World War.[2] Whatever stability can be ascribed to the monetary system of those days should not be credited to its automatic regulation by haphazard gold and/or silver supplies, but to the gradual euthanasia of these two "commodity-moneys" and their increasing replacement by man-made "credit-moneys." (Indeed, the near-monopoly of gold and silver money throughout the previous centuries had been accompanied by a gradual and uneven debasement of the coinage, reducing the pound sterling and the franc, for instance, to roughly one-fourth and one-tenth, respectively, of their thirteenth-century gold content.)

A second lesson derives from the first. In every national monetary system the world over, the broad direction of this evolutionary process has been from commodity-money to credit-money. At first the creation of this credit-money was left to the discretion and wisdom of multiple banking firms, but later it was gradually brought under the centralized supervision of national monetary authorities (treasuries and central banks).

As distinct from the former commodity-moneys, however, the new national credit-moneys commanded general acceptability only within the national borders of each country; they were not accepted, or at least retained, in payment by the residents of other countries. The settlement of international transactions required, therefore, the exchangeability of national currencies. This responsibility was gradually concentrated in the national central banks and, to settle net imbalances in international transactions, it was necessary for each of them to accumulate *international reserves* acceptable to other central banks.

The evolution of these international reserves parallels closely, although with a considerable lag, that of the national monetary systems. Commodity-reserves are being gradually displaced by credit-reserves in the international monetary system, just as commodity-moneys were previously superseded by credit-money in the national monetary systems. A parallel evolution can be noted with respect to centralization of responsibility. Commodity reserves—in the form of gold—accounted for about 91 per-

[2] In 1913 currency and deposits already accounted for about 85 percent of world money stocks, gold for only 10 percent and silver for 5 percent.

30-668 O—69——4

cent of world monetary reserves on the eve of the Second World War, but for only 53 percent as of last September. Decentralized credit-reserves—in the form of foreign exchange, *i.e.* overwhelmingly dollars and pounds sterling—rose over the same period from 9 to 38 percent of world reserves, and centralized credit-reserves—in the form of claims on the International Monetary Fund—from 0 to 9 percent.

These trends have accelerated considerably in recent years, and particularly in 1968. In the first nine months of that year, reserves in the International Monetary Fund (IMF) rose spectacularly by $850 million, while the foreign-exchange component of world reserves dropped by $275 million, and their gold component by $840 million.

This gradual shift from uncontrolled commodity-moneys and reserves to man-made credit-moneys and reserves, and later on to a conscious orientation toward the latter by national governments and international institutions, is likely to provide the best clue to future trends. This is the more true as such a shift can be viewed in a broader perspective of the evolutionary process: the persistent endeavors of man to control his physical environment rather than be controlled by it. One may hardly accept the view that these efforts could, or should, be frustrated forever as far as the international monetary system is concerned, and that reserve creation should be abandoned indefinitely to the irrelevant factors that determine it today: the hazards of gold production, industrial consumption, hoarding and speculation, and/or the international financing of unpredictable U.S. and U.K. deficits through the incorporation of their resulting dollar and sterling IOUs in the monetary reserves of the rest of the world.

III

Short-run predictions, however, remain far more hazardous than long-run predictions, for the orderly progress of this evolution is dependent on the adaptability of the institutional and legal framework within which it takes place. Conscious governmental and international action is needed at times to smooth its path, but may also make it far bumpier through misguided action or—as happens far more frequently—through excessive inertia and stubborn resistance to needed reforms.

The repeated financial crises that preceded, but finally impelled, the creation of the Federal Reserve System in the United

States can be ascribed to the political resistance to centralized monetary management in this country. On the whole, however, the irrepressible evolution of *national* monetary systems from commodity-money to centralized credit-money encountered fewer legal and institutional obstacles than did the later and similar evolution of the *international* monetary system. The centralized supervision of national credit-money systems was part of the increasing role and powers assumed by national states in the direction of their economies. International agreements among theoretically sovereign states about the composition and management of international reserves were, and still are, far more difficult to achieve.

Numerous international conferences failed, over the last century, to elicit any such agreement. The actual composition of reserve assets shifted radically over this century from bimetalism to gold and later to the uneasy coexistence of gold, reserve-currencies (dollars and sterling) and claims on the IMF. None of these changes—except for the creation of the IMF itself—was ever initiated by deliberate government planning. They were mostly the combined by-products of the absence of agreement and of the relative availability and attractiveness of alternative reserve assets.

The failure to reach international agreement as to what should constitute an internationally acceptable reserve asset at first ensured the survival of traditional commodity-moneys, even after they had lost this role within the national monetary systems themselves. The elimination of silver in favor of gold alone was belatedly ratified—rather than initiated—by the governments. The initial step in this direction can be traced back to the totally inadvertent slip of Great Britain into a de facto gold standard, as a consequence of the 1696 recoinage of outworn silver coins. Gresham's law that "bad money drives out good" was not enacted by the British Parliament, but explains why the new, full-bodied silver coins minted by a government intent on preserving the traditional silver standard quickly disappeared from circulation, as their increased silver content gave them a somewhat higher value on the commodity markets than the *legal* conversion ratio between silver and gold at the Royal Mint.

The other, and even more radical, shift from the gold standard to the gold-exchange standard, in the 1920s, was also a de facto reaction to the unplanned impact of the war upon the monetary

and reserve systems of those days. Wartime operations and postwar reconstruction had been financed in large part by monetary inflation. This had drastically curtailed the ratio of monetary gold stocks to the vastly expanded volume of national paper moneys, and created a "gold shortage" which became the subject of endless debates at gatherings of international experts and central bank meetings in Brussels (1920), Genoa (1922) and the Gold Delegation of the League of Nations (1929–1932). A broad consensus emerged at these meetings to recommend the expanded use of the "gold-convertible" currencies of major financial centers as a supplement to scarce gold. This solution was particularly favored and propagandized by British experts who rightly expected to see sterling—the most prestigious currency of the largest and oldest trading and financial center of the world—play the major role; it would enable the United Kingdom to finance its deficits and/or strengthen its slender gold reserves through the acceptance of its own paper IOUs as international reserves by other central banks. Both expectations proved correct but involved a quasi-automatic financing by other countries of Britain's return to an overvalued rate for sterling and of the balance-of-payments deficits that ensued.

While none of the conferences produced any firm agreements and commitments in this respect, the major "gold-convertible" currencies—particularly sterling, first, and later the dollar—gained increasing acceptance as monetary reserves. Since reserve holders remained free to switch, at any time, from one currency into another, or into gold, a dangerous instability was built into the system.

The Gold Delegation was still debating the ways and means that would prevent an abuse of the system by the reserve centers and protect it against destabilizing switches by their creditors when these very defects prompted the collapse of the pound sterling in September 1931. For a while, this sounded the death knell of the gold-exchange standard, a generalized rush into gold reserves, and a protracted period of beggar-my-neighbor devaluations and trade and exchange controls.

During and after the Second World War, the gold-exchange standard was revived, on the same precarious basis, bringing back the same abuses and sources of instability that killed it in 1931. The financing of World War II and of postwar reconstruction entailed, as in the case of World War I, a new bout of infla-

tion, curtailing once more the ratio of gold reserves to the increased volume of national paper moneys. The latter continued to rise with the unprecedentedly high rates of economic growth sustained in later years. The resulting "gold shortage" was again made up by huge acquisitions of sterling and dollar balances legally convertible at any time into gold. The day would inevitably come—as I pointed out as early as 1957—when a "liquidity shortage" would arise, either as a result of such conversions of overflowing dollar and sterling balances into scarce gold metal, or because the United States and the United Kingdom would seek—and succeed—to protect themselves against such a danger by eliminating the balance-of-payments deficits which now fed most of the increases in world monetary reserves. This gloomy prognosis was scornfully dismissed at first by overcomplacent officials, but was later accepted by them, prompting in 1963 the opening of another marathon debate on the need for international monetary reform.

One may still hope, however, that the outcome will be less disastrous than it was in 1931. First of all, the world economy is in far better shape today than it was then, and the overall economic and financial position of the United States is far stronger than that of Britain in 1931. Even more important, the world's monetary and financial leaders are now keenly aware of the disastrous consequences which any repetition of the 1931 policies, or lack of policies, would entail for the international monetary, economic and even political fabric of the West. They have developed, indeed, particularly since the first flare-up of gold prices in London in October 1960, an unprecedented degree of international coöperation and an uncanny ability to cope with recurrent crises one after another. They have also acquired an understanding of the basic problems and a sense of joint responsibility for their solution far greater than ever existed in the past.

IV

Thus, history need *not* repeat itself. Our hope that it will not springs primarily from the unprecedented insight now gained by responsible officials regarding the functioning of our international monetary system and the consensus already reached by them regarding the shortcomings that must be remedied by the three major reforms now under negotiation:

1. The creation of international reserves should be deliberately

oriented toward satisfying the requirements of feasible growth in world trade and production.

2. The resulting reserve pool should be protected against destabilizing switches between reserve assets, and primarily between reserve currencies and gold.

3. These reforms in the overall amount and composition of the world reserve pool must be accompanied by a strengthening of the adjustment mechanism, facilitating the financing of temporary, reversible disequilibria, but also ensuring more prompt correction of persistent disequilibria, rather than their perpetuation either by inflationary financing or by trade and exchange controls.

This consensus should, and some day undoubtedly will, lead to agreement on the kind of reform suggested by past historical trends—*i.e.* the development of a truly international credit-reserves standard aiming at the simultaneous fulfillment of all three of these objectives.

Indeed the cornerstone of such a reform has already been laid by the unanimous Rio resolution on the creation of a new reserve instrument (the so-called Special Drawing Rights, or SDRs) to be issued by the IMF in the amounts deemed necessary by the international community itself to meet future reserve needs. This was undoubtedly the hardest hurdle that the negotiators had to surmount, and contrasted sharply with their earlier myopic denunciation of such a proposal as a dangerous and utopian dream—unattainable "today and for any foreseeable future,"—to set up a "super-bank" with "no supporting super-government to make good on its debts or claims."[3]

The Rio negotiators showed rare vision and courage in setting up this central piece of the international monetary machinery of the future, but unfortunately left for later determination the role to be played by the traditional components of the gold-exchange standard (*i.e.* gold and the reserve currencies). The sterling, dollar and gold crises that were soon to dampen the high hopes evoked by the Rio agreement arose from the inability of the negotiators to tackle with the same vision and courage the more urgent problems raised by the coexistence of overflowing dollar and sterling reserves with the dwindling gold stocks into

[3] The quotation is from Robert V. Roosa, "Assuring the Free World's Liquidity," *Business Review*, Federal Reserve Bank of Philadelphia, September 1962, reproduced in "The Dollar and World Liquidity," New York: Random House, 1967, p. 102.

which they were legally convertible under the rules of the ill-fated gold-exchange standard.

The basic conflict that has so far prevented full agreement on this issue reflects an unrealistic assessment by the reserve-currency debtors and creditors alike of their true national interests. The reserve-currency debtors—primarily the United States and the United Kingdom—welcome the new reserve asset as a supplement, or even an ultimate substitute, for scarce gold, but are understandably reluctant to renounce the privilege of financing a substantial portion of their deficits through other countries' accumulation of their IOUs as international reserves. The reserve-currency holders of continental Europe, on the other hand, still see in gold settlements their ultimate protection against the inflationary potential and surrender of national sovereignty entailed in the accumulation of dollar and sterling IOUs financing U.S. and U.K. policies in which they have no voice and which they may, at times, consider directly contrary to their own interests or those of the world community. This conflict has been exacerbated in recent years by the size and persistence of British and American deficits and the fact that they could be ascribed, at least in part, to the laxity of monetary and fiscal policies—particularly in the United Kingdom. It has been further aggravated by the inflationary pressures triggered in the United States by the escalation of the Viet Nam war, and to what some Europeans regard as an excessive take-over of European enterprises by American capital.

V

Paradoxically, the main hopes for a negotiated agreement spring from the very sharpness of this conflict and from the consequent realization in both camps that neither gold nor reserve-currencies can in fact expand, or even retain, their previous role in monetary settlements.

This conclusion is being forced upon the United Kingdom and the United States by the resistance of other countries to the acquisition and retention of traditional sterling and dollar balances as growing components of their monetary reserves. These traditional "liquid" holdings of sterling and dollar IOUs by foreign central banks rose spectacularly from about $2 billion in 1937 to a peak of nearly $20 billion in 1963, but have declined even more spectacularly since then to about $13 billion in Sep-

tember of last year. Thus, the traditional reserve-currency role of sterling and dollar balances no longer assures Britain and the United States special facilities for the financing of their current deficits. It exposes them, on the contrary, to the enormous and unbearable risk of sudden or massive repayment of the enormous short-term indebtedness accumulated by them over many years past.

The creditor countries, however, also realize that insistence on gold repayment would inevitably bring about another 1931, as neither the United Kingdom nor even the United States could actually stand such a drain on its gold reserves. The total amount of these ($12 billion as of last September) is considerably short of their gold-convertible obligations to central banks and the International Monetary Fund ($28 billion).

Both groups of countries have thus been impelled by their own self-interest to negotiate new agreements based on the realities of the situation rather than on their previous hopes and expectations. The acquisition and retention of sterling and dollar assets by the major reserve holders of Western Europe, and even by the sterling-area countries, have become increasingly dependent upon such negotiated agreements. Gold or exchange guarantees against devaluation risks were grudgingly granted by the United Kingdom and the United States in order to deter their creditors from speculative switches of their reserve assets from sterling into dollars, or from both into gold. The creditor countries, on the other hand, agreed to retain a specific portion of their total reserves in sterling, and to convert part of their "liquid" dollar claims into longer-term obligations.

Taken together, these various agreements, negotiated since 1963, now cover well over $11 billion of the combined dollar and sterling reserves ($24 billion) of foreign reserve holders. A further $3.3 billion of reserve credits have been extended to the United Kingdom and the United States through the mediation of the International Monetary Fund. Finally, a vast array of reciprocal credit lines—in the form of so-called "swap" or "reciprocal currency" agreements—have been negotiated among major central banks to protect them against speculative attacks on any one of their currencies.

All these negotiations and arrangements testify to the death of the traditional "gold-exchange standard" and to a de facto gradual shift toward what might be called a "negotiated credit-

reserves standard." The official negotiators should be congratulated for having been able to avoid, in this way, a total collapse of the international monetary order. The new system, however, remains highly precarious, for it depends on continuous negotiation and re-negotiation of the short- or medium-term credit lines on which it rests. Some of the countries called upon to provide such financing also feel that it fails to provide adequate protection against the abuse of such facilities, primarily by the United States. They cling tenaciously to their legal right to gold conversion as their ultimate protection against such abuses and the total surrender of monetary sovereignty which might be imposed upon them if they were incorporated into a formal or informal "dollar area." The continuation of recent trends in that direction would be bound, sooner or later, to trigger a major breakdown, political as well as economic and financial, among the countries of the Atlantic Community. Responsible circles in the United States are keenly conscious of this danger, as is evidenced in the unanimous report of the Congressional Subcommittee on International Exchange and Payments last September.

Gold, however, is incapable of providing a reasonable alternative to a "dollar-area" system of international reserves and settlements. The $3.7 billion losses experienced by the Gold Pool countries over a short period of six months (October 1967–March 1968) forced the liquidation of the pool and the hurried adoption of a precarious and ambiguously phrased agreement among its members—with the exception of France—that would, if faithfully and generally observed in the spirit as well as in the letter, freeze forever both the official gold price and the world monetary gold stock at their levels of March 18, 1968, irrespective of future developments in the private gold market.

This is most unlikely indeed to provide a long-term solution to the gold problem, as central banks can hardly be expected to remain forever indifferent to market developments regarding the price of a commodity in which they have invested close to $40 billion and which is still regarded by public opinion in many countries—no matter how erroneously—as the ultimate guarantee of their mounting issues of paper money.

If gold were the only alternative to a dollar-area system, governments would sooner or later have to resign themselves either to a fluctuating gold price, or to a substantial increase in its pres-

ent price. In all probability, this would set the clock back to 1931, and postpone for many years to come the evolution toward rational reforms of the anachronistic and haphazard gold-exchange standard of yesteryear.[4]

VI

The way out of the present impasse lies in a comprehensive reform plan, inspired by the long-term historical evolution of the international monetary system. It should encompass all major aspects of the problem and thereby give adequate recognition to the convergent interests and feasible policy objectives of all countries concerned.

It was eighteen months ago that unanimous agreement was reached at Rio de Janeiro on the keystone of such a reform: the deliberate creation of centralized reserve assets in the form of internationally guaranteed claims on the IMF, usable and acceptable by all countries in all balance-of-payments settlements. A keystone, however, is not an edifice. The reform cannot stop with the mere superimposition of the new reserve asset upon the traditional ones. It must encompass the role of all three types of reserve assets—gold and reserve currencies as well as SDRs—in the orderly growth of world reserves and the improvement of the adjustment mechanism. The new reserve asset should be created by international agreement, in the amounts needed to substitute for—rather than merely add to—dwindling gold supplies and overflowing reserve currencies, and to adjust overall reserve growth to the requirements of an expanding world economy rather than to the vagaries of the gold market and of U.S. and U.K. balance of payments.

Surplus countries should accept such assets in settlement, retain them as reserves and be able to use them at any time to settle later deficits in their own international payments. They would remain free, of course, to slow down—or even reverse—their reserve accumulation by taking action to reduce their surpluses through trade or exchange liberalization, more expansionist monetary and fiscal policies, and/or larger outflows of capital.

[4] Contrary to Mr. Rueff's expectations, a straight devaluation might, as it did after the dollar devaluation of 1934, give a new breath of life to the dying gold-exchange standard, while a fluctuating dollar price of gold might impel most other countries to accept, at least temporarily, a dollar-area status rather than face the competitive handicap that would result for their industries from an appreciation of their currency in terms of the dollar and of the other currencies that kept stability with it.

They should not be entitled, however, to force deflation, devaluation or restrictions upon the rest of the world by insisting on gold payments in excess of available supplies. Nor should they be allowed to arrogate to themselves the right to accumulate international reserves in any national currency they choose and then to switch at any time from one currency to another. All countries should agree to deny each other a right which exposes them to political blackmail by the reserve debtors as well as by the reserve holders. Surpluses should be accumulated exclusively—except for working balances—in the new IMF reserve asset.

Such a commitment by the surplus countries would endow the IMF with the lending potential needed to finance the deficits which are the counterparts of the other countries' surpluses. The overall volume of such financing, however, would be limited by rules restricting the IMF's creation of reserves to the amounts needed to sustain feasible, but non-inflationary, growth of the world economy. A presumptive guide-line of 4 to 5 percent per year would probably rally widespread agreement in this respect, but exceptions should be authorized, by qualified majority vote, to combat actual worldwide inflationary or deflationary pressures.

The use and allocation of this lending potential should be a matter for international decision, based on a collective judgment regarding the nature of the deficits. Temporary, reversible deficits, such as those triggered by speculative shifts of private funds among major financial centers, should be met by compensatory shifts of IMF investments from the countries in surplus to the countries in deficit. Persistent deficits calling for correction should be financed only as part and parcel of an agreed stabilization program, designed to eliminate them with a minimum of hardship to the deficit countries themselves as well as to their partners in world trade and finance. External deficits accompanied by internal inflationary pressures are a sign of "overspending," which should be corrected by changes in fiscal and monetary policies designed to equate expenditures with the country's productive capacity. On the other hand, the coincidence of deficits with deflationary pressures and unemployment would suggest that the root cause of the trouble lies in uncompetitive levels of prices and costs, for which a readjustment of exchange rates will often prove the most appropriate remedy.

If the deficit country feels unable to agree with its IMF part-

ners on the action to be taken, it will, of course, retain its "sovereign" right to conduct its own affairs as it wishes, but not to obtain financing from other "sovereign" countries which disagree with its policies. The gradual depletion of its monetary reserves will willy-nilly force an adjustment of its exchange rate, though trade and exchange restrictions may postpone the day, if they are not made ineffective by other countries' retaliatory action.

More and more people now advocate a shift from stable to flexible exchange rates—whether or not they are limited to an agreed "band" or rate of "crawl"—as a way to strengthen the adjustment process in a nationalistic world. This would be an attractive solution for the disequilibria ascribable to international cost-price disparities, but might tend to foster unnecessary instability and actual distortions of exchange rates in the other two cases of deficits which call instead for financing or for changes in monetary and fiscal policies.

The reforms outlined so far would, moreover, remedy only imperfectly the so-called "deflationary bias" of the international monetary system. They would force the surplus countries to finance, but not to eliminate, disequilibria caused by deflationary errors in their own policies or to an undervalued exchange rate. Ideally, an excessive rate of reserve accumulation, even in the form of claims on the IMF, should force them to enter into policy consultations with the IMF, just as an excessive rate of reserve losses already imposes such consultations upon the deficit countries. In the absence of agreement, they should be enjoined from preventing an appreciation of their exchange rate through further market interventions and excessive reserve accumulation.

Merely to allow exchange-rate flexibility would be insufficient for this purpose, as was amply demonstrated by the outcome of the Bonn conference called last November to deal with the difficulties created for other countries by the obdurate surpluses of Germany and the rush of speculative capital into German marks. The United States, Britain, France and presumably other countries felt strongly that the best solution to the problem was a revaluation of the German mark, but even their combined pressure failed to persuade the German leaders to accept such advice. One may sympathize with the German view that the over-competitiveness of the mark is the result of the inflationary policies of other countries rather than of any deflationary policies in Germany. Yet, after such a situation has been allowed to develop,

price or exchange-rate adaptations by Germany itself may prove far more feasible and less damaging to all concerned than alternative deflationary action or devaluation by many other countries.

VII

Agreement on all aspects of such ambitious reforms will obviously take time and will have to deal with a number of transitional problems, particularly regarding gold and the bloated reserve-currency balances inherited from the past. Both problems could be met through the creation of an International Conversion Account that would convert into reserve deposits or certificates, identical to the SDRs, all reserve-currency balances in excess of those actually needed for daily interventions in the exchange market. The Account would also issue such deposits or certificates in exchange for the gold it needed to intervene in the gold market, as its members jointly saw fit, in order to regain control over a market now abandoned to speculators by the two-tier decision of March 1968.

This proposal is no longer deemed as utopian and unnegotiable as it appeared to many when I first formulated it a few years ago. The abortive Maudling plan of 1962, but particularly the comprehensive sterling agreements of last September, demonstrate Britain's receptiveness to such a solution of the sterling problem. In the United States, its main features were unanimously endorsed last September by the Congressional Subcommittee on International Exchange and Payments. Concrete proposals for such a "Conversion Account" were also developed by Finance Minister Colombo of Italy, and forcefully advocated by him at the last annual meeting of the IMF as an essential complement to the SDR agreement. Finally, President de Gaulle himself should logically welcome a plan that meets the two basic objectives repeatedly emphasized in all his speeches: the elimination of the "exorbitant privilege" of the reserve-currency countries to pay their deficits with their own IOUs, and "the organization of international credit . . . on an indisputable monetary basis bearing the mark of no particular country."

De Gaulle, of course, proposes that the basis be gold, while most of my academic colleagues and Congressional friends would, on the contrary, accelerate the "demonetization" of gold by converting all national gold reserves overnight into Conversion Ac-

count deposits or certificates. I would myself favor such a solution, but do not feel that it will be negotiable until familiarity and experience with the new system have demonstrated its practicability and developed sufficient trust in the wisdom and fairness of its management.

Such an abrupt transformation of ingrained institutions and habits of mind is, in any case, unnecessary. My own proposals would recognize the essential—but no longer determinant—role which national gold holdings will inevitably retain in our international monetary system for some years to come. All that is needed, and negotiable, at this stage is to agree on those initial steps which are indispensable to meet present-day problems and to reopen the door to the evolutionary process that will gradually improve man's control over this crucial basis of his economic life in an increasingly interdependent world.

Chairman REUSS. Gentlemen, despite the sharp disagreement on the sense-making quality of the link, we are all agreed, are we not, that it would be a fine thing if the New Delhi commitment of the developed countries to the underdeveloped world of transfers equivalent to 1 percent of GNP per annum of the industrialized nations were made good.

Mr. JOHNSON. Mr. Chairman, I would just like to add to that, that I would like to see the 1 percent commitment not only made good, but I would like to see it measured in real resources and not in a miscellaneous collection of financial transactions. It seems to me nonsense to call private foreign investment in underdeveloped countries aid, because the investors obviously hope to make a better profit than they could elsewhere, and that is a purely commercial transaction and should not be counted as assistance.

I would like to see it counted in terms of the real resource transfer net of repayments and net of private profits and so forth.

Chairman REUSS. So there is agreement and indeed the principal attacker of the link turns out to be one of the most generous of the panelists in terms of the need to help the developing countries.

Moving on then, and perhaps addressing this to the whole panel, if nothing were done about the link, if it died here this morning and was never heard of again, but if the special drawing rights proposal is ratified by the requisite number of IMF members, activated in a nice substantial way, and if the Parliaments and Governments of the developed countries do the right thing and annually vote a steady flow of foreign aid, preferably through international agencies like IDA and the World Bank and totaling one percent of GNP for each country—if all those things happen—then we have a pretty good world and no need for further discussion of the link, is that not so? I think it is so. That seems to satisfy our goal.

There seems to be agreement with this other very bland proposition. Now let us get to where we disagree. What if anything does the link do that would not be accomplished under the desirable situation I have just described? If the answer is nothing, then what political or other advantages are there in the link?

I remind us all of the fact that this heaven-on-earth situation I have just described does not depict reality, and that all the industrial nations are badly defaulting on the amount of aid that is made available to the developing countries. So I guess this third question is addressed largely to the proponents of the link, notably Mr. Dell, Mr. Prebisch, and Mr. Triffin. What do you gain by the link over the situation where each of the developed countries finds its soul and does what it promised to do at New Delhi?

Mr. DELL. Mr. Chairman, I fully agree that if the developed countries were prepared to transfer 1 percent of GNP through the normal processes of aid-giving, we certainly would not now be discussing the possibility of a link, and I think that the advantages of the link lie in the fact that governments have found difficulties of one kind and another in meeting this obligation. The difficulties that they have cited include the loss of reserves which may occur as a result of the provision of aid on an untied basis. At the same time, certain countries that cannot claim balance-of-payments difficulties do claim budgetary difficulties.

I also fully agree with Professor Johnson when he says that countries are unlikely to adopt the link unless they are prepared to increase aid. There is no sleight-of-hand here. There is no magic about the link.

When Parliaments consider this matter, I am sure they will be fully aware of all that the link involves in the way of transfer of real resources, and yet it does seem to me that from the standpoint of the balance-of-payments aspect, and from the standpoint of the budget, the link does offer certain advantages to governments which they may be prepared to consider seriously, and I think that that is the real reason why one wants to pursue this possible method.

If I may, Mr. Chairman, I would like to address myself to one or two of the other points that were made against the link. Professor Johnson said that new reserve creation does not involve the creation of a pool of resources on which the less developed countries have a moral claim, and I agree with that.

I do not dissent from that at all and I do not think that those of us who are supporting the link are putting it in those terms. What we are saying is that the governments of the developed countries have accepted an obligation to transfer 1 percent of their GNP to the less developed countries, and here we are trying to find a way in which they might be able to achieve this objective.

Secondly, Professor Johnson says that a real transfer to the less developed countries is unnecessary from the standpoint of creating reserves. Perfectly true. It's perfectly true that the developed countries can, if they wish, decide to create new reserves costlessly, and it would be an act of economic statesmanship on their part if they were to decide that they wish to associate a real transfer to the less developed countries with the process of creating reserves.

Now this question of inflation, if additional reserves are created for the link. I think that it is clear that all of us who are supporting the link are arguing that the requirement for reserves should be determined on the basis of the monetary needs of the world economy and not on the basis of the needs for aid.

Professor Scitovsky surprised me by laying such emphasis on the danger of inflation. It seems to me that there is a generation gap between Professor Scitovsky of 1969 and Professor Scitovsky of 1965, if I may say so, because I have here the report which Professor Scitovsky signed in 1965, when he was a member of the UNCTAD group of experts, in which he dismissed the danger of inflation:

> But let me make this point on the possibility of inflation. I have made a calculation on the assumption that $2 billion of SDRs were distributed to all countries, and that the Part one IDA countries made a voluntary contribution to IDA in an amount equal to their own SDR allocations, namely $1360 million. In that case, if the United States obtained orders from IDA equivalent to about one quarter of the total new contributions to IDA, which is quite a reasonable proportion to take, the spillover of demand to other developed countries would amount to about $140 million.

In other words, the resources that other developed countries might have to make available over and above their own allocations to IDA under the link would be of the order of $140 million, and I calculate that as amounting to less than one-fiftieth of 1 percent of the GNP of these countries.

I really wonder whether this is a serious problem that one need spend a great deal of time on. But in any case, even if it is, I would refer to

the point which the UNCTAD expert group made in 1965, which is that "As long as more development aid is needed, this need cannot take the last place in the ordering of their resources by the richer countries."

Finally, if I may come back to Professor Johnson, Professor Johnson said that the Patel proposal is not a link at all. Well, I do not mind calling it something else as long as we can all agree on its substance.

Thank you, Mr. Chairman.

Chairman REUSS. Mr. Scitovsky, let me say that the records of testimony before this committee are full of the most marvelous processes of human growth, so do not feel that there is anything wrong with someone saying one thing when he was working for UNCTAD and then another thing when he is working for Yale, because this happens to all of us.

Mr. SCITOVSKY. Mr. Chairman, I am very much aware of this. As a matter of fact, I have been proud from time to time in my career for having grown, as you put it so nicely. But I am afraid I have not grown in this respect, and perhaps Mr. Dell did not quite get my point.

My feeling is that I am still very much in favor of the link, though not primarily as a means of helping the developing countries. I really agree with Professor Johnson that the developed countries will be making up their minds to what extent they feel free to fulfill their obligations about donating 1 percent of their gross national product quite independently of reserve creation; and the only way in which the link might conceivably help would be that the countries might put an obligation like this on themselves collectively in a more general spirit than individually. I am not certain how realistic this is.

But I am very much in favor of the link from the point of view of offering some kind of safeguard to those countries most likely to oppose the creation of SDR's, and I am trying to look at it from the point of view of how we can increase the volume of SDR's that will be created. I mention the inflationary danger not as something I believe in, but as something many of the central bankers, especially of surplus countries are fearful of.

This is why I believe that the kind of link which would allay those fears rather than add to them would be a very desirable type of link; this is why I suggested a link of the type which would place whatever inflationary or expansionary effect the manufacture of equipment for developing countries is creating on the particular country which wants to acquire SDR's. This would be a very desirable type of link, because it would allay the fears of surplus countries of the inflationary pressures that might be put on them.

This is the economic justification or the economic argument for it, which is completely independent and separate from any good that it might do for a developing country that is going to get the piece of equipment that will be bought out of a development assistance.

Chairman REUSS. I have it in mind to return later in the discussion to the important point you raise in formulating any link proposal. It seems to me one has to have in it some safeguards against inflation. I am rather impressed by what Mr. Dell had to say, that really the amount of excess demand in any one country that you are going to get from these few crumbs that drop from the international table is not going to inflate things very much.

30-668—69——5

The only country I know anything about is the United States. But, by and large, in the U.S. industries which make the kind of equipment that developing countries like to buy, earth-moving equipment, mining equipment, construction equipment, electrical equipment—in the engineering industries generally—there tends to be a good share of excess capacity around. Indeed, and I will come to this later, one of the things I think that commends the link is just the opposite of this alleged inflationary evil, namely it is a nice little guarantor of full employment to have these extra crumbs of demand floating around.

We will get back in a moment to how you do respond if the crumbs turn out to be too heavy, but I should think there are a number of ways of doing it. One way, Dr. Scitovsky, is your tied link aid.

I should think though there are quite a few things that countries can do to choke off excess demand, if it wants to make its own people suffer so that the developing countries can prosper. It can of course tax its own people and keep them from buying. That is asking a little too much, I am afraid, of any parliament.

I presume a country could do what Germany is now doing. They could put a tax on exports and raise the prices of exports, and, therefore, drive away orders from the developing countries by pricing themselves out of the market. We will return to this, but I should think there are ways of handling these problems.

Let me return now to Mr. Dell. You have said in effect that there are really two reasons why it may be possible for the developed world to achieve the goal which we have all agreed ought to be our standard, namely somehow convey 1 percent of GNP to developing countries. It may be possible to achieve this goal more effectively through the link device than by the straightforward method of budgetary appropriations every year, for two reasons.

First, the link avoids fear of reserve losses, and second, the link makes it possible to do these wonders without increasing taxes. Now, I would like to explore these, because these are indeed advantages.

On the first one, that it enables countries to be generous without incurring reserve losses, I really cannot see it being much of a help there. It all depends on the decisions made by Mr. Schweitzer and the IMF as to how many SDR's to create, and it is really going to be a pretty speculative exercise anyway. Nodoby knows, it seems to me, how much monetary reserves are really needed. Even if you throw in a link, it is pure guesswork as to whether that is going to make the participants distribute any more SDR's in any one year than they would otherwise.

So while I think there is much to be said for your other points, which I will get to in a moment, let me now pause and ask you to disagree. Have I, too, cavalierly dismissed the loss of reserves point? Either Mr. Dell or anyone else may express dissent from what I have been saying, because I want to try to get us all talking about the same thing.

Mr. Dell. Mr. Chairman, I am afraid I do not quite understand the point you have just made. It seems to me that under a link proposal, the worst that could happen to a country, to a donor country which obtained no orders at all from the IDA against the allocations of SDR's or of currencies made to IDA for lending, the worst that could happen to any donor country is that its reserves would remain the same as before. In other words, it would not gain from the allocation of SDR's.

That is a rather extreme situation and most unlikely to happen. As I mentioned just now, I have made some calculations regarding the position of the United States, which I think is probably one of the few countries that might stand to gain less from the allocation of SDR's than it would if there were no link. It will be found that even the United States would nevertheless gain substantially by way of allocation of reserves, despite the link. It would certainly not lose.

I really do not see how the link would cause the United States to lose reserves, unless you mean, of course, that the United States would gain less reserves than it would if there were no link. If that is what you mean, Mr. Chairman, then, of course, I fully agree that the risk that the United States would run, in subscribing to a link, is that it would gain less reserves, net, than it would if there were no link.

Chairman REUSS. What I was saying was this: I understood you, Mr. Dell, in your testimony, to say that one of the things which inhibits countries now, today, from coming up with adequate development assistance is that they are afraid of losing reserves. This is certainly true. This keeps countries from voting enough in the first place, and after they vote it, they make it much more expensive by tying that assistance.

My question is this: I do not see how the link is necessarily going to change and improve the situation now that we are going to have SDR's anyway. If Mr. Schweitzer and company are willing to create $3 billion a year in SDR's under the present proposal, I do not see how you much improve the propensity of the developed countries to give foreign aid by taking part of those new SDR's and saying they shall be linked.

Bear in mind, that I am coming to other arguments of yours, which I find most persuasive indeed, but taking them one at a time, I am left a little cold by the loss of reserves argument, and you have not quite warmed me up on that yet, but I welcome somebody else trying.

Mr. Johnson?

Mr. JOHNSON. Mr. Chairman, I think you have put your finger on the point. If we take as our basis of comparison the situation with no SDR's, and then we create SDR's, then it is obvious that countries can both get some of the SDR's and give some of them away in real terms.

But it still is the case, the purpose of creating SDR's is to provide an increase in reserves which is appropriate to the growth of the world economy, and any country which gives foreign air is thereby reducing its share of those SDR's, unless it earns them back by exporting, and it seems to me Mr. Dell is trying to establish the position that these SDR's are, as I describe it, a pool of new resources which can be shared out among people, and it is not necessary at all to the SDR process that the SDR's be given away and then earned back.

Chairman REUSS. To get on to Mr. Dell's side of the argument, it could well be as a political matter that if Mr. Schweitzer's future annual exercise were conducted under a link amendment to the SDR facility that he would have all the developing countries lobbying with him saying, "Come on now, don't give $3 billion a year, give $4 billion a year, those are the real monetary needs of the world," with, of course, all the proper protestations that this has nothing to do with develop-

ment aid. So you might bump what IMF is willing to do a little on the upside, which would be a good thing in my judgment.

Representative MOORHEAD. Would the chairman yield?

Chairman REUSS. May I say to Mr. Moorhead and Mr. Widnall, I wish you would join right in on this.

Mr. MOORHEAD. As a political matter I think this is important. Wouldn't you also have the developed countries lobbying Mr. Schweitzer to bring that figure down? I want to know whether as a political matter—I think SDR's are so important that I think whether link is good or not that we also ought to consider whether it is politically bad for SDR's or good.

We have two lobbying groups. I think there is a political question, an international political question that should be considered.

Chairman REUSS. Yes, any member of the panel?

Mr. TRIFFIN. One point on this, Mr. Chairman, really is that this would help correct the conservative bias which the 85-percent voting rule will impose on the creation of SDR's, and that therefore some added pressure to create SDR's would only offset in part the conservative bias deriving from the 85-percent majority rule.

Representative MOORHEAD. You mean the link would be a political plus?

Mr. TRIFFIN. Yes.

Representative MOORHEAD. If you favored SDR's?

Mr. TRIFFIN. That is right.

Chairman REUSS. How about Mr. Moorhead's point though, which I think has to be answered. Wouldn't that be counterbalanced by the niggardliness of the "Big Ten" developed countries, knowing that under the link that they are not going to get it all themselves. Aren't they going to be lobbying with Mr. Schweitzer to keep the whole thing low? I do not know.

Mr. TRIFFIN. This is true, but Mr. Chairman, I think that it is really absurd to give in to *erroneous* fears of inflation. They have been described here as erroneous and nobody has objected to that. We should not pander forever to the prejudices which have dominated past negotiations. We have seen the officials change their minds very radically and many times over the period of negotiation of the SDR's, and I would hope that they could learn to establish their plans for future monetary reforms not only the basis of erroneous prejudices, but on the basis of what they can learn from a discussion such as the one that we are having here this morning.

Representative MOORHEAD. I quite agree with you in the best of all possible worlds.

Mr. TRIFFIN. Yes.

Representative MOORHEAD. But I am afraid we are dealing with a political world.

Mr. TRIFFIN. That is true.

Representative MOORHEAD. I think we have to address the political things and we have to deal with erroneous fears of our constituents and recognize them just as I am afraid Mr. Schweitzer is going to have to deal with erroneous fears of his constituent countries. This is my concern.

Mr. TRIFFIN. Right. On the other hand, I think that those same gentlemen would be receptive to some of the other arguments in favor

of the link; for example, that the present distribution of SDR's like manna from heaven to everybody, whatever their policies are, is certainly contrary to one of the cardinal principles that they always repeated, that the creation of new reserves assets should be linked to an improvement of the adjustment process.

They certainly are not doing that, if they distribute these assets automatically to everybody, even to countries whose current policies may be totally obnoxious in their view. That is why I think it would be politically unviable if they feel, for instnace, that they are to create $10 billion or $15 billion of SDR commitments at once, since they will take those decisions theoretically at least for 5 years at a time.

Well, that would mean that whenever they create $10 billion of SDR's, they are committed to give $3.6 billion to the United States and the United Kingdom. If at that time, they do agree with the policies of the United States or the United Kingdom, they are not going to create the SDR's at all. Therefore, I think that by stressing that SDR's should be used to promote internationally agreed objectives, and not policies with which the lenders themselves or the prospective lenders disagree, one might in fact elicit more support from them for actual SDR creation.

Mr. JOHNSON. Mr. Chairman, I think that Mr. Moorhead has put his finger on a very fundamental point here, which goes right down to the basic economics of this situation, and it also refers back to something you said about preferring $4 billion SDR's to $3 billion.

Now, the argument for having more international reserves has to be that it will enable the world economy to expand in a better fashion than it has before, and particularly Mr. Karlik's paper stressed that present system makes the countries resort to trade restrictions and other undesirable policies, and the idea of larger SDR's must be to make it possible for countries to avoid such policies.

Our problem is that we can have two different consequences of a more rapid rate of growth of international reserves. One is that countries follow more liberal policies. The other is that they simply make the world economy inflate faster.

If more SDR's mean more inflation, it is hard to argue that that is good for the world economy, and in fact what it amounts to saying in the context of the present proposal is that we prefer world inflation so that the less-developed countries can get more resources.

In other words, it is the policy of financing development by inflation.

The question arises as to whether the terms on which SDR's are created will be such as to make countries hold more SDR's and follow less restrictive and less damaging policies, or whether they will simply lead them to be more inflationary. The question then arises what are the terms on which countries hold SDR's.

Mr. Moorhead's point, which I admit had not really occurred to me but which is very opposite, to the extent you can only get more SDR's by paying real resources to the less developed countries you have an incentive not to create enough SDR's, but instead to create an insufficient quantity, and then resourt to exactly the kind of policies which are now held to be daamging to the world economy.

Mr. TRIFFIN. Mr. Chairman, could I address myself to that point?

I agree very much with what our friend Harry Johnson has said, but not with his conclusions. It is quite clear that the creation of SDR

is designed to be expansionist, and should be expansionist. By permitting the SDR's to serve the function of helping development finance, you admittedly do create an expansionist force, but this is equally true if you create the same amount of SDR's and allot them instead automatically to all countries to follow whatever policies they are following at that moment. It is simpy a substitution of one form of expansion for another.

If that other form of expansion, which would be the result of the absence of a link, is to finance the policies of the British Government, for instance, well, this is considered inflationary also, just as well as development financing. If it is to help us finance a reescalation of the war in Vietnam, this is also inflationary, and this may be more obnoxious to the prospective lenders than expansionist financing of the developing countries. It is not an addition. It is a substitute.

Mr. SCITOVSKY. Mr. Chairman, may I add something to this?

My feeling is that these are prescisely the kinds of problems that would be solved by tying the link to the development assistance from the particular countries that are receiving the SDR's, and I think that Professor Triffin is very right that one misgiving of some countries, and certainly the French, has been the kind of situation where the SDR's are created primarily in the interests of the United States and Great Britain, whereas the cost of it is paid, so to speak, by say Germany, Italy, and France. One advantage precisely of a tied link, as I was trying to describe it, is that this would create the expansionary force not in Germany and Italy, but in the country which was the most in need of and the most demanding of SDR's, for example the United States.

It ought to be a certain reassurance for the continental European countries that SDR's will be created only under conditions when the United States has excess capacity and is able to use this excess capacity for the production of development goods; and that the creation of SDR's in favor of the United States would not lead to expansionary forces being centered on Germany, just because equipment happened to be cheaper in Germany than in the United States.

My feeling is that this is a very important advantage of the link, if it is created and administered in this fashion, tied to the country which receives the SDR's.

Mr. DELL. Mr. Chairman, I am not sure if I understood you correctly to say that the fact that some SDR's might be used for the purpose of a link might deter the Group of Ten from creating sufficient reserves, because there would be a danger of losing them.

I think that the Group of Ten would not as a whole lose SDR's. On the contrary, they would probably gain more than their original allocation of SDR's, since the developing countries would be likely to spend part of them.

What would probably happen is that the distribution of additional reserves among the members of the Group of Ten would be affected to some extent by the link. Such a redistribution of reserves would affect individual members of the Group of Ten, but the Group of Ten as a whole would, as far as I can see, gain at least the full amount of the SDR allocation.

I do feel that this question of inflation is being overplayed. It is a perfectly valid theoretical point, but the orders of magnitude simply

do not justify the amount of attention that is being given to it. I am bound to say that the order of magnitude of this problem in this context, and under present conditions, is not such as to justify such a serious derogation of principle on a multilateral basis as would be involved in having a tied link. I should say that that would be a most serious disadvantage. If one looks at the real magnitudes, one is bound to be impressed by the fact that the operation of the link is likely to give rise to considerably less inflationary pressure than the existing provision in the amendment to the effect that countries do not need to maintain more than 30 percent of their cumulative net allocations of SDR's. I would say that that provision, which already exists, is a potentially more inflationary provision than anything that has been suggested this morning, although I would not rate even that inflationary impact as particularly important.

Thank you, Mr. Chairman.

Chairman REUSS. Mr. Johnson?

Mr. JOHNSON. Mr. Chairman, I would like to take issue with Mr. Dell, who keeps telling us that the inflationary impact is negligible. This is true if you only look at the direct demand involved in purchasing of goods by developing countries from developed countries, but the essence of this matter is not the direct contribution of aggregate demand but the contribution of extra reserves to the ability of countries to pursue inflationary policies without being subjected to a constraint through the loss of reserves, and this is the main issue.

Chairman REUSS. What countries?

Mr. JOHNSON. All countries. Any country which has more reserves is therefore free to follow more inflationary policies, and if you have more reserves for the world as a whole, these reserves get passed around and all countries can pursue more inflationary policies or else they are obliged to follow them, primarily because the United States is so important in the world economy that whatever happens to its price level has an impact on the world price level.

Now the whole argument about whether or not additional reserves are needed, and how large a scale to provide them on, is precisely on that issue; namely what is the likely impact on the inflationary trend in the world.

This manifests itself and has manifested itself in the specific form of how inflationary can the United States be, and how inflationary can the United Kingdom be. But the reason why that is a matter of grave concern to other countries is that this determines how inflationary they have to be. Under the fixed rate system, all countries have to have their price levels moving the same way.

Now the argument that I and others have put forward for more exchange rate flexibility is designed to relieve that obligation of everybody to have the same rate of inflation. But accepting the system, then the question of how many additional reserves you create is relevant to what sort of world inflation you have.

Chairman REUSS. I wonder. Take the United States. I think you would have a very difficult job proving that; in years in which the United States was earning reserves—you have to go back quite a few years to find one, but there have been periods—we were very inflationary at home, and in years when we were losing reserves, we were being very frugal and responsible.

In fact, I should think that in the United States, domestic inflation is an abundant political provoker of about as good anti-inflationary action as you are likely to get. In fact, what is now stimulating and should stimulate anti-inflationary action in the United States is the fact that we are having a 5 percent increase in the cost of living. This is getting the voters quite upset, and a democratic government will react.

Therefore, do you need this hair shirt, this burr under the saddle of international reserves, in order to convince governments today to do the right thing about fighting inflation? Aren't the evils of domestic inflation enough? Why all this overkill?

Mr. JOHNSON. Mr. Chairman, I do not think that the evils of domestic inflation are enough, and one reason is that I happen to hold the view that inflation is not all that damaging or dangerous, aside from the balance-of-payments position, and so I start from a disagreement probably with the mass of the electors on how far it is worthwhile resisting inflation.

But if you do have a fixed exchange rate system, then you do have to watch the international position. You have to recognize in particular that the U.S. inflation is an inflation for everybody else as well, and while the domestic voters may prefer less unemployment of blacks in the cities to less inflation, this particular weighing of advantages and disadvantages has implications for the rest of the world which they do not particularly like.

So the question of the size of reserves is really a question of forcing the United States to take some account of the attitudes of other countries on this issue.

This is really the problem. We have an international system in which the rate of inflation is really determined by the balance of political opinion in the United States, and that balance of voters may be annoyed about the 5 percent rate of price increase, but they would be a lot more annoyed if they had a 7 percent rate of unemployment.

Mr. TRIFFIN. Mr. Chairman, I think that the argument of Harry Johnson leads to exactly the opposite conclusion from the one he has drawn from it. Let me try to make this simple.

Under the present system if we create, let us say, $2 billion of SDR's a year, $500 million—25 percent—will automatically be given to the United States. If it is true that the inflationary policies of a country are influenced to a major extent by the state of its reserves, those $500 million will induce us to follow more inflationary policies than we would follow otherwise.

I might mention here by the way an estimate that the excess of total spending over maximum productive capacity in the United States last year was probably of the order of $30 billion.

Now let us assume instead that instead of distributing the $2 billion of SDR's in this automatic fashion, we use them—through the link proposal—to strengthen the resources of IDA, or the IBRD, and enable these institutions to increase by $2 billion their loans to underdeveloped countries which are free to spend them wherever they want. This might mean that fewer of these SDR's would be spent here. They would be more likely to be spent in the most competitive countries, such as Germany, for instance.

Now, having those $500 million at the moment go to Germany rather than the United States would not be more inflationary. It might have other disadvantages, but it would not certainly accelerate inflation in the more inflationary countries.

Chairman REUSS. May I get on to the next point that was in my mind, namely the very important point made by Mr. Dell, that a link enables these good things to be done without having to go to the parliament or Congress, and pass tax measures to raise the revenue.

Would you run through just how that would work? Let us assume that the proposal that you and Mr. Prebisch present here today were negotiated and put into effect. How would it work? Let us suppose a year or two from now the IMF determines to activate $3 billion a year of new SDR's. Well, now, would you take it from there and tell us just how the mechanism would work? But let us suppose it is $3 billion SDR's, of which 25 percent are reserved for the link, if those percentages are all right. Use that if you will as your model. How does it work?

Mr. DELL. Mr. Chairman, you mean you want me to indicate the specific institutional procedure that would be involved?

Chairman REUSS. Particularly in this country. How does the Treasury or the Federal Reserve get dollars to the IDA or the World Bank without its appearing in the budget and without taxes having to be levied. This is an awfully important point, and let me say that if true, it is very attractive.

Representative WIDNALL. Would you yield at this point?

Chairman REUSS. Yes.

Representative WIDNALL. I was going to ask a question of Mr. Dell which is very much along this same line with maybe a little change in phraseology. You maintain that a nonorganic link could probably be introduced without making taxes higher, and participation of industrial nations necessary, but if nations making currency contributions to IDA or the World Bank are not doing so by printing the additional money, wouldn't they have to raise the funds through additional taxes?

Chairman REUSS. To my knowledge I think that is the same question.

Mr. JOHNSON. It puts it more precisely I think, Mr. Chairman.

Chairman REUSS. It is more clearly put.

Mr. DELL. Mr. Chairman, may I just first comment on the last point which was addressed to me by Professor Johnson, and say that I am not sure whether he is under the impression that I was advocating a larger increase, a larger allocation of SDR's for the purpose of the link than there would otherwise be.

I am assuming that the total allocation of SDR's is determined by a collective decision in the IMF on the basis of the monetary needs of the world economy, and on the basis of a noninflationary assessment of needs, and that what follows after that, is, as he put it in his opening remarks, a redistribution of those reserves. I am certainly not suggesting that the link ought to be accompanied by an inflationary creation of SDR's.

Now as regards the specific institutional mechanism, whereby a voluntary link might escape the need for annual budgetary allocations, I must admit that I am not a lawyer conversant with U.S. practice in

this matter, and I woud only like to answer this question in a very general way.

One would not, of course, eliminate parliamentary consideration altogether. One would simply try and make provision for an enabling act by parliament, by the Congress, to set certain procedures in motion which by-passed the annual aid appropriation.

One such procedure might be to have agreement among all the Part 1 countries of IDA, whereby at the time at which SDR's were allocated, each of them would make a voluntary deposit in a special account in the IMF, equivalent to some proportion of SDR allocations. The IMF would then be authorized to transfer these proceeds in national currencies to the IDA.

Another way of doing it would be to empower the Central Bank to buy World Bank bonds or IDA bonds. Of course, if these bonds were purchased at normal market rates, and if the World Bank could sell all the bonds it wished at these rates, it could be argued that this would not add to the total sales of World Bank bonds, but I have it in mind that Central banks could be empowered to buy a special issue of World Bank or IDA bonds on IDA terms. Quite recently Switzerland has lent money to IDA on IDA terms.

Now, Mr. Chairman, I want to say once again that I am not competent to advise this subcommittee on the correct legal procedures whereby some thing of this sort can be done. I am an economist, not a lawyer. And I am merely suggesting certain possible lines of attack on the problem.

Mr. SCITOVSKY. Mr. Chairman, may I just mention one very simple way of accomplishing this. You mentioned the example of $3 billion creation of SDR's, with 25 percent of it, that means $750 million to be used for the purpose of development assistance.

The easiest form I think would be this. The Central banks of the various member countries of the IMF would be required to hand over their national currencies in exchange for the SDR's issued to them. Now all that would be required is to empower the IMF to use 25 percent of the total national currencies it has received, that is $750 million, for the purpose of buying IDA bonds. This would certainly be one way of making $750 million available to IDA, which would require no parliamentary or Congressional approval of taxation.

Chairman REUSS. Before calling on Professor Triffin, let me suggest this. That if you pursue the so-called nonorganic link, I do not see at this moment how you have accomplished very much in political terms that could not be accomplished by a more heroic frontal attack, namely induce the U.S. Congress to pass a law which says we up our miserable present IDA contribution by three times, having in mind that we are now better able to do this, because we have now a regime of SDR's and much of our reserve problems will therefore be alleviated.

I do not think that in a nonorganic or so-called parallel way of proceeding with the link, we accomplish very much. If, however, we get organic, as Mr. Scitovsky has just suggested, then you may be able to achieve some fiscal monkey business, which would be all to the good.

This of course would take an amendment to the SDR amendment, but I do not know that amending it is so impossible. Everbody seems to assume so but we are all going to have to do something about the problem of insufficient aid to developing countries, and it is going to

have to be something that the majority agrees to. They cannot be hoodwinked into it. Therefore they might perfectly well agree, if it is properly put into an amendment to the SDR proposal.

Thank you for waiting for this digression.

Mr. TRIFFIN. Mr. Chairman, I think that you put your finger on the confusion which threatened to develop in our discussion. We are really discussing two very different proposals aiming at the same objective. One is the nonorganic link, and the second is the organic link. Let us take the two separately in connection particularly with the question raised by Mr. Widnall.

I think that if it is the nonorganic link that we have in mind, we have to remember this, that when the monetary authorities of the United States add to their reserve assets by buying gold, they create dollars. If instead of buying gold they buy SDR's and put that in their assets, they create dollars also, and those dollars could then be invested in IDA or IBRD bonds. But this would of course require specific congressional authorization for the purpose.

In the case of the organic link, the situation would be far simpler of course. The International Monetary Fund would create, let us say $3 billion of SDR's but those SDR's would not be distributed among members. The Fund would invest part of those SDR's in the purchase of IBRD bonds. The IBRD then would lend those SDR's let us say to Bolivia. Bolivia would spend——

Chairman REUSS. Through its IDA window.

Mr. TRIFFIN. Or, IDA, yes. Then IDA or IBRD would spend those SDR's to buy goods in Germany, and then whatever inflationary impact would result from this would fall upon Germany. That is why I think that this need not be more inflationary than the present proposal, and would not involve any additional creation of dollars in that case.

Chairman REUSS. I think we are making some progress here, in clarifying the issues. Let me first ask Mr. Dell whether he agrees that the organic method would make it easier to get over this little parliamentary hurdle, which is bothering us throughout the world so much. It seems to me it would.

Mr. DELL. Mr. Chairman, yes; I fully agree that the organic link would be substantially better if it were attainable, and the proposal which I have made is merely designed to get over an immediate difficulty, perhaps a temporary difficulty, resulting from the fact that existing arrangements preclude the organic link.

At the same time I do not see quite so hard the fast a line between the organic link and the nonorganic link as you appear to suggest. It may be perfectly true that, as you say, once you bring parliament to the point of approving a nonorganic link, they may be prepared to increase their contribution to IDA anyhow. That is a point of political judgment, and I think you may be right.

Certainly the assumption on which my paper is based is that it might be somewhat easier, in view of the political realities, in view of the difficulty of getting all the members of the IMF to go all over the negotiations once again, it might be easier all around to introduce the link on a nonorganic rather than on an organic basis in the immediate future.

Representative WIDNALL. Mr. Scitovsky, under your plan as I understand it, you would allow a deficit industrial nation to obtain an

unlimited supply of SDR's to finance its deficits with other developed countries, by selling selected products to developing countries. Might not some Western European countries object to this possibility, and how would you suggest it be dealt with?

Mr. SCITOVSKY. Mr. Widnall, I did not think that I suggested unlimited quantities. I believe some kind of upper limit would be desirable. But I did suggest that, within these limits, the quantity that an industrial country would wish to acquire, should be of its own decision, given the fact that it would have to pay in exchange in terms of resources.

My feeling is that the reason why other developed countries, other industrial countries would not object to it is that in this form, whatever the expansionary force this link creates would be an expansionary force that would not fall on them, but would fall on the United States or whatever industrial country had decided that it wanted to obtain these SDR's, so I am really proposing this as a means of reassuring the other industrial countries that the SDR's issued let us say to the United States will not create expansionary problems for them. It will create the expansionary problems for the United States itself. I do think there is an advantage in having the obtaining of something and the paying of the cost for it located in the same country.

Representative WIDNALL. Then as I understand it, you are presuming there would be no objection on the part of the Western European nations.

Mr. SCITOVSKY. I am presuming that there would be no objection on the ground that this would protect them against the kind of expansionary forces which most other forms of link would impose upon them.

Representative WIDNALL. Mr. Johnson, would you care to comment on that?

Mr. JOHNSON. Yes. I think that there is a difference of assumptions between you and Professor Scitovsky. He says other nations would not object because the inflationary impact of these extra reserves would be focused on the country that was acquiring them. I think you must have had in mind something which I would consider an important point, which is that under Professor Scitovsky's scheme, a country would in fact be selling its goods presumably at prices above world market prices, to the developing countries, as a counterpart of its receipt of reserves.

I would think that there could be very substantial objection to a scheme under which a country could create markets for itself, financed by these international reserves, and enable itself to sell its goods at higher prices than its competitors could, using this scheme as the justification. So I think that you are both right in a sense.

Professor Scitovsky is right on the question of the inflationary impact, but countries do not object to inflationary impact if it comes through the thriving expansion of their exports in markets which they would like to establish long-term interest in.

Mr. SCITOVSKY. Mr. Chairman, may I just comment on this. I did in my prepared statement deal very explicitly and in some detail with the problems that would be raised by the good supplied say by the United States, being higher in price. Obviously, this would create problems which have to be solved, and I was dealing with those.

Chairman REUSS. Let me now put to Mr. Johnson, the skeptic, the refurbished organic shiny formulation of Mr. Triffin, to wit: Under an amendment to the SDR agreement, in a couple of years the IMF decides to create $3 billion worth of new SDR's, provided that one-fourth of them, $750 million, will, instead of being distributed, be used to buy a new issue of IDA bonds, which will then enable IDA to triple, I believe, the funds currently at its disposal.

Now why isn't that a pretty cute idea? What is worng with that?

Mr. JOHNSON. What is wrong with it is not that it is not a cute idea, but that you are creating international money at a real resource cost to the developed countries. If they are prepared to do it that way, then as I say in my paper, I am not going to object to it. But it seems to me that they would be tricking themselves into providing more aid than they otherwise would, and I just do not see governments accepting that.

Chairman REUSS. I want to recognize Mr. Triffin in just a moment. Governments might decide though that since quite another part of the international monetary world, the SDR people, had created this manna from heaven and in an absent-minded moment had actually breathed life into these SDR's, or at least 70 percent of them, then it might occur to the heads of state that this is really quite a happy accident. Therefore, why not take advantage of it for relatively painless foreign aid through IDA, and also foreign aid which would have a pretty good chance of being maintained year after year, and hence be much more efficient than the off-again on-again brand of foreign aid which depends on parliaments.

It would seem to me that something more than sheer self-delusion could be an ingredient in such a decision.

Mr. JOHNSON. Well, self-delusion is not necessarily an objection, but to take the manna from heaven objection, the manna from heaven parallel, we have this manna come down from heaven. Now the proposal here is that I shall give all my manna to the poor and then try to earn it back by selling them things.

If I want the manna in the first place, and I do not really want to give a gift to the poor otherwise, why should I kid myself that somehow this is not a gift, and does not involve exactly the same kind of elements as a gift would do.

Chairman REUSS. Are you really kidding? Is one really kidding himself that this is not a gift? I would have thought not. I would have thought that the common sense decision would have been that of course this is a gift, and will involve the transfer of real resources, as machinery made in Milwaukee to somebody in Tanzania. But this is a way of accomplishing it by one legislative decision right at the beginning, when the Congress ratifies this next round of IMF organic legislation.

Indeed it is analogous to long-term, more than one year authorizations, which we do do in IDA, the Inter-American Development Bank, the Asian Bank and so on.

Mr. JOHNSON. Yes. Well, let me make two comments on that. The first is supposing you did this. Some countries at least might want God not to throw down so much manna, because of the obligation to provide the real resources.

The other point, which gets us back to a matter we discussed earlier, is that the attractiveness of this scheme is precisely in the organic form, where it is automatic. Mr. Widnall asked about the question of rasing taxes, and what you are really trying to trade on is the fact that countries may be unwilling to give foreign aid, but if there is an international reserve asset such as gold and somebody sells it to you, then you automatically monetize it, and that provides the money, and the organic scheme would be simply to create SDR's in place of gold, and when they get sold to the country, and automatically under existing institutions, no legislation is required to provide the real resources which are bought with that money.

Now, you may recall, sir, that in the 1930's this country was providing a tremendous amount of resources to other countries, in exchange for gold, to the point where a couple of Princeton professors wrote a book called "The Golden Avalanche," in which it was suggested that too many American resources were being invested in sterile gold, so that there is even a limit I think to that process. But the whole essence of the matter is that because it is money, automatically you are prepared to exchange real resources for it.

If we compare that with the non-organic scheme, the non-organic scheme would require legislation, and would raise exactly the same issues as current aid does. I mean I cannot see the Congress of this country or the governments of most countries committing themselves automatically to legislate funds from tax revenue to be put into IDA in counterpart to the SDR's received.

Chairman Reuss. You have made I think a prety good case against the inorganic method, but can't you be a litle more out-going toward the organic method?

You see, the beauty of the organic method is individual nation states are not asked to give away anything they have ever received. They never get this $750 million. That is all a bookkeeping entry, or as if somebody up yonder turned that much gold into the coffers of IDA.

It does seem to me therefore a rather useful way of getting development capital into the hands of the less developed world, without any diminution in the fixed resources of any nation state. It internationalizes part, to wit, $750 million a year in our model, of the new international money.

Mr. Johnson. I am torn in a sense between my personal conscience and my professional one, and also obliged to make some judgments on political matters.

I agree with the two colleagues on either side that the developed countries ought to be providing far more resources, and I would also in that context go along with the notion that any means by which the developed countries can be induced to provide more resources is a desirable thing.

The questions that arise in my mind are whether in fact countries will either accept this or, if they accept it, will not realize sooner or later that it is costing them real resources, that is whether they may not cut down their other aid, and there is a danger, I think, that when one sells a gimmick of this kind, that people may feel that the problem is over.

Supposing you did get that scheme. It is possible that people would

take the view "Well, that takes care of the developed countries problem," and that I think would be undesirable.

Chairman REUSS. Do you think that what bothers taxpayers in a country, a given developed country, is really the loss of resources? I would have thought that it was being taxed, and if you can get rid of that hang-up, you have got it made.

Bear in mind that throughout this discussion we have always said that any country that is bedeviled by inflationary excess demand can do, has to do, that which is necessary to sterilize that excess demand. This can be done by something like Mr. Scitovsky's tie-in proposal. It can be done by present-day Western Germany export taxes. It can be done by any one of a number of means, not all of them bad by a long shot. So having said that, it does seem to me you have achieved something politically. You have told the American, the Frenchman, the German, the Italian, the Dane that the domestic tax burden is not going to have to be increased on them, in order to make possible additional help for developing countries. The taxpayer might, of course, say to his government, "Well, if you had not gotten involved in this scheme and let the IMF take $750 million and dissipate it by purchasing IDA bonds, then we would have received our share, and I would be better off." The answer probably is that if all the IMF were doing was just creating SDR's on the present basis, they would not create $3 billion in this hypothetical year. They would only create $2,350 million.

Mr. JOHNSON. If I may just make a short comment on that, essentially what is involved here is the fact that the taxpayers are conscious of the taxes they explictly pay, but they are not so conscious of the tax which is levied on them through the inflation of the money supply, and what is being proposed here is simply that a tax be levied on people through the inflation of the money supply.

Now they may not be conscious that they are being taxed, either because they are stupid or because since it is coming out of increased income which they have not had, they do not notice it. But essentially the argument has to be that people will stand being taxed through inflation when they will not stand being taxed by Congress.

Chairman REUSS. I am going to call on you in just a second, Mr. Triffin. You assume away the argument though, that the new international money supply deposited there at $3 billion a year is not going to be inflationary in any harmful sense, unless it leads to an effective demand in the constituent countries over and beyond the ability of a country's economy to produce. Since by hypothesis we are not going to do that, I do not see why you are really taxing the individual taxpayer by inflation.

Similarly, in a domestic situation, the Federal Reserve in this country can create an expansion of the money supply at the rate of 2 percent a year, 3 percent a year, 4 percent a year, whatever it wants to. As long as the actual rate selected does not cause the wheels to spin too fast, there is no harm done. There is no inflation. There is simply full use of resources.

Mr. JOHNSON. That is correct, sir, but——

Chairman REUSS. So why do you have to assume that this plan would inevitably lead to the creation of international money at a rate in excess of the capacity of the constituent countries to meet by supplying goods and services?

Mr. JOHNSON. I am sorry, I took a short cut in the language I used, because the inflationary tax exists when a country is growing at stable prices, and as a result of increase in productivity it is possible to issue more money.

Now when the economy grows and the Fed increases the money supply by 2 percent, effectively people are holding a non-interest-bearing asset, and the Government is getting the benefit of the real resources involved. In other words, a loan to the Government with no interest, and in that sense, which perhaps is a bit of a technical one, this is an inflationary tax, and people as their income rises will hold more money, and they will thereby be lending more at zero interest to the government, but they would not be conscious of this. Still the fact exists that they are surrendering real resources in return for that increased money supply, and this proposal simply transfers that from the domestic to the international field.

I am not maintaining that the $3 billion would cause more inflation of world prices than otherwise, but simply that the growth of an economy does involve this capacity to get real resources in exchange for non-interest-bearing money, and this is precisely what is involved in this scheme.

Chairman REUSS. Mr. Triffin?

Mr. TRIFFIN. Mr. Chairman, I think that the organic link from this point of view is obviously far less inflationary than the present SDR agreement for the very simple reason, that under the organic link, the SDR's would be spent essentially in the countries with balance-of-payment surpluses. That is where the SDR's would land, and this would be no more inflationary for those countries than if instead of getting SDR's they got gold, dollars, or sterling. It is simply a substitute for other forms of reserves which are surplus countries must accumulate. As long as they are in surplus they must issue their own currency to purchase those assets. It makes no difference from that point of view whether they get SDR's, gold, dollars, or sterling, except of course if too many SDR's are being created. But there we come back to the basic point from which we all start, that SDR's would be created only in the amounts necessary to avoid deflationary pressures on the world reserve systems, and not to create inflationary pressures.

Second, since we were discussing before the question of acceptability, it seems to me that the organic link should be all the more acceptable to conservative central bankers as this is exactly what they were doing when the dollars and sterling exchange standard was working according to Hoyle, was working well. At that point the British, and later the United States expanded their possibility of providing assistance or financing for overseas development, because countries were accumulating sterling or dollars as reserves, instead of gold.

If this had not been true, their ability to finance foreign aid or development financing would have been much less. It is true, of course, that if we go on with the present SDR plan and offer countries, for the first time in the history of the world, the chance to get manna from heaven through the SDR's, instead of having to earn reserves, those countries will prefer to have the manna without transferring any real resources. It is really, to my mind at least, an immoral privilege which would be given to those countries, under the present proposal.

But do not forget also something else—this manna from heaven is really paid by somebody. Somebody is going to transfer real resources, and those are the countries with balance-of-payments surplus, the prospective accumulators of SDR's, those that will receive them in later settlements. For those countries, the present system amounts to what this Nation rebelled against 200 years ago "Taxation without representation."

Each time $10 billion of SDR's are created, the surplus countries would be committing themselves to give $3.6 billion to the United States and the United Kingdom without having any say in the policies of the United States or the United Kingdom. It seems to me that if they are to accept the creation of the SDR's, they will want also to know what the SDR's are used for. They should be used for internationally agreed objectives, and not to sustain national policies which may be maladusting as well as adjusting, or which may be politically or economically obnoxious to the prospective lenders.

Chairman REUSS. Mr. Johnson, a moment ago you were saying that in our model—in which $3 billion a year of SDR's are created and one-quarter or $750 million are put into either debentures or securities—that this $750 million represented something like a tax on individual citizens of the countries.

This is so, is it not, only if you assume that but for this linkage agreement, $3 billion of SDR's would otherwise have been created and distributed as under the present amendment. If only $2,250 million SDR's would have been created otherwise then there is no difference in the effect on the individual citizen in the one case over the other, is there?

Mr. JOHNSON. That depends on what the consequences of the difference in the total distribution are for income and employment, and if you assume that there are no consequences, then the tax is paid even so.

If I am given money, less or more, which I am going to hold, and not use, which is the purpose of these reserves on the average, then there is no resource cost to me. If I may have to earn a part of it as a matter of institutional arrangements, then the tax on me is the amount I have to pay for with real resources. It makes no difference whether I get $2 billion or $3 billion, my share of $2 billion or $3 billion, and do not pay for them with real resources. That simply increases my assets. But it involves no tax on me. If I have to pay a part of the $3 billion in real resources, whereas I do not have to pay a part of the $2, I am still paying a tax.

Chairman REUSS. In this country, in the early sixties, everybody now agrees that we were under producing by $30 to $60 billion a year, at least that is what the Joint Economic Committee was saying all those years.

Mr. JOHNSON. Yes.

Chairman REUSS. And I think people now retrospectively think that was probably right.

Mr. JOHNSON. I agree.

Chairman REUSS. And people also say, conservatives and liberals both, that that was really a bad way to run a railroad, and we should have done better, and should not have wasted those resources by not

30-668—69——6

calling into being the goods and services we were capable of producing.

Mr. Johnson. Right.

Chairman Reuss. If you say of the organic model we are now discussing that it can be safeguarded against inflationary over-demand, and that it would in fact make available each year $750 million worth of goods and services that would not otherwise have been produced, there being that much excess capacity in the developed countries, then I think that through this bright new scheme we could produce financially painless foreign aid.

True, it requires the sweat and work of human beings to make those tractors which are being delivered by us, but this has not been the political problem of the developed countries. The problem of sweat has been financial, the problem of taxes.

Mr. Johnson. But let us take the analogy with the early sixties. We all agree that policy was poor at that time, and we also agree that policy could have been better. Now you could have had full employment in the American economy by two separate routes. One would have been, and I just construct this example for purposes of the analogy, one would have been to distribute enough money to the American poor so that they would have been able to buy those goods and services. In that case you would have had full employment and you would have had a solution to other American problems as well.

The other possibility would have been to give the money to the less developed countries, and let them buy the goods. Now in the one case the goods would have wound up in American hands. In the other case the goods would have wound up in the hands of the less developed countries. And either policy has exactly the same mechanism to it, so you have the choice.

The fact that you had unemployment in that period gives you no argument for giving away goods and services to the less developed countries. I personally believe that is a good thing to do, but from the standpoint of the policies required for full employment, that is not necessary.

Mr. Triffin. Mr. Chairman, this objection would apply to any kind of SDR scheme. The prospective lenders that will accumulate SDR's could of course create employment at home through all kinds of social programs. It would apply to Germany or France as well as to the United States. This is a denial of——

Chairman Reuss. I think this. The brightly furbished plan that we are talking about, the model that we have before us, could of course be defeated if every one of the developed countries decided to and did adopt policies for domestic full employment without inflation that really worked. Then you would be right back where you started from, because then you could transfer assets to the developing countries only by taxing away income from our own citizens to distribute goods abroad. We would then confront the political problem that was our jumping off place at the start of the discussion this morning.

However, I still put to you, Mr. Johnson, that that is not likely to happen, and such is the flexibility of modern economies that they can really, if you manage them well, produce quite a bit more than anybody thought without undue inflation. You cannot stretch this too far, and we are stretching it too far in our own country now. But certainly, when you look at the record over the last 15 years, there has been all

sorts of excess capacity floating around at one time or another in one or another of the developed countries.

So since not every country of the developed world is likely to have full employment simultaneously why I put it to you again, isn't this a pretty cute idea?

Mr. JOHNSON. Well, that gets us into another range of issues, but the reason why countries choose not to have full employment, assuming that they have some choice, in the sense that they have the instruments for full employment, is among other things that they wish to avoid inflation.

We could have had full employment at a much higher level of output, but the problem has been that stretching the economy does tend to generate inflation, and while it is true that you could have more output, you would have to face the inflation problem, and this is where the cuteness of the idea comes into question.

As I have mentioned several times this scheme could be, though my two colleagues have been very careful not to make it so in their own presentation, a way of imposing inflation on the world with the benefits going to the less developed countries.

Chairman REUSS. I do not think it is so historically that in the last 10 years the big reason why so much of the developed world's productive capacity has been wasted is that the men in charge were really afraid that if they brought the economy to full employment, they could not stop it there and it would go over into extra-full, over-full employment and inflation. I think the big cause was just plain colossal stupidity on the part of the managers of our underemployed economy and most others, was it not?

Mr. JOHNSON. I do not think it was entirely stupidity.

Chairman REUSS. I think it was inability to figure things out.

Mr. JOHNSON. There are two remarks to be made on that. One is that perhaps there was less intelligence applied than there should have been, but on the other hand this is the political process. Politicians are not deliberately stupid, in my judgment. They are made stupid by the fact that their electorate has conflicting ideas of what should be done and they try to arrive at a compromise which seems to fit what the electorate wants.

There is the additional factor that in many countries such as the United Kingdom while the politicians would probably be quite happy to have as full employment as possible they have committed themselves to a fixed exchange rate and they find themselves running into balance-of-payments problems all the time.

Chairman REUSS. There are many hands up and I wanted to go around again starting with Mr. Dell.

Mr. DELL. Mr. Chairman, I am not at all sure about the sense in which Professor Johnson is using the word "inflation." I have the feeling that sometimes he uses the word "inflation" simply in the sense of additional effective demand.

It does seem to me that by saying that you can reach a position of full employment without inflation, either by distributing goods and services to the domestic poor or by distributing goods and services to the foreign poor, Professor Johnson has in effect conceded your main point, which is that a noninflationary link is possible. It is an alternative. It is an alternative, in other words, to distributing a similar volume of goods and services to the domestic poor.

Mr. JOHNSON. I never denied that.

Mr. DELL. Under noninflationary conditions. I am glad to have Professor Johnson's confirmation of that, because it does mean, Mr. Chairman, that you have succeeded in your main point.

Now as regards this choice between the domestic poor and the foreign poor, I would put the point this way: Governments have accepted an obligation to transfer 1 percent of their gross national product to the foreign poor. This is a matter which they have already agreed to, and we are here only considering how they can get there.

I do not see that we need reopen that principal question. In other words, governments have decided to take the view that the needs of the foreign poor do not have zero priority in their own ordering of resources. They do feel that there is a claim to the extent of 1 percent of their resources, and I think that the whole point about the link is that it enables us to get nearer to the 1-percent target that we otherwise would.

Chairman REUSS. Mr. Prebisch, do you have anything to add?

Mr. PREBISCH. No, Mr. Chairman.

Chairman REUSS. Mr. Scitovsky?

Mr. SCITOVSKY. Mr. Chairman, what I learned from this very useful discussion this morning was I think really this: that one can have a link without these supposed or real dangers of creating additional inflationary pressures. I think we have been talking of quite a variety of links, and I became aware in the course of the discussion that what Professor Triffin had in mind was very different from what I think most of the rest of us had in mind.

What he had in mind I think was that within the framework of a given quantity of SDR creation, a certain proportion would be created not in favor of countries in accordance with their quotas in IMF, but for the purpose of being handed over to the IDA, for them to distribute as they see fit to developing countries in addition to whatever SDR's they got as members of the IMF.

Obviously, if you interpret the link the way in which Professor Triffin interprets it, and I think he uses as an argument in favor of it the moral argument that there is something immoral about giving people something for nothing, it seems that this would not create inflationary pressures additional to whatever the given SDR creation might be giving rise to.

I believe the rest of us were talking about a different kind of link. The rest of us were thinking of a kind of link where a given quantity of SDR's are created in favor of members of IMF in proportion to their quotas, and there would be resources made available to IDA, in addition to this, for example, by the IMF buying IDA bonds out of national currencies or something like that.

This I think does create a danger of adding to inflationary pressures, but I believe you emphasized several times that one can certainly guard against these additional inflationary pressures too. One can guard against them along the lines that I was suggesting in my statement, or individual countries can guard against them in the form of West Germany's export tax or something like that.

What I have drawn as a conclusion from this discussion is that the link is possible in either formulation, without really creating additional inflationary pressures, although in some cases it will create ex-

pansionary forces which need not necessarily be inflationary at the same time.

Chairman REUSS. Is there any analogy in the history of central banking within a country? I do not know of any. For example, you would have an analogy I suppose in this country if the Federal Reserve were directed to invest $3 billion a year in the bonds of ghetto corporations, let us say.

Mr. JOHNSON. Or low-income States, sir.

Chairman REUSS. Or in low-income States. You would then be directing that a portion of the new money supply, the increment, would be directed at a particular purpose. The reason that has not happened is that ideas like this arouse such horrors among conventional-minded people that it would not get very far; isn't that the reason?

Mr. JOHNSON. Yes.

Chairman REUSS. In SDR creation, of course, you do have the advantage of a clean slate. The international money men have done such dashing things in the last year anyway, perhaps without knowing it, that they might be persuaded into another step in the course of progress without too much trouble.

Dr. Triffin?

Mr. TRIFFIN. Mr. Chairman, to pursue your analogy there, I think that I must go back one step. It is that my main argument is that the lending potential which inevitably is associated with the creation of SDR's should be used for the internationally agreed objectives, and I would not limit those simply to financing the ghetto or to financing overseas development, but I would think that among those internationally agreed objectives, this would be one which has a fairly high ranking alongside others which I have mentioned in my previous papers on this subject.

Chairman REUSS. Financing a U.N. police force would be one?

Mr. TRIFFIN. That would be the ultimate one, but I was thinking also of recycling of speculative capital movements and so on. The choice among equally acceptable alternative objectives would be made in the light of the priorities of the international community at the time the SDR's are created.

It seems to me that this is much closer to the operations of a bank than what is proposed now. After all, if you create a bank, the management, the board of directors decides what are the best uses to be made of the bank's lending potential. What we are proposing now, with the present SDR agreement, is, as I put it in my statement to you, to create a new bank which is committed by its own charter to distribute credit among all potential customers in proportion to their height or to their waistline, so as to not have to bother the management about those difficult decisions as to how to spend the money. The main argument against my proposal was that it would be very difficult to reach agreement as to how the money could be used most satisfactorily to all concerned. This would necessitate long discussions. It would be too much of a burden on the management. So we cut the Gordian knot and decided to distribute it in strict proportion to the quotas, which bear no more relationship to the relative usefulness and priorities of such loans than what I said about the waistline or the height of the customers of the bank.

Chairman REUSS. Let me recall another possible analogy. The historians—I am sure Mr. Johnson can throw some light on this—in the early thirties when the United States raised the price of gold from $20 to $35 an ounce, this resulted in a considerable manna-from-heaven windfall profit for the United States, without anybody ever putting his mind on it some rascal did glorious, somewhat narrow things with it. Among other things wasn't that windfall used for buying somebody a marvelous home in Japan?

Mr. JOHNSON. I am not familiar with that piece of history, Mr. Chairman.

Chairman REUSS. Doesn't anybody know about that?

Well, what was the manna? What was the amount of the manna from heaven in that increase in the price of gold?

Mr. TRIFFIN. $2.8 billion.

Chairman REUSS. $2.8 billion you said?

Mr. TRIFFIN. I quote from memory.

Chairman REUSS. Does something like that sound right?

Mr. TRIFFIN. That was used to create the U.S. stabilization fund primarily, and out of that came our initial capital contribution to the IMF, I believe.

Chairman REUSS. So there is an analogy that it is not hopeless because we did use that for international purposes, except for this Japanese house which sticks in my mind.

Well, gentlemen, you have been most helpful, and I think have carried the discussion forward. You certainly have helped me a great deal, and the committee is most grateful to each of the participants.

We now stand in recess until 2:30.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 2:30 p.m., on the same day.)

AFTERNOON SESSION

Chairman REUSS. Good afternoon.

The Subcommittee on International Exchange and Payments will be in order to continue its hearing on linking reserve creation and development assistance.

We are delighted to have with us this afternoon a former colleague, widely respected and well known to us, Prof. Byron L. Johnson of the University of Colorado.

Professor Johnson, you have a prepared statement which under the rule and without objection will be included in full in the proceedings.

Will you now proceed in your own way, sir?

STATEMENT OF BYRON L. JOHNSON, PROFESSOR OF ECONOMICS, UNIVERSITY OF COLORADO

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

I have set forth my qualifications, in addition to the ones you have stated, in the text. I will not repeat them here except to remind you that my interest began in graduate school in your State at the University of Wisconsin, where I was in a class made famous by my classmates Walter Heller and Joe Pechman. When I left the university in 1942 I joined the Fiscal Division of the U.S. Bureau of the Budget. This was the unit that preceded the Council of Economic Advisers. I

learned a great deal from our late distinguished colleague, Gerhart Colm, whose death last Christmas saddened us all, and from his deputy who served this committee for so very long, my good friend Dr. Grover Ensley.

And as I left the Executive Office my colleague there, Arthur Smithies, continued his work with the Keynes and White plans. I had the good pleasure of having Smithies come to my luncheon club to report on Bretton Woods, where he had served as rapporteur to Keynes. Against this background you can understand how overjoyed I was to receive your invitation to testify.

I would like to respond to your invitation first of all by starting several propositions that I think need to underlie further discussion of these issues.

My thesis goes beyond that set forth in your call or in the testimony this morning. I hold that the world has an obligation to arrange an adequate transfer of resources to the developing nations, and it has had that obligation since 1945, when the nations created the United Nations.

Secondly, I hold that the United Nations already has the power within the U.N. Charter to convert the IMF machinery into what would be the equivalent of a World Central Reserve Bank, and incidentally if we choose to do so, into a Central Bank of Issue of a World Currency.

Moreover, I insist we should use that power forthwith.

Thirdly, I agree that the volume of resource transfer needed is not less than the roughly 1 percent of the GNP of the developed nations, as agreed by the General Assembly, by development economists, and, as Dr. Prebisch noted in his paper and again this morning, by the UNCTAD meeting at New Delhi. Having been a delegate to several U.N. conferences, I am keenly aware of the concern of the less-developed nations that this pledge be honored, and not merely stated.

Thus, the resource transfer that could take place through linkage with reserve creation, or world currency creation, will be less than the volume needed, because we are talking here roughly, about $15 billion. But the linkage would be a very significant contribution nonetheless to the magnitude of the problem.

My fourth basic proposition is that the U.N. Charter is an international legal commitment which justifies insistence that this linkage—which I take it in light of this morning's discussion should be organic—is not simply a humanitarian gesture, which might be diverting the U.N. from its duties, but is rather a wholly appropriate use of the international machinery.

I think these propositions can be better discussed if we also set aside the interesting, but irrelevant questions, of gold, and I was glad this morning that no one was hung up on this question.

Changing the price of gold, we can affirm makes no constructive contribution. The present or probable future production of gold even if it all had to go into international or world reserves would not solve the problems. Thus, tinkering with gold production or gold marketing or gold distribution no longer needs discussion in this context.

As I have said elsewhere, the god of gold is not yet dead but is dying. I do not know that any financial columnist has as yet written "The Death of God" textbook, but the day will come when the death of the "god of gold" will have to be duly noted in an appropriate text.

In my prepared statement I seek to establish these four propositions, citing chapter and verse from the U.N. Charter.

As a junior member of the Executive Office during the years 1942 to 1944 I should like to attest here publicly that there was a great joy in the exciting opportunity to engage creatively with history during this period, in the midst of World War II. It was not only the United Nations itself that was being born, but each of the specialized agencies were being created. Many Federal agencies, notwithstanding the very heavy duties that the war brought about, had a very active involvement and a very great sense of engaging creatively with history in the building of the CAO, FAO, WHO, IMF, IBRD, and the whole range of U.N. activities.

It was our firm belief that the world was never again to be the same as it had been. World War II was to be a watershed in world history. The world was creating machinery to provide an orderly basis for attacking not only its political and international diplomatic problems, but to tackle its substantive problems as well. We were, as President Truman later was to remark, engaged in a war against man's ancient enemies—disease, hunger, misery and poverty. For this he said, is the only war we seek."

Well, how quickly we seem to forget. Yet, for all the difficulties that now plague the world, one should nevery forget what a change the United Nations has already wrought, and one should not retreat from the potentialities which still lie within the United Nations.

The U.N. Charter is actually shorter than the U.N. Constitution. The significance of the document is not in its length. It is in its import, and the import of the U.S. Constitution is summarized in the very few words which make up the preamble. In the same way I submit that the import of the U.N. Charter is to be found in a preambular page.

The first preambular clause is a statement of four very important purposes. The charter begins by saying:

> We the People of the United Nations, determined—
>
> To save succeeding generations from the scourge of war, which twice in our lifetime has brought untold sorrow to mankind.
>
> To reaffirm faith in fundamental human rights, in the dignity and worth of human persons, in the equal rights of men and women and of nations large and small.
>
> To establish the conditions under which justice and respect for the obligation as arising from treaties and other sources of international law can be maintained.

And the fourth is most important to my argument:

> To promote social progress and better standards of life in larger freedom.

Just as the U.S. Constitution restates in the document, certain essential preambular language, so also the charter of the United Nations restates that purpose. For example, paragraph three of article 1 states as a purpose of the U.N.:

> To achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights . . .

Moreover, chapters 9 and 10, articles 55 through 72, of the charter, relate to international economic and social cooperation. These set forth the work of the Economic and Social Council which was established under the General Assembly. The whole fabric of specialized agencies, including the IMF, is to be brought into harmonious relation-

ships under the United Nations in accordance with article 55 dealing with the U.N. Economic and Social Council, where we find:

The United Nations shall promote:
(a) Higher standards of living, full employment, and conditions of economic and social progress and development;
(b) Solutions of international economic, social, health, and related problems; and international cultural and educational cooperation; and
(c) Universal respect for, and observance of, human rights and fundamental freedoms.

The phrase, "shall promote," means an obligation not a permissive arrangement. Moreover article 57 declares that—

The various specialized agencies shall be brought into relationship with the United Nations in accordance with the provisions of Article 63.

Article 63 in turn gives the U.N. Economic and Social Council power to define the terms of the relationship with the specialized agencies, subject to approval by the General Assembly.

Parenthetically may I add, Mr. Chairman, that it was my good fortune to be one of the U.S. delegation to the U.N. Economic and Social Council and see this process at work in Geneva during the summer of 1962.

Mr. REUSS. Mr. Johnson, do those specialized agencies include the World Bank and the International Monetary Fund?

Mr. JOHNSON. Yes; these also attend the meetings of the Economic and Social Council, and have seats at the Council. They are normally listed to report to the Council and the Council could put questions to them or could make proposals to them or could suggest a modification of the arrangements.

Chairman REUSS. What is the constitutional difference, if any, between the World Bank and the IMF on the one hand, and the FAO, the WHO, the ILO, and UNESCO, on the other hand?

Mr. JOHNSON. Essentially each is an independent creature of the member states, and the member states in each case are not necessarily identical. I think that almost all of them have something like 107 or more members. The largest number may be 127 or more. Thus, there are some slight differences in membership. It would be a much more satisfactory situation if the United Nations and each of the member organizations did in fact have universal membership.

Chairman REUSS. My question was is there a difference in the relationship to the United Nations of the World Bank and the IMF on the one hand and FAO, WHO, ILO on the other hand?

Mr. JOHNSON. Theoretically there is no difference, but of course de facto the World Bank and IMF operate without assessments, except for the capital assessments, and each operates off its own income, whereas each of the other agencies lives off of assessments, which must be voted each year, and therefore it is like the difference between the budget for the Department of Commerce and the budget of the Federal Reserve System. The Federal Reserve does not come in, neither does the IMF or the IBRD.

Chairman REUSS. In practice has not the U.N. Economic and Social Council had more to say about the operations of the FAO, WHO, UNESCO than it has had to say about the IBRD and ——

Mr. JOHNSON. Perhaps publicly, but the nations of the world have been unhappy as to the interest in development by the IMF. In my 4

years with the International Development Agency, traveling around the world visiting with finance officers, budget officers, and development officers, I have heard repeated criticisms in years gone by for IMF's overweening concern for stability. I think the long discussion this morning on the question of inflation underlines this banker's obsession with price levels and indifference with the problems of development.

But then I realize that development is really a concept in economics which only began to take hold during World War II. Those of us who had lived through the depression only believed in recovery, we did not really believe in development. Even the IBRD name suggests that our first concern was reconstruction of war devastation. Development was an afterthought, and unhappily the IBRD—the World Bank—has only recently taken the development aspect with great concern. Only in the last few years has the IMF begun to raise the question of development to a priority item.

It was more concerned with orderly markets and stable price levels than it has been with development. It recommended monetary contraint—or "discipline" as they like to call it—to nations. One former Finance Minister in a Middle Eastern country told me that after the IMF report was accepted in his country there was increased unemployment, there was more beggary, there was more thievery, that they were risking a revolution in his country by following IMF constraints. He wished the IMF could share their own concern about development.

In recent years the IMF seems to have shown somewhat greater concern, but its past indifference to development has been a very sore point. Perhaps this is one reason why the U.N. Economic and Social Council, which has been deeply concerned with development, has tended to find the IMF not terribly relevant to their continuing concern, so that the practice may be differed from the theory.

Well, I recite this legal background to point out that the world has an obligation to transfer adequate resources to developing nations, not just as a humanitarian thing but as a responsibility. Second, that the U.N. has the power, under the charter now in articles 57 to 63 to convert the specialized monetary and financial agencies into serving as a World Central Reserve Bank, a central bank of issue of a world currency, which could be called Bancor, UNITAS, or any other name.

The world has not yet seen fit to use this power, but this should not surprise the Congress. Its power over interstate commerce for example lay dormant for about a century and a half. Only in this generation have the meanings of these powers become fully clear.

The Supreme Court has only recently seen fit to read into the Constitution meanings not previously seen, but long dormant.

Considering that the nations spend for national security programs approximately $150 billion a year, the sums allocated to international cooperation are miniscule. If more of the world's resources indeed were applied to international cooperation, less would be required for national defense.

I believe also that it is futile to wait longer for reduction in world tensions before increasing U.N. outlays for economic and social development. Indeed, it seems to me after experience both domestic and international that increasing the U.N. outlays for those purposes may well be one of the best ways to reduce tensions. I may add, Mr. Chair-

man, it is important to see this entire question posed by the committee as a United Nations question, not just as an IMF question, and it is important to strengthen the U.N. itself.

I was delighted with the closing comments of Mr. Triffin this morning, pointing out that if we are going to create reserves, and make them available for the United Nations, it should be for all of the agreed international purposes, and not merely for development.

In other words, the first three purposes of the charter are quite as important as the fourth, and I would argue consonant with that.

But I do want to justify this 1 percent figure with some mathematics, and the prepared testimony sets forth the logic of the suggestions that we need up to $15 billion to bridge the gap for the developing nations.

Now at the time of the Congo bonds that were voted, the Congress requested the United States to use its best endeavors to promote a pattern of financing that would avoid any future large scale borrowing. Working at that time in the Department of State—and writing, as a matter of fact, a portion of the U.S. Report to the U.N. on the Economic and Social Consequences of Disarmament, where I included brief language to this point—I found the Department of State tends to resist any suggestion that there be any other means of financing than assessments.

So far as I know, Mr. Chairman, these hearings are the first public inquiry that begins to respond to that Congressional request of almost 9 years ago. The volume of new reserves created under the stamp plan, as originally stated, would be about $3 billion. With world trade expanding at 7 percent per year, with gold reserves now frozen at about $40 billion, the $3 billion figure seems to be about on target at present rates, although I suspect that experience will demonstrate this to be the lower limit and not the upper limit of the annual reserve creation.

In order to get away from the hang-up this morning about inflation, about whether this sum is enough for development, and worse, since it seems to be not enough whether we should do it at all, I would include in the record my article for War/Peace Report called "Financing Expanded U.N. Economic Aid," which appeared in February of 1968.

(The article which follows appeared in *War/Peace Report*, February 1968:)

FINANCING EXPANDED U.N. ECONOMIC AID

By Byron L. Johnson*

A former U.S. congressman suggests seven novel ways to increase the total budget of the world organization from $550 million to $14 billion, allowing for a vast increase in assistance to underdeveloped nations.

How many dollars ought the world's international organizations be spending to meet the concerns of the human race? $100 million? $500 million? $1 billion? $14 billion?

The U.N. is a bargain. There are more than two billion people living in the nations that are now members, of the three billion persons on Earth. The U.N. itself will spend less than seven cents per person in 1968 to run the world organization on a budget of $130 million. The various specialized agencies will spend about another 10 cents per person, with budgets of almost $200 million, and the

*Byron L. Johnson was an officer in the U.S. Agency for International Development from 1961–64, and served as a U.S. Congressman in 1959–60. He is currently professor of economics at the University of Colorado.

autonomous agencies—mainly the U.N. Development Program—account for another 11 cents per person, with budgets of $226 million. The grand total adds up to a meagre 28 cents per capita per year for international peace and development, with budgets of $550 million. That's about what the U.S. spends on the war in Vietnam in a week!

An American state with only two million people, not two billion, spends more than that sum providing state services alone, not counting local or federal services. State governments typically spend $300 per capita per year, not 28 cents.

Special peacekeeping operations have required more than $100 million in only one year, 1961, for the Congo operation; otherwise these sums have been negligible. But the debates have been monumental. "Never have so many argued so much about so little money as in the United Nations," says John Stoessinger in opening his book, *Financing the United Nations System.** That the system has worked at all is a tribute to the world's desire that the U.N. be able to operate, whatever the difficulties.

The Congo bonds occasioned a U.S. Congressional request that the U.S. use its best efforts to promote a pattern of financing that would avoid any future large-scale borrowing. Adequate financing is certainly needed.

U.N. HAS THE POWER

In its Charter, the U.N. has significant financial power—and in 1962 an advisory opinion of the World Court held (9 to 5) that even special peacekeeping expenses were within the meaning of Article 17 of the U.N. Charter. Article 17 says simply that the General Assembly shall consider and approve the budget, that "the expenses of the Organization shall be borne by the Members as apportioned by the General Assembly," and that the General Assembly shall consider and approve budgetary arrangements with the specialized agencies, and examine their administrative budgets and make recommendations to them.

Article 19 of the Charter gives the General Assembly the power to deny the vote to any nation more than two years in arrears. Notwithstanding the World Court opinion, the U.S. chose not to try to enforce Article 19 when challenged by the Soviet Union and France. Given this situation, assessments as presently voted do not truly assure the United Nations of adequate funds.

But somehow, the U.N. must get more money. If the world is to take seriously the original purposes of the U.N., *much* more money will be needed. For Article 55 declares that:

"the United Nations shall promote:

a. higher standards of living, full employment, and conditions of economic and social progress and development;

b. solutions of international economic, social, health, and related problems; and international cultural and educational cooperation; and

c. universal respect for, and observance of, human rights and fundamental freedoms. . . ."

Moreover, Article 57 declares that "the various specialized agencies . . . shall be brought into relationship with the United Nations in accordance with the provisions of Article 63." Article 63, in turn, gives the U.N. Economic and Social Council power to define the terms of relationship with the specialized agencies (e.g., agriculture (F.A.O.), health (WHO), education (UNESCO), labor (LLO)), "subject to approval by the General Assembly." In other words, the U.N. could give specialized agencies direct support, if it had the means to do so.

These three articles, together with the budgetary and financial power of Article 17, provide a basis for a much more vigorous program by the U.N. and the specialized agencies, if there were some better way of financing than direct assessments on member states. U.S. history demonstrated in the 18th century the difficulties of relying on assessments upon member states.

Considering that member nations spend for national security programs approximately $150 billion a year, the sums allocated to international cooperation are miniscule. If more of the world's resources were applied to international cooperation, less would be required for national defenses.

It is futile to wait for a reduction in world tensions to increase U.N. outlays for economic and social development. Indeed, increasing the U.N. expenditures for these purposes may well be one of the best ways to reduce tensions. As the U.N. organizations become a more important part of our common life, there will be a greater worldwide willingness to rely upon the U.N.

---

*Published by The Brookings Institution, Washington, D.C., 1965.

How much more money is needed?

A little lesson in arithmetic will help establish some magnitudes. The underdeveloped nations of Africa and Asia have gross national products (G.N.P.) amounting to $110 per capita (or less). Latin America has an average of $325 per year. In other words, 1.5 billion people on these three continents live on a G.N.P. of $230 billion. That equals the *increase* in U.S. G.N.P. since 1961! The world's arms budget of $150 billion is two-thirds of the whole annual income of these less developed nations.

The U.N. has long since agreed that members should seek to increase their G.N.P. by at least 5 per cent per year. As a useful rule of thumb, it takes an investment of at least $3 billion to yield a $1 billion increase in annual income. Thus, success in raising the $230 billion income of the 1.5 billion people living in underdeveloped areas by 5 per cent will require annual investments approximating 15 per cent of their income, or about $35 billion annually.

On their own, these countries are doing much through personal and corporate savings, taxation and borrowing. But it is hard to save much from a subsistence economy.

Currently, through both loans and grants, the developed nations are putting up less than one-fourth of that sum, mostly through bilateral programs, for international development. Suppose an equal sum were to be put up through the United Nations: then the U.N. would need to be spending not $550 million, but more than $7 billion. And if the developed nations were to provide most of their support for development through the U.N. channels, the U.N. ought to be spending $14 billion a year, which could about bridge the gap between the requirements and the resources of the less developed countries.

Since assessments have proved inadequate, what are the alternatives? Here are seven, all of which are possible, in my view, without Charter amendment:

1. *World Trade Taxation.* International trade, communication and transportation now approximate $200 billion per year. Hence a simple 1 per cent tax would yield about $2 billion—and that would grow as trade and traffic volumes increase.

2. *U.N. Ownership of the High Seas and Sea Bed.* If the U.N. were to treat as U.N. public domain the seas and the sea floor, then it could lease rights and draw royalties on drilling, mining and other commercial activities. This could yield the U.N. rapidly growing sums for common purposes, and at the same time protect the resources of the sea against reckless plunder and pollution. Malta has recently placed on the U.N. agenda an item calling for the resources of the ocean floor beyond national boundaries to be exploited on behalf of mankind. (See WPR, November, 1967: "The U.N.'s Greatest Challenge: The Sea Bed.") It is estimated that the sea bottom could yield $5 billion a year net, by 1975, with presently developing technology and current lease and royalty arrangements.

3. *Internationalization of Vital Transportation and Communication.* The U.N. could take over important international waterways, canals, airports, communication satellites, etc., taking a percentage of their incomes. This could provide hundreds of millions of dollars, and the revenues would grow rapidly.

4. *U.N. Taxation of International Business Firms.* The time will come when registration of all public and private enterprises doing international business will be needed for these reasons: 1) to provide global information so that world taxes can be levied and spent fairly, 2) to protect weak nations against powerful corporate interests, and 3) to protect every nation against evasion of its own legal codes. To finance the U.N., I suggest as a suitable initial tax on international business firms either 0.5 percent of gross receipts or 5 percent of net profits, whichever is larger. This might provide $1 billion per year.

5. *Budgetary Reforms.* Most of the profits of the International Bank for Reconstruction and Development and of the International Monetary Fund could be channeled to the soft loans program, the International Development Association, thus aiding development.

6. *International Currency.* As soon as the I.M.F. begins to create an international reserve currency unit, or a true international currency, one can anticipate a growth of 5 to 7 percent per year in the $20 billion of I.M.F. capital. The world's need for additional international currency is growing by nearly 7 percent per year, the annual growth rate of world trade. The newly-created resources are not needed to add to the book value of world central banks. Instead these resources could be harnessed to the need for more U.N. funds. They could yield up to $1.4 billion a year.

7. *Voluntary Defense Contributions.* Recognizing that larger U.N. outlays favor world peace and security and therefore reduce each nation's need for defense spending, members could cut back a portion of their defense expenditures and contribute this amount to the U.N. What U.N. resolutions have not accomplished could happen directly as individual nations having heavy military budgets act this way voluntarily.

All these ways of giving the U.N. the funds it needs are perfectly possible from an economic point of view. The real problem is political, not economic. The world can easily afford more adequate financing for the United Nations.

As Barbara Ward reminded the 1966 World Council of Churches Conference on Church and Society:

> "When you remember that the largest and wealthiest of our economies is the United States, which added $17 billion to its gross national product between Christmas and Easter, which is half the entire national income of the Indian people, you'll guess that there is just a little bit to spare, especially during Lent. . . ."

Or, if one thinks of $14 billion for the U.N. as equal to the amount of new capital put in place in the United States every six weeks, the sum becomes manageable. It *is* time to start providing adequate financing for the United Nations. The power exists. We do have the means. What is needed is the will.

Mr. JOHNSON. In that article I suggested that we could finance international development by taxing world trade—for example, a 2-percent tax on $240 billion of world trade would yield $4.8 billion—or we could accept Malta Ambassador Pardo's proposal to use the resources of the seabed—which might yield $5 billion a year in a few years—or operation of vital international transportation and communications links, or we might tax international firms, or we might still take voluntary contributions. I have less hopes for that.

I do not hope to finance the State of Colorado by voluntary contributions from the 63 counties, nor do I expect the State of Wisconsin to be financed by voluntary contributions from its 71 counties.

Chairman REUSS. Seventy-two.

Mr. JOHNSON. Sorry; seventy-two.

Chairman REUSS. Menominee Indian Reservation.

Mr. JOHNSON. That is a new one. It has been 20 years since I looked at Wisconsin's counties.

A confirmation of these might well be sufficient to provide revenues adequate to U.N. responsibilities, including development.

In the last 30 years world trade has increased tenfold from $24 billion to $240 billion. Gold in central bank reserves has increased in the same 30 years from $26 billion to $40 billion. This is the heart of the problem with which the IMF is concerned, with which this committee is concerned.

I am most interested in Maxwell Stamp's proposals.

He suggests some variance for the Triffin plan, especially to meet the needs of the less developed countries for long-term, low-interest loans. He suggested that the new reserves be used to make 50-year, low-interest loans to IDA for it to make development loans. As he puts it, this would kill two birds with one stone, the need for greater world reserves and greater funds for development assistance. In the process this would make it easier for developed countries to sell to the less developed countries, because the units would of course flow back to the trading nation's reserves as these were used.

In the discussion this morning this would be called earning the reserves.

Stamp had proposed originally creation of $3 billion a year of new reserves. Then backed off from that to $2 billion. I think $3 billion was the right magnitude to start with, and, as I say, I would go up rather than down.

Any of these plans, Keynes, Triffin, or Stamp, would be better than what we actually have been doing with the SDR's in the actions of 1967 and 1968, because as you noted this morning, these will be allocated directly to the member nations or to their central banks according to quotas, so the United States would be given 26 percent of the new reserves directly.

This does little to meet the needs of the less-developed nations although these nations have repeatedly pressed their needs upon us and been rebuffed except verbally. The easy assurances which are given in the resolutions which are passed do not translate into adequate credit facilities for poorer nations. The SDR plan does nothing to meet the total needs of the U.N.

The time has come for a much more creative response immediately. I think the time has come to start talking seriously about a world currency, not only as a reserve unit or as a clearing unit between nations or as additional primary reserves, but also a device for transferring resources in support of the entire United Nations' commitment, including the commitment to "promote higher standards of living, full employment, and conditions of economic and social progress and development."

Moreover, it is time to start thinking of a world currency that would be a circulating currency as well. Many useful purposes might be served by having it circulate not only among central banks, but among citizens and shopkeepers as well.

In other words, going beyond the stamp plan, the Johnson plan would, for example, permit foreign travel to be much simpler if a traveler could use the same currency at every hotel, watering-hole, bus, plane, and taxi stand. Also the nations with small populations might much prefer to let the IMF be their Central Bank of issue and adopt Bancor, or whatever you call the unit, as their own currency.

Gresham's Law—that bad money drives out good—probably could be reversed if the good money were a world currency. I think it is quite possible in an inflationary country that the good money could drive out the bad. Nor is it fanciful to consider a world currency. It would be much better if the U.N. were universal in membership, but the legal documents cited, are relevant.

The Economic and Social Council could well begin this process, and invite affirmative action by the General Assembly, by an agreement whereby the International Monetary Fund becomes in effect a world central bank and a source of support for the United Nations and its other specialized agencies.

I agree with the comment made earlier that control of the amount of such support would have to rest with the IMF, so that orderly growth of world trade was the primary concern, and to avoid any temptation to pursue global inflation for U.N. purposes by any action in the General Assembly. This purpose will be better served as all three, the U.N., IMF, and the World Bank group all become truly universal in membership.

I would suggest not only an IMF investment in IDA, but three ways by which these new reserves could be employed—

First, by direct appropriation to the United Nations organizations of such portion of newly created sums as are needed to operate the entire United Nations and its specialized agencies. Curently this is only $550 million a year.

Second, by direct appropriation of at least $1 billion annually to the United Nations Development Fund, to be used as matching grants to the poorest nations, and I would suggest a variable or equalization-matching formula, giving the largest matching percentage to the poorest states, and least to the states that reach say $600 per capita, with no matching above that point or whatever might be the agreed cutoff point.

I would permit the investment in human capital quite as much as public infrastructure outlays to be eligible for these matching grants.

Third, I would of course agree that the balance of the newly created reserves may be invested in the IDA for its use in making loans to developing countries. But there is no reason to give the newly created reserves directly to the Central Banks.

When the funds are spent they will end up in these same Central Banks reserves and facilitate world trade thereafter, having first served development. Nor would I contemplate introducing world currency universally from the outset. Instead, it would be wise to experiment by having the circulation only in the smaller nations at first, say those with populations below 1 million, and then increase the number of people in the state eligible to circulate the currency. To be doubly sure, keep it permissive. A nation need not accept the world currency as a circulating currency if it chose not to. In succeeding years, as procedures and safeguards are developed through such experience, one could broaden the base.

I have expressed opposition to flexible exchange rates, mostly because I think businessmen are interested in long-term contracts, and if we use flexible exchange rates most parties will want large margins for error.

Furthermore, the recent gambling against the franc indicates that de Gaulle was right. He has a responsibility to help the people of France, not to help speculators reap a profit by betting against the franc, or encouraging others to do this. If speculators in foreign currencies are rewarded by flexible exchange rates the pressures will be heavier and more immediate with each new adverse wind.

Let me summarize my comments in response to the five issues set forth in your call to this hearing.

First, the United Nations Charter has long obligated the world to use its machinery to "promote higher standards of living and economic and social progress and development."

Second, the appropriate links between reserve creation and the United Nations can run in each of three directions. The U.N. can, through the Economic and Social Council and the General Assembly, perform its function of negotiating with the IMF to serve as a World Central Bank, with the equity in the increased money supply belonging to the world organization for all of its purposes, including the operations of the U.N. and its specialized agencies.

The reserve will flow from the U.N. agencies to the various national Central Banks, but they ought not to belong at the outset to Central Banks, any more than the assets of the Federal Reserve System belong to the State treasuries of the 50 States.

I see a parallel here which I think is absurd.

Third, the amount of reserve creation should be related to the demands of world trade. This need not be emphasized further. Whatever is being created should belong to the United Nations. The funds are created on the faith and credit of the world organization, not of the Bank of France, the Bank of England, or the Federal Reserve Bank.

Fourth, therefore, all the newly created reserves should be available for the total purposes of the United Nations, with special attention to the support of economic and social progress and development.

But finally, in response to your question of the benefits of such action, I think they beggar description. But let us just illustrate a few. It would greatly strengthen and revitalize the United Nations. It would contribute to peace through development and to peace through independence. It would contribute to the prosperity of all the world. And one of my colleagues used to say you cannot really do business with paupers. You can give them things but you cannot sell them much.

It would increase respect for the pledges in the charter and the powers of the charter. It would greatly improve the development prospects of the less developed countries, partly because it would provide an assured flow of funds rather than the stop-and-start chance flow that now comes from the various bilateral programs. It would reduce the strain internally in the more developed countries of voting the development funds. This is, I think, what you mean by the organic link.

It would avoid the temptation to play international politics as the price of development. No nation likes to have its sovereignty threatened nor its dignity outraged by the need to beg for development assistance.

It would recognize that development requires an adequate international assistance program and not just a bootstrap operation, because part of the components of development must come from abroad. Even if domestic savings were to be adequate—for example by the use of some Spartan sacrifice techniques—this would not assure a developing country of access to the foreign resources which its development program needs. Wther or not the world currency circulates, these arguments would apply. But to say the best for the last, I offer as a tentative further prospect that this might provide an approach to end the balance of payments problems of the major powers as well.

I suggest that the United Nations could give slight preference to sales from, as occasion may require, nations experiencing a decline in reserves, just as FNMA, for example, can use the point system to encourage or discourage sales in the mortgage markets, or as the Federal Reserve can raise and lower its requirements or its basic pricing policy—so the U.N. could tilt the flow of funds from its table through the developing nations, back to the developed nations, by a prearranged formula which would serve to counterbalance the flow of funds.

30-668—69——7

Foreign exchange speculators would be deterred by the automatic operation of the formula. They would no longer be tempted to bet against any nation's domestic currency, and the panic response that has been so inhibiting and alarming in recent years could be avoided.

We now experience private control of output and price. It has moved from the national level to the international level in all too many fields in recent years. The world now needs an international structure competent to counteract private action which is destructive of either the small powers, or of any one of the great powers.

I thank you for the opportunity to testify.

(The prepared statement of Mr. Johnson follows:)

PREPARED STATEMENT OF PROF. BYRON L. JOHNSON

ON LINKING RESERVE CREATION TO DEVELOPMENT ASSISTANCE

Mr. Chairman, members of the subcommittee, former colleagues and friends: My name is Byron Johnson. I teach economics, including international development, at the Denver Center of the University of Colorado, where I have been a professor of economics since 1965.

For the previous four years, I had been in the service of the Agency for International Development of the U.S. Department of State, and in that capacity had examined closely the development programs especially of the Philippines and of Chile, had taken part as delegate or alternate in international development conferences in every region of the world, as well as at UN headquarters in New York and Geneva, had visited UN agencies at work in their headquarters and in the field, and had opportunity to consider and explore development and international monetary problems with central bankers, finance ministers, budget officers, and with planning staffs and agency heads around the world. In addition, my colleagues in the agency contributed many insights.

During 1959 and 1960, it was my pleasure to serve on the House Banking and Currency Committee while representing the Second District of Colorado. In that fateful session we considered legislation increasing our quota in the IMF; we strengthened the Development Loan Fund; we approved the creation of the Inter-American Development Bank. UN conferences in which I participated gave rise to the economic development training institutes in Latin America and in Asia, gave rise to the UN Industrial Development Organization, and to the formation of the UN Conference on Trade and Development. In 1966, while attending a World Council of Churches conference in Geneva, I renewed acquaintance with the U.S. delegation, and conferred with officials of UN agencies meeting there for the Economic and Social Council then in session.

But my interest began while in graduate school, where I took a Ph.D. in economics with finance as my field of concentration—in the class made famous by my classmates, Heller and Pechman. Upon completion of my course work, I joined the Fiscal Division of the U.S. Bureau of the Budget in 1942—the unit that preceded the Council of Economic Advisers. I learned much from our late distinguished colleague, Gerhart Colm, and his deputy who served this committee for so long, Grover Ensley.

After a three-year stint (1944–47) under Wilbur Cohen, I started teaching at the University of Denver, where Ben Cherrington contributed greatly to my international education and encouraged my interest in development economics.

Having seen the United Nations born almost under my eyes in the Executive Office, and having discussed the IMF at the time with my colleague, Arthur Smithies, who was at Bretton Woods as *rapporteur* to Lord Keynes, I welcome this opportunity to testify, with deep appreciation.

Mr. Chairman, I'd like to respond to your invitation by discussing several propositions that should underlie further discussion of these issues:

1. That the world has an obligation to arrange an adequate transfer of resources to the developing nations, and has had that obligation since 1945, when the nations created the United Nations.
2. That the United Nations has the power to convert the IMF—IBRD—IDA—IFC machinery into a world central reserve bank, and into a central bank of issue of a world currency, and should use that power, now implicit in the United Nations charter, forthwith.

3. That the volume of resource transfer needed is not less than roughly 1% of the GNP of the developed nations, as the General Assembly, and many development economists, have long insisted. Therefore, the resource transfer that could take place through linkage with reserve creation, or world currency creation, will be less than the volume desirable and needed—but the linkage would be a very considerable contribution to the magnitude of the problem.

4. That acceptance of the international legal commitments in the UN Charter justify insistence that this linkage is not some unrealistic humanitarian gesture, diverting the IMF from its duties, but is a wholly appropriate use of international machinery. Indeed, the legal situation would justify the complaint that the world's international monetary machinery has been usurped by the central banks of the member nations, thus frustrating the purposes of the peoples of the world as expressed in the UN Charter.

These propositions can be better discussed if we set aside the interesting, but increasingly irrelevant, question of gold. Let us dismiss it for now by affirming that changing the price of gold would make no constructive contribution to (but would sharply interfere with) the basic problems of liquidity, of adequate world reserves for growing world trade, of economic development, and of transfer of real resources to the less developed nations. Therefore no change in the price of gold need be discussed here.

And let us add, the present or probable future production of gold, even if it all were to go into national or world reserves, and even if all personal and industrial uses were to be proscribed, would not solve these problems. Therefore tinkering with gold production, gold marketing, or gold distribution need not be discussed here.

Before detailing the processes by which I would link world reserve creation with development assistance, let me establish the first four propositions, citing chapter and verse from the Charter.

The United Nations was conceived by the Allies, and especially by the United States, in the very heat of World War II. The Executive Office and the Department of State, with all of the pressing matters of a war to attend to, nonetheless found time to plan for a post-war world that would be operated "to save succeeding generations from the scourge of war."

As a very junior member of the Executive Office Staff during the years 1942 to 1944, I can attest there was a joy in the exciting opportunity to engage creatively with history during this period. For it was not only the United Nations itself which was being born. Those concerned with food and agriculture were building an international organization, intending to assure all mankind an adequate food supply. Those concerned with health were building the World Health Organization. Those concerned with the emerging form of transportation—the airlines—were building an International Civil Aviation Organization. Those concerned with international monetary affairs and with reconstruction and development were building an IMF and an IBRD.

The planning enlarged, included other nations, and extended over the whole range of the United Nations activities.

The world was never again to be the same as it had been. World War II was indeed a water-shed in world history. Colonialism was doomed. The hundreds of millions who had lived under subjection to foreign rule in the continents of Asia and Africa and in the islands of the sea were soon to experience the freedom which had been won in the Americas during the late 18th and early 19th centuries. The world was to have machinery providing an orderly basis for attacking not only its political and international diplomatic problems, but to tackle its substantive problems as well. We were, as President Truman later was to remark, engaged in a war against man's ancient enemies—disease, hunger, misery, and poverty.

How quickly we forget. It is an old rule in politics that gratitude is a very evanescent emotion. It can vanish as quickly as the dew before the rays of the morning sun. The United Nations, officially christened in 1945 in San Francisco, opened for business at Lake Success on August 16, 1946, and was enshrined on the East River in 1952. It is barely through its adolescence. Not all of the world's problems have been solved during this brief quarter century. Many very serious problems remain. For all the difficulties that now plague the world, one should never forget what a change the United Nations has wrought. One should never forget that the United Nations represents a profound break with all past history. But because UN performance has fallen short of the initial pledges, the initial hopes and dreams, and because there have been difficulties, some have been led

into a kind of national introspection. There has been some holding back on the promise of tomorrow. Some would solve the problems of the world by major amendment to or modificatin of the machinery. A few seem to believe the whole machinery could be scrapped, as though we might somehow do better if we started over.

Wherever it is that we are going, we shall get there from here. The promise of tomorrow is only to be realized as we renew our awareness of what tomorrow could be and take affirmative steps toward the fulfillment of its promise.

There is a growing awareness of what the risks may be. If we fail to make progress, if we scorn or abuse machinery of international cooperation, then those who do not learn from the lessons of history are indeed doomed to take them over again. Those of us who have already taken it once, have no desire to wish that tragedy on our children or our children's children.

In these years of the early maturity of the United Nations, it is now time to realize a wider fulfillment of the pledges the nations of the world made to each other in 1945 in signing the Charter of the United Nations and the Statutes of the International Court of Justice.

The United Nations Charter is shorter than the United States Constitution. It takes only 18 pages. Ten more are sufficient to recite the Statutes of the International Court of Justice. The 111 Articles of the UN Charter are each quite brief, as are the 70 Articles of the Statute of the World Court. But the significance of the document is not in its length. It is in its import. The import of the United States Constitution is summarized in the few words which make up the preamble. In the same way *the import of the UN Charter is to be found in its preambular page.* The first preambular clause is the statement of purpose. It reflects far more eloquently than did the early drafts the collective judgment of mankind expressed by the representatives of 50 governments at San Francisco.

1. The First Pledge; the Charter begins:

> WE THE PEOPLES OF THE UNITED NATIONS, DETERMINED—to save succeeding generations from the scourge of war, which twice in our lifetime has brought untold sorrow to mankind, . . .

In fulfillment of this pledge, the United Nations has established: the General Assembly in Chapter IV; the Security Council in Chapter V; machinery for the settlement of disputes in Chapter VI; and action with respect to threats to the peace and breaches of the peace and acts of aggression in Chapter VII. It gave limited approval to regional arrangements, such as are provided in the Organization of American States. And it provided the Statute of the International Court of Justice, "as the principal judicial organ of the United Nations." Peacemaking machinery exists.

Peacekeeping machinery also exists. Chapter VII, Articles 39 through 51, provide the legal basis for action in the event of threats to the peace, breaches of the peace, and acts of aggression.

In order to enable the United Nations to take urgent military measures, Members shall hold immediately available national air force contingents for combined international enforcement action. (Article 45)

Plans for the application of armed force shall be made by the Security Council with the assistance of the Military Staff Committee (Article 46). Article 47, Section 2 provides:

> The Military Staff Committee shall consist of the Chiefs of Staff of the permanent members of the Security Council or their representatives. Any member of the United Nations not permanently represented on the Committee shall be invited by the Committee to be associated with it when the efficient discharge of the Committee's responsibilities requires the participation of that Member in its work.

2. In the Second Pledge, the Charter recites:

> WE THE PEOPLES OF THE UNITED NATIONS, DETERMINED—to reaffirm faith in fundamental human rights, in the dignity and worth of the human person, in the equal rights of men and women and of nations large and small. . . .

One must remember that the Charter was signed by representatives of many nations throughout the world, that at the time did not recognize the equal rights of men and women, and did not honor the dignity and worth of human persons, particularly those belonging to minority groups. The very fact of the pledge was an earnest of mankind's intention to change not only international law and order, but customs and mores, the habits of mind and the laws of the Constitutions of the several states themselves. Otherwise this pledge could not be realized.

3. The Third Pledge in the Charter:

> WE THE PEOPLES OF THE UNITED NATIONS, DETERMINED—
> to establish the conditions under which justice and respect for the obligations arising from treaties and other sources of international law can be maintained, . . .

The orderly resolution of disputes is itself a major contribution to civilization. This pledge represents an effort to bring the process of civilization into the jungle of international affairs. In this 20th century world where technology has shrunk time and space, respect to the obligations of international law is just as necessary as respect for law was within Rome in the first century.

4. My argument rests primarily, however, with the Fourth Pledge of the UN Charter:

> WE THE PEOPLES OF THE UNITED NATIONS, DETERMINED—
> to promote social progress and better standards of life in larger freedom, . . .

For the Charter of the United Nations restates that purpose in paragraph 3 of Article 1:

> To achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights, for fundamental freedoms for all without distinction as to race, sex, language, or religion; . . .

Moreover, Chapters IX and X, Articles 55 to 72, of the Charter, relate to international economic and social cooperation and to the work of the Economic and Social Council which was established under the General Assembly. The whole fabric of specialized agencies was brought into harmonious relationships with the United Nations in accordance with Articles 57 and 63.

Article 55 declares that:

"The United Nations shall promote:

a. higher standards of living, full employment, and conditions of economic and social progress and development;

b. solutions of international economic, social, health, and related problems; and international cultural and educational cooperation; and

c. universal respect for, and observance of, human rights and fundamental freedoms . . ."

Moreover, Article 57 declares that "the various specialized agencies . . . shall be brought into relationship with the United Nations in accordance with the provisions of Article 63." Article 63, in turn, gives the UN Economic and Social Council power to define the terms of relationship with the specialized agencies (such as FAO, WHO, ILO, UNESCO, etc.), "subject to approval by the General Assembly." In other words, the UN could give specialized agencies direct support, if it had the means to do so.

These three articles, taken together, provide a basis for a much more vigorous budgetary and financial program for the UN and the specialized agencies. But they require some better solution than direct assessments of member states. U.S. history demonstrated in the 18th century the difficulties of relying upon assessments from member states.

The foregoing is cited to establish the first two propositions stated at the outset, namely:

1. That the world has an obligation to arrange an adequate transfer of resources to the developing nations, an obligation accepted with the approval of the U N Charter in 1945. Thus it is not sufficient for this committee to consider such a transfer as a "humanitarian" thing to do, as an opportunity to be seized or neglected at will. And in addition:

2. That the United Nations has the power, in Articles 57 and 63, to convert the specialized monetary and financial agencies into serving as a world central reserve bank, and into a central bank of issue of a world currency, whether called Bancor, Unitas, or other, that the world has not yet seen fit to use this power should not surprise the Congress, which has allowed its powers over interstate commerce, for example, to lie dormant for a long time. Only in this generation has the meanings of these powers become clear. Similarly, the Supreme Court has only recently seen fit to read into the Constitution, in deciding cases before it, meanings not previously effective, but long dormant.

Let us turn then, to the third proposition, and give some attention to the magnitude of the resource transfer needed, so that the importance of the issue we are discussing here can be clarified.

Considering that member nations spend for national security programs approximately $150 billion a year, the sums allocated to international cooperation are

miniscule. If more of the world's resources were applied to international cooperation, less would be required for the national defenses.

It is futile to wait for a reduction in world tensions to increase the UN outlays for economic and social development. Indeed, increasing the UN outlays for these purposes may well be one of the best ways to reduce tensions. As the UN organizations become a more important part of our common life, there will be a greater world-wide willingness to rely upon the UN.

How much more money is needed?

The UN long since agreed that members will seek to increase their gross national product (GNP) by at least 5% per year. Success in raising the $250 billion income of the 1.5 billion people living in underdeveloped areas by 5% will require annual investments approximating 18% of their income (given their out/capital ratios), or about $45 billion annually.

On their own, these countries are doing much through personal and corporate savings, taxation, and borrowing. But it is hard to save much from a subsistence economy. They have raised about $30 billion.

Currently, through both loans and grants, the developed nations are putting up roughly 7 billion (ignoring repayments) mostly through bi-lateral programs, for international development. Suppose an equal sum were to be put up through the United Nations: then the UN would need to be spending not $550 billion (the present total for all purposes), but some $7 billion. And if the developed nations were to provide most of their support for development through the UN channels, the UN ought to be spending at least $14 billion a year which could about bridge the gap between their requirements and their resources.

(This is the magnitude involved in the recurrent resolution in the UN to the effect that member nations reduce their defense budgets by 10% in order to finance economic and social development.)

To put the present outlays for the entire family of the United Nations into perspective, I have noted (WAR/PEACE REPORT, February 1968):

"The UN is a bargain. There are more than two billion people living in the nations that are now members, of the three billion persons on Earth. The UN itself spent less than seven cents per person in 1968 to run the world organization on a budget of $130 million. The various specialized agencies will spend about another 10 cents per person, with budgets of almost $200 million, and the autonomous agencies—mainly the U.N. Development Program—account for another 11 cents per person, with budgets of $226 million. The grand total adds up to a meagre 28 cents per capita per year for international peace and development, with budgets of $550 million. That's about what the U.S. spends on the war in Vietnam in a week!

"An American state with only two million people, not two billion, spends more than that sum providing state services alone, not counting local or federal services. State governments typically spend $300 per capita per year, not 28 cents."

Special peacekeeping operations have only required more than $100 million in one year, 1961, for the Congo operation; otherwise these sums have been negligible. But the debates have been monumental. "Never have so many argued so much about so little money as in the United Nations" says John Stoessinger in opening his book on *Financing the United Nations System*. That the system has worked at all is a tribute to the world's desire that the UN be able to operate, whatever the difficulties.

The Congo bonds occasioned a U.S. Congressional request that the U.S. use its best efforts to promote a pattern of financing that would avoid any future large-scale borrowing. Adequate financing is certainly needed.

The Department of State, I found, tends to resist any suggestion of other means of financing. These hearings are the first public inquiry that begins to respond to the Congressional request.

Obviously the United Nations will not jump from half a billion to 15 billion dollars in economic activity in any short time span, even if the member nations agree that it should. The order of magnitude of the changes being discussed here are nonetheless a significant step toward a meaningful response.

In this connection, the report of the Section on Economic Development in a World Perspective, at the 1966 Geneva Conference of the World Council of Churches, had a cogent observation that merits note (Para. 61, Page 70, of the Report):

"A word must be added here about the quantitative importance of foreign resources in the process of development. Though the contribution of the developed to the underdeveloped countries is far less than one percent of the national income

of the former, it is over three percent of that of the latter. Since the domestic savings of the underdeveloped economies are generally not more than 10 percent of their national income, foreign resources constitute a very high percentage of investable funds. The use of foreign resources entirely for productive investment and an increase in the amount of aid will, therefore, have a far greater impact on underdeveloped economies than is generally obvious."

Until the IMF uses the new Special Drawing Rights, it is difficult to estimate with any assurance what will be the volume of new reserves created per year. Under the Stamp Plan, as originally stated, about $3 billion would be the likely limit. (With world trade expanding at 7% per year, and gold reserves now about $40 billion, the $3 billion figure seems about on target at present rates.)

This sum would add at least 40% to the volume of development assistance now available annually, and could do so on terms much more acceptable to the poor nations. The high costs on conventional loan terms mean that in a very few years, the burden of repayment will exceed the capacity of the poor borrowers. Or, to put it another way, attempting to finance economic development among the less developed countries on conventional loan terms will soon require increased lending simply to refinance existing loans, and make no significant further input of resources to the less developed countries.

There are other ways by which the peoples of the world might strengthen the financial powers of the United Nations, so that it might more fully perform as a major factor in facilitating international economic development. I have summarized some of these in the attached article, as including taxation of world trade (a 2% tax on $240 billion of world trade would yield $4.8 billion), UN development of the resources of the sea bed and of the sea (up to $5 billion by 1975, according to Ambassador Pardo of Malta), UN operation of vital international transportation and communication links, UN taxation of international business firms, other earnings from UN agencies, and voluntary contributions. A combination of two or more of these proposals might well be sufficient to provide revenues adequate to UN responsibilities.

The issue these hearings raised was raised within the IMF and in the Committee of Ten deliberations. Representatives did press for the use of the additional reserves as a way of transferring resources to the developing nations. But the Central Banks of the major powers preferred to concentrate on the problems of their own liquidity and balance of payments, and to dismiss the claims and requests of the poorer nations. Within the context of an IMF meeting, it is understandable that the Central Bankers should have made that choice.

When overseas on behalf of development, I have heard repeated complaints from officials of the developing nations that the IMF has always given primary attention to the concerns of the major powers, for stability, liquidity, and redress of any imbalance of payments. Only in recent years has the IMF even begun to be sensitized to the claims for development as a high priority concern of nations.

My purpose in this testimony is to underline that economic development is a commitment, an obligation, of the entire United Nations, not just of the International Bank for Reconstruction and Development and of its IDA, nor only of the United Nations Development Program. Therefore the IMF should also be operated so as to perform this obligation more faithfully. To this purpose, however, the UN Economic and Social Council, and the UN General Assembly, will also have to take affirmative action. As the world prepares for the Second Decade of Development, it is time to re-examine the problems, and to find solutions suited to the next 25 years of the life of the UN.

The day must come, and will come, when there is a world international currency. For the growing world trade needs growing international monetary nourishment—but it is not getting it. Hence world trade has had to cope with, or be hurt by, slow starvation. In the last 30 years, world trade has increased ten-fold, from $24 billion to $240 billion a year, and is growing by 7% each year. But the gold in central banks reserves has increased in the same 30 years from $26 billion to only $40 billion.

To accommodate the rapid growth in trade against the modest growth in gold, the world has had to improvise, to accept supplemental reserves through the holding of one another's currencies, especially those of the major powers. But each time any such currency comes under pressure, some holders have wanted to convert to gold, or when that is impossible, into a stronger currency, and a sense of monetary crisis develops.

The new gold now being produced is going either into personal and industrial use, or into personal and national hoards. So long as there are hopes that the

official price will be raised, the estimated $4 billion of hoarded gold will not come in to world reserves—and the major powers have said they won't buy any more gold. Instead, the new Special Drawing Rights are expected to provide new reserves, in addition to those provided indirectly by the U.S. loss of reserves to other nations.

If the Bretton Woods Conference in 1944 had in fact adopted for the IMF the proposals of Keynes, set forth in the British White Paper of April 1943, the world could have avoided much of the present troubles. Lord Keynes had proposed an international currency (Bancor) "governed by the actual current requirements of world commerce . . . capable of deliberate expansion and contraction of offset deflationary and inflationary tendencies in effective world demand . . .

"More generally, we need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety, for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self-protection from disruptive outside forces." This is still true, 25 years later.

Keynes proposed a currency unit that would be an international clearing house currency, and provided automatic incentives to nations to keep their balances near their quotas, by putting interest rate penalties on being too high above, or too low below, such quotas. The clearing house would have been able to create additional Bancor—but Bancor would not really have circulated. It would have been an international unit of account, and an international reserve, but not a circulating international currency.

The Triffin Plan has, since 1959, tended to dominate the discussion of international monetary reform. Keynes' plan was written before there was an IMF—he helped create it. Triffin starts with the IMF, but would have nations convert their subscription of gold and foreign exchange into Bancor, as an international reserve unit. Triffin suggested that Bancor be expanded by annual creation of an additional 3 to 5% of Bancor units (which is less than trade is now growing), and to this by granting Bancor credits and by the purchase of securities with new Bancor. This would build a nation's deposit accounts just as the Federal Reserve does for member banks.

Maxwell Stamp proposed a few variants to this plan, especially addressed to the great need of the less developed countries for long-term, low-interest loans so that they might accelerate their development, and a play a larger role in the world trade. Under the Stamp Plan, the increased reserves would be lent on 50-year, low-interest loans to the International Development Association (IDA), a subsidiary of the World, Bank, for it to use in making development loans. This would, as Stamp puts it, kill two birds with one stone—the need for greater world reserves, and for greater funds for development assistance. In the process, it would make it easier for the developed countries to sell to the less developed countries. The units would flow back to trading nations' reserves as used.

Stamp had originally proposed IMF creation of $3 billion a year of new reserves. This would represent little more than 20% of an annual increase in world trade, well below the present ratio of reserves to trade, hence a modest figure.

Any of these plans would be superior to the 1967–68 IMF action to create Special Drawing Rights from time to time, which will be allocated directly to each of the member nations, or their central banks, in accordance with their quotas. These will indeed increase reserves, especially of the most prosperous nations. The U.S. would currently be given 26% of the new reserves. Such rights do little to meet the needs of the less developed nations, although these nations have repeatedly pressed their needs upon the richer nations, only to be rebuffed. The easy assurances given by political leaders since 1941 do not translate into adequate credit facilities for poorer nations. The new plan does nothing to meet the total needs of the United Nations for more adequate resources.

A much more creative response is clearly indicated—starting now.

It is time to talk seriously about a world currency, as a reserve unit, as a clearing unit between nations, as additional primary reserves, and as a device for transferring resources in support of the United Nations commitment to "promote higher standards of living, full employment, and conditions of economic and social progress and development."

Moreover, it is time to start thinking of a world currency that would be a circulating currency as well. Many useful purposes might be served by having it circulate not only among central banks, but among citizens and shopkeepers.

For example, foreign travel would be much simpler if meals, transportation, and shelter were being quoted in international currency units so that a traveler could use the same world currency everywhere, and need not adjust to 12 different currency units. Or, for example, the nations with very small populations might prefer to let the IMF be its central bank of issue, and adopt Bancor, or whatever the unit be called, as its own currency.

Gresham's law, that bad money drives out good, might well be reversed when the good money is a world currency. Thus trade in and with nations experiencing inflation might be facilitated if it could also be conducted in stable terms by reference to and use of a stable world currency unit.

Nor is it fanciful now to consider a world currency. Obviously it will only become a truly world currency when it is authorized by the United Nations, and when the United Nations is universal in membership and attendance. However, a legal basis for action now is to be found in Articles 57 and 63 of the UN Charter, as noted above.

The Economic and Social Council could begin the process, and invite affirmative action by the General Assembly, to develop an agreement whereby the International Monetary Fund became, in effect, a Central Bank and a source of support for the United Nations and its other specialized agencies. Obviously control of the amount of such support would have to rest with the IMF, so that orderly growth of world trade was the primary concern, and to avoid the temptations to pursue global inflation for UN purposes, by any action in the General Assembly. Obviously this purpose will be better served as the UN, the IMF, and the World Bank group become universal in membership.

I suggest United Nations consideration of three ways by which the increased reserves (and world currency when initiated) might be used to achieve these purposes:

1. By direct appropriation to the United Nations organizations of such portion of the newly created sums as are needed to operate the United Nations and its specialized agencies (currently, about $550 million).
2. By direct appropriation of at least one billion dollars annually to the United Nations Development Fund, to be used as matching grants to the poorest nations, on a variable or equalization-matching formula, giving the largest matching percentage to the poorest States, and the least to those nearest, say $600 per capita, with no matching for states richer than that. Investment in human capital as well as public infrastructure outlays may be eligible for the matching grants.
3. By investment of the balance of the newly created reserves in the International Development Association, for its use in making loans to developing countries, at terms they can afford, in support of their development programs.

There is no reason to give the newly created reserves directly to the Central Banks in proportion to their IMF quotas—the funds when spent will end up in the same Central Banks reserves, and facilitate other world trade therafter, having first served development.

Nor would I contemplate introducing a world currency universally from the outset. Instead, it would be wise to experiment with only the smallest nations the first year, only permitting nations up to one million in population to use it the first year (whether they use it as the sole currency, or as an alternate currency).

In succeeding years, as the procedures and safeguards are developed through such experience, successively larger nations might be permitted to use the world currency as a circulating unit. (If the population permitted were doubled each year, the process would take 11 years before India or China might qualify.)

I cannot conclude this presentation without a comment about flexible exchange rates. We have recently seen efforts by speculators to bet almost $4 billion on the devaluation of the franc, and the upward revaluation of the Deutchmark. Many of my fellow economists have repeatedly urged policies that have encouraged just such speculation.

The *New York Times* published a letter of mine, in January of this year, just when such pressure was being placed against France, and when DeGaulle had refused to yield. In that letter, I argued for DeGaulle:

"Flexible exchange rates are a seductively simple answer to a persistent loss of reserves. It is a nice name for devaluation. It could weaken confidence in the dollar. It should be voided.

"Some of my fellow economists recommend it, Market-oriented, they concentrate on the current transactions, the short-run market. Thus they fail to see why the

international money market should not fluctuate the way wheat future markets do.

"Speculators agree. The currency speculator may have no great obligation to any one country. He sees no reason why money should not be like wheat and respond to his market pressures. He does not see why money managers insist on acting contrary to his own judgments. He could probably make money by manipulating currencies.

"But many business men are more interested in long-term contracts. They want a high degree of predictability, not uncertainty. Flexible exchange rates will mean that both parties to a long-term international contract will want large margins for error. The strength of every national economy is profoundly dependent upon the willingness of residents and foreigners to undertake long-term contracts, in relative security about the values on both sides of the contracts.

"Flexible exchange rates would put bankers, including Central Bankers, under pressure to hold their foreign currency holding, to avoid inventory losses. This would tend to reduce the volume of international transactions, and increase their costs.

"Thus DeGaulle has been unfairly criticized. Like many public officials, he bears a heavy responsibility for a healthy domestic economy. He has no responsibility to help the speculators reap a profit by betting against the franc. He has no reason to encourage others to play the same game. For if speculators in foreign currencies are to be rewarded by flexible exchange rates, then the pressures will be heavier and more immediate with the next adverse wind, and international trade will decline. Public officials must be expected to favor the long-range interests of the solid business men over the short-run interests of manipulators of so-called 'hot money.'

"Long-run increases in international transactions are better than quick tricks to restore a momentary equilibrium in international payments. It is more important to encourage trade and development than to reward currency speculators. Of course there should be appropriate steps to restore equilibrium. But these should be trade-expanding, not trade-contracting. Flexible exchange rates represent an advance decision that these will fail, and demand the surgery of exchange uncertainty regardless of consequences.

"Increasing world trade demands increasing world reserves. One day soon the world must go beyond Special Drawing Rights, and adopt a world currency.

"The annual increase could help provide capital for the International Development Association, with less political strain on the developed nations. Economists must move beyond Ricardo, Keynes, and White to Maxwell Stamp. So must the world."

In summary—

It is evident that my response to the five issues set forth by the subcommittee are:

1. That the United Nations Charter has long obligated the world to use its machinery to "promote higher standards of living . . . and . . . economic and social progress and development," both in the preambular paragraphs and in Article 55. The only argument against making use of the UN Charter is that the world has tended to neglect this obligation during the first quarter century of the UN.

2. The appropriate links between reserve creation and the United Nations can run in a variety of directions. In effect, I am proposing that the Economic and Social Council perform its function of negotiating for the IMF to serve as a world central bank, with the equity in the increased money supply belonging to the world organization for *all* its purposes, including the operations of the UN and its related specialized agencies, including the Development Program and including investment in the IDA. The new reserves will flow from the UN agencies to the various national central banks, but ought not belong to them, any more than the assets of the Federal Reserve System belong to the State treasuries of the 50 States!

3. The amount of reserve creation should be related to the demands of world trade, not the need to finance the UN or development. Thus the amount of reserve creation should remain a function of the IMF, not of the Economic and Social Council nor of the General Assembly. But whatever amount is created should belong to the United Nations—the funds are created on the faith and credit of the world organization, not the Bank of France, or the Bank of England, etc.

4. Therefore all the newly created reserves should be available for the total purposes of the United Nations, with special attention to the support of economic and social progress and development.

5. The potential benefits of such a link beggar description. But to illustrate: It would greatly strengthen and revitalize the United Nations. It would contribute to peace through development and to peace through interdependence. It would contribute to the prosperity of all the world (You can't do business with paupers). It would increase respect for the pledges in the Charter, and the powers of the Charter. It would greatly improve the development prospects of the less-developed countries, because it would provide an assured flow of funds, rather than the stop-and-start chance flow that now comes from the various bi-lateral programs. It would reduce the strain internally in the more-developed countries of voting the funds for bi-lateral programs. It would avoid the temptation to play international politics as the price of development (no nation likes to have its sovereignty threatened nor its dignity outraged by the need to beg for development assistance). It would recognize that development requires an international assistance program (not just a bootstrap operation) because part of the components of development must come from abroad, and requires foreign exchange. Even if domestic savings were to be adequate, by the use of spartan sacrifice techniques, this would not assure a developing country of access to the foreign resources its development program needs.

Whether or not the new reserves are a world currency, permitted to circulate, the foregoing arguments would apply. For if the new reserves had to be sold to Central Banks by the UN to gain the foreign currencies needed, the problems of the developing countries would be largely solved.

But to save the best to the last, this approach could be the end of the balance of payments problems of each of the major powers as well. For the United Nations could give slight preference to sales from, as occasion might require, nations experiencing a decline in reserves—and, conversely, it could exercise a slight restraint against purchases from nations already experiencing a too-rapid increase in its reserves. Thus the tilting of the flow from the UN table, through the developing nations, back to the more developed nations, could by a pre-arranged formula serve to counter-balance the flow of funds. Foreign exchange speculators could be deterred by the automatic operation of the formula, so that they would no longer be tempted to bet against any nation's domestic currency, and the panic-response that has been so inhibiting and alarming in recent years could be avoided. The private control of output and price has moved from the national level to the international level in recent years. The world needs an international structure competent to counteract private action which is destructive of either the small powers, or of any one of the great powers.

In closing, I want to congratulate the Joint Economic Committee for these hearings, and especially Congressman Reuss. His continued, fearless, and constructive leadership in these fields has been a beacon of responsible statecraft.

(The following letter and article were later submitted by Professor Johnson:)

University of Colorado,
College of Arts and Sciences,
Denver, Colo.

Hon. Henry Reuss,
Joint Economic Committee

Dear Mr. Chairman: There was a passing reference in the morning session to the use of the word "aid", noting that it should really be net of repayment, and should not include conventional loans, but only the savings from below market interest rates.

I should like to have included my own article on this point, from *War/Peace Report* of November 1966 "Let's Stop Calling It *AID*", at this point.

During the morning discussion, there was discussion that suggested that international development assistance was using up some *stock* of goods otherwise available in the donor country. In point of fact, the assistance is more likely to increase the *flow* of goods and services in both countries, so that it really is not likely to divert resources that would otherwise be employed. Only if one makes the assumption, contrary to fact, that there might be full employment and then that there might be aid, would the argument have a semblance of truth. And if there were to be full employment in the donor countries, development assistance would be desirable, for it would encourage new technology and progress, and increase the true incomes in both countries as a result of the success of the development. It is important to break out of the "Static Analysis Trap" in which all too much discussion among economists tends to take place. We live in a dy-

namic, developing world. We do not now live, nor have we for many centuries, lived in a static economy. The discussion would have been more accurate if it had dealt with the increase in *flow*, and abandoned archaic notions of a limited *stock* which assistance diverts from home to abroad.

Yours,

BYRON L. JOHNSON.

LET'S STOP CALLING IT *AID*

By BYRON L. JOHNSON

A former A.I.D. official, calling the acronym AID a hypocritical misnomer, charges that American "aid" consists of self-promoting, arrogantly-administered loans that offend the pride of developing nations.

The problem is not *aid!* The problem is *development!*

Americans should rid themselves of the invidious terms with which they burden themselves and the world dialogue.

Take the word *aid*—it usually means to give relief or support. But the U.S. is not *giving* aid—mostly it is making development loans, to be repaid by the borrowing country. This is not *aid.*

Take the words: *mutual security* or *defense support.* The U.S. is not *giving* others military aid—rather it is buying some kind of national defense or security for itself. This is not *aid.*

Take the words: *building markets* or *buy American.* When U.S. involvement in the economic life of others requires that the dollars be spent in the United States, this looks like self-serving export promotion. The others don't see it as *aid.*

Take these words away.

And take away, however painful it may be, the words *free world* and *anti-communist.* United States alliances with military dictatorships, oligarchies, racists and neo-fascists feed a growing cynicism about U.S. dedication to a *free world.* Hypocracy seems patent whenever tyranny can be an ally simply by professing to be *anti-communist.* The others do not see such involvement as *aid,* but as an obsession, shamelessly using anti-democratic regimes out of fear. The U.S. appears to be supporting the enemies of freedom within their own countries. (It hurts to serve as a U.S. official and be asked overseas as I have been, whether one must really be an enemy of the U.S. to receive *aid* from it.)

Take away also the U.S. notion of *leadership.* Who appointed the U.S. to serve as monitor, disciplinarian, headmaster, autocrat, or chief among equals? One foreign cabinet member, when asked for counsel by an American, asked incredulously, "You mean that you came to *listen?!*" There is no *aid* in arrogance, only offense. Foreigners may be polite enough not to express their offense, and Americans may be too insensitive to to detect it.

The chief problem of the developing nations, obviously, is *development.* No outsider can make the essential adjustments and changes in habits of mind, in concepts, in institutional arrangements, and in administration of business and public affairs within a people or a nation. They must do it for themselves.

ACT AS NEIGHBOR

What, then, should be the goals of United States policy toward developing nations? Affirmatively, U.S. policy should be to act as *neighbor*, especially to those in need. The world was told 19 centuries ago what it means to be a neighbor: it is to love one's neighbor as one's self. Americans are well aware how well they love themselves. They crave adequate food, good health, suitable shelter, full opportunity to realize their highest potentials—and all these in even richer measure for their children.

Americans have been *taught*, but not always *learned*, that the way to destroy an enemy is to make him your friend. The lesson was learned with Germany, Italy and Japan after a most bloody war, but it is not yet learned with China, Cuba, North Korea, North Vietnam and others.

When the U.S. presents, defends, approves and administers the programs of the Agency for International Development on grounds of fear, self-interest, ideology or narrow nationalism, it weakens, if it does not destroy, the chances for success. Here's why:

• Among the developing countries, this approach appears to be selfish, arrogant, and offensive to their national sovereignty and rights of self-determination. The assurances to the contrary by overseas American staff are not easily accepted, especially with disclosures that some Americans, whether posing as tourists or university staff, are also C.I.A. agents.

• Among the U.S. development staff, efforts to encourage self-help and reform are frustrated. They are slowly eviscerated and embittered by such narrow nationalism and by the lack of public concern at home for the valid objectives of national development abroad.

• Among U.S. citizens at home, this approach debases the historical tradition of support for popular sovereignty, the U.S. reputation for tolerance, and the avowed desire to be a *good neighbor.*

• Among friends abroad, it betrays those who would emulate the finest U.S. traits and aspirations. It is a betrayal not only of the American Dream, but of their own dreams as well. The more they care, the more it hurts.

What then, shall the U.S. now do? It should recognize that:

• *The name must be changed from A.I.D.* (After 5 years, the agency is overdue for a change in name anyway!) AID is a very bad, untrue, and unfunny pun. If the name must be clever, let me suggest A.B.C.D., the Agency for Better Cooperation in Development.

• *A slogan like "Decade of Development" suggests that development is less than a continuing process, and a long hard pull.* A more appropriate word would be *decades.*

• *Leadership is personal and transient; administrations change, but nations and peoples endure.* No harsh words or actions of one official represent the continuing interest of a nation. Pique and petulance are not substitutes for statecraft, anywhere.

• *Development involves change.* Change requires time and education. Education means schools, books and teachers. These need money from a well-administered tax system. Orderly change requires free speech, a free press, and a stable yet flexible political process.

• *Development demands investment in both physical and human capital.* These require a system for accumulating savings and for channeling investments wisely. These make necessary not only a tax system, but good budgeting and financial and monetary institutions yielding expansion without inflation. These investments mostly can use local land, labor and materials that need not be paid for with foreign currencies.

• *Development requires competent planning, a process which must identify gaps throughout the economic structure that will require attention in the period ahead.* (The world was not *aided* by U.S. hostility to the words *development planning* during the 1950's.) Planning must be *with* others, not just *for* others, with continuing feed-back, communication and cooperation between the planning and the action.

• *Trade is a two-way street!* To sell, we must buy, To buy, we must sell. Foreign exchange is vital to buy essential imports and to service foreign debts. Every nation needs and wants greater opportunities to engage in foreign trade. Barriers to trade among all nations of the world must be pulled down. This can contribute to "peace through interdependence."

• *You can't do business with paupers!* One can give them things, but one can't sell them much. The development of each nation advances the well-being of all the world.

• *The role of external resources is limited, but critical.* The special manpower and materials that are essential to development but which cannot yet be created at home require foreign exchange. When one's requirements exceed resources, one must look to others. Because the U.S. produces and enjoys virtually half the world's annual income, for only 6 percent of the world's population, it has the opportunity and obligation to be generous in meeting the world's needs.

• *U.S. capacity to meet the need far exceeds performance.* Every *nine days* the U.S. will invest as much new capital at home as it lends or gives to economic development abroad each year. The Alliance For Progress was predicated on Latin America investing, during the whole of the 1960's, a sum no greater than what the U.S. invests in new capital each year $100,000,000,000. The U.S. once afforded 2 percent of its annual output in gifts to Europe during the four years of the Marshall Plan. Yet now it provides little more than 0.3 percent for both gifts and loans to the world. The U.N. has pleaded for developed nations

to give 1 percent of their gross national products; by this standard, the U.S. should *triple* its performance.

• *Just as U.S. prosperity was served by a semicontinental market, so now is European prosperity enhanced by regional cooperation.* The same development principle applies not only to the U.S.S.R. and China, but to Latin America, Africa and Asia. Every nation should be more ready and more generous in encouraging further regional cooperation in economic development.

• *The United Nations is a more suitable vehicle for development cooperation than any one nation.* The nations of the world jointly own and operate the United Nations. If it were given adequate financial strength, independent of any nation-state or transient administration, it could help accomplish development with far more grace than any nation can muster in another nation's backyard. Yet the total present budget of all the U.N. agencies is less than the state of Colorado spends each year. The world can do better. Let's give the U.N. the resources equal to its responsibilities.

• *Development and change take time, and require patience.* Clearly the purposes of the War Between the States are not yet fully realized, one century after the fact. Let no one expect that the day of instant miracles has arrived. Just as parents help support the development of children throughout the whole community without demanding total or instant success, so the family of nations must take an equally mature and patient approach to each of its members.

THE WORTH OF A NATION

I never met a nation, but I have been in many. I have met many people, many persons. Each has his own dignity, his own self-regard, his own sense of present worth and his own aspirations as to the future of himself, his children, and the development of and for his people. Each deserves to be accorded the dignity due another person as his natural right.

Goals can only be defended if they are valid. And they are valid only if they are consistent with the well-being of all who may be affected by them. If all of us apply this test, and then choose only the better or best among the valid alternatives, the peace and prosperity of ourselves and of all others will be more secure.

Chairman REUSS. Thank you very much, Mr. Johnson. You add a gloss to some of the things that were said this morning when you say, as you do on the last page of your presentation, that "The United Nations could give a slight preference to sales from countries that were losing reserves, or a slight discrimination against purchases from nations that were gaining reserves."

Mr. JOHNSON. Or discouragement.

Chairman REUSS. To get that favorable balance-of-payments effect, of course you would be sacrificing a fairly good principle of competitive markets—letting people buy where they could buy most cheaply.

Mr. JOHNSON. I believe the open market should apply for the non-official trade. What I am suggesting here is that we need some kind of fairly automatic balancing mechanism. Those who propose to use a flexible exchange rate, no matter whether they let the rate float at 1 percent or 2 or 3 per year, are in effect asking every buyer and every seller, every investor, every lender, every borrower, to gamble on the future terms.

I am suggesting let us stay in the private sector with the degree of certainty which the IMF was designed to provide.

I lived through the 1930's—indeed, I was reading newspapers even in the late 1920's as a young newsboy. I well remember the chilling effect on trade of the unilateral decisions by nations to revalue.

The IMF has largely ended what will be remembered as a tragic period in international finance.

Chairman REUSS. Of course more flexible exchange rates, the widened band and calling peg in which this committee has displayed

some interest, would take the place of some of these political devaluations or worse, political failures to devalue.

Mr. JOHNSON. I suppose that if there are no better ways of solving the problem, I would come to these, but I am suggesting here that the Fanny Mae, or Federal Reserve type of variable percentage rates, in which you use the discrimination for or against any given intrusion in the market to counterbalance market forces and maintain a stable economy, is the kind of thing one can expect of a governmental structure, and cannot expect of a private structure.

The private structure almost always runs with the wind rather than stands against it. Only a governmental agency or a world agency can afford the luxury of standing a little bit against the wind. I am suggesting that it might be worth the experiment to propose that the IMF, if it is going to play the role of a world central bank, can use a little discrimination in the best sense of that word, to see to it that we temper the wind to the shorn lamb when necessary.

Chairman REUSS. This is tying aid on a pretty wide scale isn't it, worldwide?

Mr. JOHNSON. It is not so much tying as offering an inducement of either a par sale to reserve-short currency countries, or selling at a slight discount the currency of a country which is long on reserves. In other words, it is an effort to see to it that the total flow of funds retains an orderly balance. You know very well the sad political consequences in every country of any balance-of-payments crisis. As you know, we have two great all-purpose arguments in policy, both domestic and foreign. You do not have to deal with the substance or merits of an issue. If you say "it is inflationary" it is automatically bad, or "it will hurt our balance of payments" it is automatically bad. It is shameful in effect to have national policies determined not on their intrinsic merits but on their balance-of-payments effect.

Chairman REUSS. You would be letting developing nations use these new credits——

Mr. JOHNSON. Partially to——

Chairman REUSS. In the cheapest markets?

Mr. JOHNSON. Yes.

Chairman REUSS. If you combined your modernized Stamp plan proposal with the proposal to allow somewhat greater flexibility in the exchange rates?

Mr. JOHNSON. Yes. I think really I am proposing a step which is the first concession I would make to flexible exchange rates—because I have been basically hostile to them for the reasons set forth in the full statement—to let the U.N. make its flow of funds tilt one way or the other. To give you the parallel——

Chairman REUSS. That is not a concession to flexible exchange rates. That is rather a defense against them.

Mr. JOHNSON. Well, in the same sense that the Fanny Mae (FNMA) purchases of mortgages may be at par, below par or above par, in effect this is the kind of a concessionary price policy which tries to tilt the flow of funds in the way which seems to be socially advantageous domestically.

Let me give you the antecedent of this in my own experience. Working in the International Development Organizations Staff of AID, we were involved in backstopping consortiums which flow aid, for

example, to India and to a number of other countries. Also, overseas I have been abused for the language "Buy American," which the Congress thinks so highly of, because it sounds good in America. But it sounds terrible overseas, and so I have offered a counterphrase—"Borrow Where You Buy."

If you are going to buy in Japan do not borrow dollars with which then you buy yen, but borrow yen, if you want to buy from Japan.

Now this makes sense overseas. They can understand the logic of that. If you want to buy from Germany you borrow marks. This is an invitation to all nations to come in. Carrying that logic a step further back home, I proposed within the agency that in our consortium arrangements each year we take a look at where was the money spent, because if, for example we use program rather than project loans, which are not tied, if we use program loans to a country, and the loans are used to buy foreign exchange, to buy items in a third country, we are in effect adding to our balance-of-payments dilemma, by financing loans for purchases from, shall we say, Belgium.

I was suggesting that each year we take a look at where the money went and then the next time around suggest that the donor or lender be sensitive to where the previous flow of funds went.

In other words, the Germans will cheerfully finance aid which is spent in Germany. This my former student and colleague, Jack Knusel, has made very clear in his book. We found in 1960 that the Germans will finance sales from Germany, the French will finance sales from France. Let us use the international development machinery we already have, so I have suggested, to at least redress the balance of payments.

Chairman Reuss. I thought we all regarded it as regrettable that not only ourselves but the Germans, the French, and others tie their aid. I thought this was a momentary evil.

Mr. Johnson. It is regrettable.

Chairman Reuss. Which we all hoped to jettison.

Mr. Johnson. It is regrettable.

Chairman Reuss. Then why do you embed it——

Mr. Johnson. I am not trying to tie the aid.

Chairman Reuss (continuing). In a plan which I would have thought largely got rid of balance-of-payments problems anyway, if you take the model as presented by Mr. Triffin this morning and as discussed in the panel? That is to say, if we are going to create 3 billion dollars' worth of SDR's in a particular year, create $750 million of those not to be given to any country to add to its reserves in the first instance, but instead use it to buy IDA bonds?

Mr. Johnson. I am suggesting more than that.

Chairman Reuss. If you do this, then goods can be shipped by any country without a balance-of-payments cost. Indeed, they get a balance-of-payments benefit from it.

Mr. Johnson. I think I am saying the same thing, and I withdraw any suggestion that would restrict or prevent purchase of whatever currencies the recipient wanted to buy. What I was really trying to say in the testimony, and the only point I am suggesting for consideration in your future study of this, is that instead of moving toward upsetting all calculations in the international payments by supporting a retreat from fixed exchange rates, if you must consider it at all, that you confine your consideration to a very slight deviation from par in terms of

the exchange rate between Special Drawing Rights, whatever the world reserve unit is to be called in the future, and the individual national currencies which the nation might use to buy.

This would have the same basic effect of *encouraging, without requiring*. I do not mean to tie, I only mean to stimulate. I would like very much to abandon the ties and my feeling is that as we move toward a larger share of total reserves, the inhibiting constraints which Keynes noted have always plagued us in the past, will gradually disappear. I think we would not have tied our aid but for the balance of payments difficulties in the late fifties.

I wrote a memorandum for the head of the Development Loan Fund, Hon. Frank Coffin, in early 1961, suggesting that at worst this should be a very temporary thing. It is 8 years later and the temporary condition has rapidly become permanent and is extended. I think it is most important to increase reserves.

One reason I think the $3 billion figure is at the lower end I am not quite sure $3 billion will be adequate, to assure the world of adequate reserve balances.

Chairman REUSS. But you suggest "exercising a slight restraint against purchases from nations already experiencing a too rapid increase in its reserves." By so doing you are simply telling countries they cannot buy in the cheapest market.

Mr. JOHNSON. No, no.

Chairman REUSS. Probably the reason that a country is accumulating reserves is that it is being very productive and efficient, is selling wisely, and is the best supplier.

Mr. JOHNSON. Supposing the IMF said we will sell the currencies of that unit for the next 90 days at 98.5 percent rather than at par. In other words, supposing we simply put a slight point discount on sales of a given currency. You are still free to buy from them, but we put a slight point discount, we are trying to help equilibrate the total reserve flow.

Chairman REUSS. But you are helping equilibrate at the expense of developing countries, whom you are discriminating against to the extent that you put in that requirement.

Mr. JOHNSON. Could I reverse the emphasis?

Chairman REUSS. Why not equilibrate by a broadened band and a crawling peg?

Mr. JOHNSON. Well, I guess the difference between us is that I would rather move gingerly into any crawling peg or variable band by first doing it only as between the central banks and the IMF on this new reserve currency.

The proposal you mention, which is more commonly offered by my fellow economists, serves to upset the calculations of every buyer and seller, every lender, every businessman.

I really believe that the crawling peg will be more inhibiting to long-term lending activities. It will not upset equity investment, but it will certainly upset long-term loan investment, and as one who believes that there is a role for debt financing as well as equity financing, I am disturbed by the ease with which my colleagues—who seem to think only in terms of short-term markets and not in terms of long-term mortgage money—suggest the crawling peg.

I am suggesting that maybe by tilting the calculations of only a few, namely the development officials and the IMF, we may be able to achieve the same purposes. I think the difference is one of emphasis here.

Chairman REUSS. I would have one other question.

You urge that the United Nations probably through the Economic and Social Council still take the lead in putting in place some sort of a linkage?

Mr. JOHNSON. Yes.

Chairman REUSS. Why go around the barn that way? After all, the United Nations is not going to act unless its big members decide that this is what they are going to do. And if they decide that this is what they are going to do, why don't they simply tell their executive directors on the IMF and the World Bank to get busy and work it out? Unless, and this could well be your reason and a good reason, unless you want to "strengthen the U.N." by giving it something to do?

Mr. JOHNSON. I think you have hit it correctly. I was going to say I am intrigued as an economist I am offering legal advice to a lawyer. I will withdraw, except to note that my argument has to turn upon the existence of present legal power. The legal power technically lies, in article 63, with the U.N. Economic and Social Council subject to the approval by the General Assembly.

Now de facto you are exactly correct, that nothing happens in the U.N. Economic and Social Council except some member nation proposes it. May I say further, after being a delegate or alternate to some six international conferences, that I have learned the hard way that unless the United States make the opening speech nothing happens. They will adjourn for another day until the United States is ready to make an opening speech.

Our power economically is so great. Whether our political power is as great need not matter. The other nations want to respond to whatever lead we take, rather than have us hold back. So that it is probably a political necessity, though not a legal necessity, that the United States make clear its willingness to consider this, just as the United States had to take the lead in creating the U.N. Indeed the U.N. was the name first chosen by those nations that accepted the Atlantic Charter. The legal history as you recall was that the United States and Great Britain, in a meeting at sea between Churchill and Roosevelt, formed the Atlantic Charter in August 1940. And on January 1, 1942, after Pearl Harbor, the nations associated with us in that war met with us, declaring themselves to be the United Nations, and accepted the Atlantic Charter. Thus, the name United Nations actually generically traces from the declaration of the United Nations of January 1942.

But it was the U.S. lead, or the United States and United Kingdom lead jointly, which set forth this thing. The Charter approved at San Francisco was first cooked up in the State Department by some of my former teachers and colleagues. It was discussed at Dumbarton Oaks right here in Washington, D.C., before San Francisco. The first meeting was at Lake Success, and then subsequently on the East River.

The United States will of course have to say we are prepared to do this sort of thing. But I remind you that back in late 1959 and in the early months of 1960, the President of France, Charles de Gaulle, had

in a series of speeches outlined precisely his approach that the developed nations should share their resources with the poor nations, that this was far better than preparing for the destruction and desolation of the human race.

The tragedy of history, and the tragedy of De Gaulle was that this initiative of his was shot down in May of 1960 when the U-2 spy plane crashed, with the pilot intact and all the artifacts of the plane captured by the Russians on the very eve of the Paris Conference. The world has forgotten that De Gaulle was tragically rebuffed by this action.

There might have been a chance 10 years ago to have done precisely this, not in this legal form, but in this political sense, and the time has come again to pick up where he was seeking to go at that time by this route.

Chairman REUSS. Thank you very much, Mr. Johnson, for your great contribution to our deliberations.

We will include at this point in the record the views of Prof. Benjamin Cohen, of Princeton, as outlined in his letter to me of May 12.

We will also include a table revised to December 31, 1968, submitted by Prof. Robert Triffin as a substitute for the table appearing on page 146 of our hearing of September 9, 1968, entitled "Next Steps in International Monetary Reform."

The letter from Professor Cohen and Professor Triffin's revised table follow:)

DEPARTMENT OF ECONOMICS
PRINCETON UNIVERSITY,
Princeton, N.J., May 12, 1969.

Representative HENRY S. REUSS,
Chairman, Subcommittee on International Exchange and Payments, Joint Economic Committee, U.S. Congress, Washington, D.C.

DEAR REPRESENTATIVE REUSS: The idea of linking reserve creation and development assistance has never really received serious public consideration at the national government level. The hearings of your Subcommittee are therefore to be welcomed, and I appreciate this opportunity to restate my own views on the matter.[1] I will not presume to comment on all of the issues that are involved here. However, it does concern me that on the most basic issue of all—whether there is any legitimate rationale for a link—there is still so much doubt and hesitation. I believe that such doubt and hesitation is unwarranted. There is no need to fall back on considerations of charity and humanitarianism, or even of convenience. A sufficient case for a ling between reserve creation and development assistance can be made on strictly *economic* grounds.

The case may be summarized briefly in the form of a pair of logical syllogisms, as follows:

Major premise: the international distribution of the cost ("burden") of balance-of-payments adjustment is a function (at least partially) of the structural attributes of nations.

First minor premise: less developed countries are characterized by the least favorable structural attributes.

First conclusion: less developed countries therefore pay a disproportionate share of the cost of adjustment.

Second minor premise: newly created reserves should be allocated among nations in proportion to the distribution of the cost of adjustment.

Second conclusion: less developed countries should therefore receive the largest proportion of new reserves.

[1] I have previously stated my views in my *Adjustment Costs and the Distribution of New Reserves*, Studies in International Finance No. 18 (Princeton: International Finance Section, 1966).

The separate elements of the argument may be elaborated upon at length. The cost of adjustment is the cost of making the change that is required to eliminate a disequilibrium in the balance of payments. Adjustment implies transition, and in economics each transition, each reallocation of resources, has a cost. The cost of balance-of-payments adjustment can be measured directly in terms of real national income foregone; in practice, it may be identified by observing the extent to which each of the two countries sharing a payments imbalance must undergo either price inflation or resource unemployment so that equilibrium can be restored. Plainly, some part or even virtually all of the adjustment burden may be borne by either country even though the process of adjustment itself is shared. That is, the complementary reallocation of resources may be paid for largely or even wholly by either the deficit or the surplus country.

The basic explanation of the distribution of the adjustment burden is to be found in the economic structure of nations. Four structural attributes in particular are important. These are: (1) diversification in production; (2) degree of industrialization; (3) international investment status; and (4) secular growth rate. Countries that are highly specialized economically, showing a high degree of concentration in relatively few industries, are by definition more dependent on foreign markets (with respect to both exports and imports) than diversified nations. They are more "open," and being more exposed to all kinds of outside pressures, they tend to pay a disproportionately large share of the cost of adjustment. They have a higher "adjustment vulnerability." Likewise, adjustment vulnerability tends to be higher in countries that are manly producers of primary products rather than industrialized; that are net capital importers rather than exporters; that are growing rapidly over the long term rather than slowly.

Generally speaking, these are the characteristics of less developed countries. LDCs tend to be overspecialized, heavily dependent on primary production and on capital imports, and often stagnant as well. They are the weakest members of the international economic system, the most sensitive to external pressures, and consequently they are the nations with the highest adjustment vulnerability. They must pay a disproportionately large share of the cost of adjustment. No wonder, then, that so many less developed countries insist on policies of diversification and industrialization.

However, such policies require vast amounts of long-term development capital, particularly in the form of capital imports. This capital is, regrettably, all too difficult to accumulate in a setting where the volume of domestic saving is limited by the low level of per-capita incomes, where export earnings are limited by protectionist policies and inelastic demand in the developed world, where potential foreign investors prefer to confine their ventures mainly to the industrial and financial centers, and where the donors of foreign aid are in practice becoming increasingly niggardly. In such a setting, less developed countries are obliged to draw upon whatever resources they can obtain, including their own international monetary reserves. To be sure, this is not the normal function of reserves, which are presumably held as a safeguard against future contingencies rather than to finance current purchases. And certainly the developing nations are conscious of the advantages of having adequate reserves. But such is their sense of urgency that even their exchange reserves are used for capital imports. Once their reserves are exhausted, however, these vulnerable nations are even less capable than before of defending themselves against external pressures—at least against payments deficits, the variety of external pressure to which the less developed countries are most prone. As a result, they find that the share of adjustment costs they must pay is as large as ever.

What we see here is another of the series of vicious circles enmeshing the less developed countries. Because they are overspecialized and concentrate in primary production, developing nations have a relatively high adjustment vulnerability. To reduce their vulnerability they seek to diversify and industrialize. Because of the inadequate supply of development resources available to them, they fall back on their exchange reserves to finance many of their capital imports. But with their reserves diminished, they find themselves no less vulnerable to external pressures than before.

How can this vicious circle be broken? The solution, clearly, lies in a sizable increase in the amount of economic assistance being provided to the developing nations. Additional assistance could, of course, be provided through many channels, but we are concerned here specifically with monetary reform. A good deal

of assistance could be provided to the developing nations by distributing to them the largest part of any new reserves that are created as a consequence of reform. For the creation of new reserves effects a saving of real resources, and these resources might just as conveniently accrue to the less developed countries as to any others. Unfortunately, though, the idea of a link is usually resisted: the problems of international liquidity and economic development are distinct, it is said; the less developed countries should not be granted "something for nothing." As a matter of fact, the opposite is the case: the two problems are already closely linked by the fact that the less developed countries at present must actually *pay* a very considerable "something for nothing" because of the strikingly inequitable distribution of the adjustment burden. They pay the largest total of adjustment costs without even the benefit of a *quid pro quo*. It seems only reasonable, therefore, since monetary reform does involve a saving whose distribution is in any event a matter of deliberate choice, to let the main benefit accrue to those who until now have been obliged to pay the highest price for the privilege of membership in the system. And it seems only equitable to let the benefit accrue roughly in proportion to the present distribution of adjustment costs.

This is not to suggest that an approach to the problem of economic development via monetary reform is preferable to all other types of aid schemes. It is my intention only to demonstrate that there is a logical connection between these two areas of concern. In fact, all approaches to the development problem are useful; all are preferable to the vicious circle of adjustment vulnerability and reserve exhaustion that presently entraps the less developed countries of the world.

Sincerely,

BENJAMIN J. COHEN,
Assistant Professor of Economics.

MAXIMUM IMPACT OF A CONVERSION ACCOUNT

[In billions of dollars, as of Dec. 31, 1968]

	Gross reserves			Actual gold holdings (d)	Worldwide conversion account		Gold pool conversion account	
	Total (a)	Working balances (b)	Other (c=a—b)		Maximum gold holdings (e=c×0.623)	Maximum gold shifts (f=e—d)	Maximum gold holdings (g=c×0.733)	Maximum gold shifts (h=g—d)
I. Reserve centers	18.13	2.50	15.63	12.36	9.74	−2.62	11.46	−0.90
United States	15.71	1.73	13.98	10.89	8.71	−2.18	10.25	−.64
United Kingdom	2.42	.77	1.65	1.47	1.03	−.44	1.20	−.27
II. Other gold pool	28.06	3.41	24.65	17.18	15.36	−1.82	18.07	+.89
Switzerland	3.93	.20	3.73	2.62	2.32	−.30	2.74	+.12
European Community	24.13	3.21	20.92	14.56	13.04	−1.52	15.33	+.77
Germany	9.94	1.24	8.70	4.54	5.42	+.88	6.38	+1.84
Italy	5.34	.51	4.83	2.92	3.01	+.09	3.52	+.60
France	4.20	.63	3.57	3.88	2.24	−1.64	2.62	−1.26
Netherlands	2.46	.42	2.04	1.70	1.27	−.43	1.49	−.21
Belgium	2.19	.41	1.78	1.52	1.11	−.41	1.30	−.22

III. Subtotal	46.19	5.91	40.28	29.54	25.10	−4.44	29.54	
IV. Other developed countries	16.57	2.57	14.00	5.95	8.72	+2.77		
In Europe	7.54	.93	6.61	3.22	4.12	+.90		
Canada	3.04	.66	2.38	.86	1.48	+.62		
Japan	2.91	.65	2.26	.36	1.41	+1.05		
Other	3.08	.33	2.75	1.50	1.71	+.21		
V. Less-developed areas	13.52	2.15	11.37	3.43	7.07	+3.64		
VI. All countries	76.28	10.63	65.65	38.93	40.90	+1.97		
VII. International organizations				1.97		−1.97		
VIII. World				40.90	40.90			

NOTES

1. Working balances retained directly in foreign currencies—primarily dollars, in practice—should not exceed 10 percent of 1968 exports and are assumed (in column (b)) to average about 5 percent. This assumption is made only for illustrative purposes. Agreed levels of working balances should be a matter for negotiation and should take into account foreseeable needs for proximate debt repayments and the countries' very different exposure to shifts of short-term funds between major money markets.

2. Reserves proper—i.e., beyond working balances—as shown in column (c). They should be held exclusively in gold and/or deposits with the conversion account:

a. The proportion retained in gold should not exceed, as a maximum, the average proportion of the participating countries' gold holdings to their total reserves beyond working balances; i.e., as of December 1968, 62.3 percent for a worldwide conversion account and 73.3 percent for a conversion account limited to the former gold pool countries; see cols. (e) and (g).

b. The remainder should be held in minimum, and in free, deposits with the conversion account.

3. Cols. (f) and (h) show the maximum gold shifts that would have resulted from such an agreement, as of Dec. 31, 1968, and facilitate a comparison of the implications of these 2 alternative arrangements.

4. If countries were allowed to convert into gold the portion of their deposits which exceeds the agreed minimum, only when their working balances exceed 10 percent of exports, maximum gold withdrawals would have been cut sharply—

a. in the case of a worldwide conversion account, from $7.38 billion to $1.69 billion, releasing $5.69 billion of gold to the account for agreed interventions in the private gold market;

b. in the case of a gold pool countrys' conversion account, from $2.66 billion to $0.69 billion, releasing $1.87 billion for such interventions.

5. Insofar as countries did not exercise fully their rights to gold withdrawals, the gold needed to cover actual withdrawals and agreed market interventions would be called by the account from the countries whose ratio of gold reserves to total reserves is highest (and ratio of account deposit to total reserves therefore lowest). This would, over time, tend toward a gradual harmonization of reserve composition.

6. Subsequent surpluses and deficits would be financed first through accretions to, or drawings from, each country's working balances. Deficit countries would draw freely upon their deposit with the account to reconstitute depleted working balances, while surplus countries would deposit with the account the accretions to working balances in excess of the agreed ceilings. The obligation of all countries, however, to keep in deposit with the account a minimum proportion of their gross reserves would insure sufficient gold deposits by deficit countries to the account to balance allowable gold withdrawals by surplus countries.

Source: International Financial Statistics, April 1969.

Chairman REUSS. The subcommittee will now stand in adjournment.

(Whereupon, at 3:20 p.m., the committee adjourned, to reconvene subject to the call of the Chair.)