On the Creation of New Reserve Assets: the Report of the Study Group of Ten

It will be recalled that the Deputies of the Group of Ten carried out last year, parallel with the International Monetary Fund, a study of the problem of international liquidity which has been published in the form of a Ministerial Statement accompanied by a " Deputies' Annex ". This study represents a first and important result of a long process of inquiries that were conducted first on a theoretical level and subsequently by independent or governmental experts.

The Deputies, while reaffirming the concept that a shortage of international liquidity does not exist, recognized in their Report the need, in the long run, for a new or additional reserve asset, and consequently decided to entrust to a Study Group the detailed examination of the proposals, aiming at this objective, which had been mentioned or discussed during their work.

The Study Group was composed of experts, nominated by the Deputies of the Group of Ten, belonging to the competent Finance Ministries and central banks of member countries, as well as to three international organizations (IMF, OECD and BIS). These experts worked independently, however, and therefore their views do not necessarily reflect the positions of the respective Governments.

The Report of the Study Group, presented to the Deputies on May 31, 1965, was published on August 10 of this year.

The nature and limits of the Mandate

1. The Mandate given by the Deputies laid down that only those types of proposals for the creation of reserve assets which had been discussed by them during the previous year should be ex-

amined. The Study Group had to provide a description and detailed analysis of those proposals, and bring out the similarities and differences of underlying principles, functions and modes of operation. In addition, it had to endeavour to determine the economic and financial repercussions of the various proposals on the functioning of the international monetary system. In effect, the Study Group was asked to assemble the elements necessary to enable first the Deputies, and then the Ministers and central bank Governors to evaluate the merits of the individual proposals; but it had to avoid expressing preferences, making recommendations or seeking points of agreement for a solution of the different problems.

2. Problems connected with the qualitative composition of reserves and their regional distribution therefore either did not come entirely within the limits of the Mandate or remained outside it. These problems are of a particular urgent nature and cannot be solved through an increase of the volume of international liquidity.

Regarding the first problem, each central bank, as is known, maintains, either by governmenal regulations or by custom, a certain ratio of gold to the other reserve assets; this ratio can vary from time to time and differs from country to country. Thus any alteration in the propensity of central banks to hold gold instead of other reserve assets (conversions of dollars into gold or of sterling into dollars or gold), as well as transfers of fiduciary reserve assets (dollars, sterling or French francs) between central banks having different propensities, constitute factors of instability in the international monetary system. Other factors of instability are transfers of dollars or sterling from commercial banks to central banks or movements of funds from the European currency markets to the London gold market.

As regards the problem of regional distribution of reserves, one of the proposals drawn up by the Group Ten last year was to grant reciprocal long-term credits for monetary purposes (see Deputies' Annex, paragraphs 47-48). According in the proposal, a temporary transfer of reserves from countries with large holdings to countries with low holdings was considered likely to strengthen the economy of the latter in anticipation of a permanent increase in their reserves, to be achieved over a long period through moderate balance of payments surpluses. This would have had the advantage of not compelling those countries to make repayment within a period

which would be too short in relation to the needs and policies of internal development. This proposal, however, did not fall within the terms of the Study Group's Mandate.

Structure of the Report

3. The Report of the Study Group is divided into an Introduction, six Chapters, a Final Remark and a Statistical Appendix. The Introduction recalls the terms of the Mandate. In Chapter I the nature of the problem is defined. Chapter II contains a description of the existing types of reserve assets and their functions. In Chapter III the various proposals discussed by the Deputies for the creation of new reserve assets are examined. Chapter IV contains a comparative analysis of the various proposals, made in such a way as to bring out four fundamental questions of a political character which arise in relation to the process of creating new reserves. These fundamental questions are then highlighted in the Final Remark. Technical problems are also examined in this Chapter, together with the effects that the process of reserve creation might have on the volume of international liquidity and on the adjustment process. In Chapter V the analysis mentioned above is applied to the individual schemes in a way that assembles the arguments in favour of or against each of them. Chapter VI is mainly recapitulatory.

The nature of the problem

4. In examining the nature of the problem, the experts referred back to the consideration, expressed by the Ministers and Governors in the Ministerial Statement, that the supply of gold and reserve currencies, while fully adequate at present for the needs of the international monetary system as a whole, may prove to be inadequate in the future on account of the continuing growth of world trade. In fact, there is a limit to the flow of gold to the monetary reserves, both because production is limited and the contribution of the sales by the Communist countries is modest, and because private hoarding and the use of the metal in industry still remain considerable. On the other hand, the contribution of dollar holdings to the growth of reserves is bound to diminish because of the progressive elimina-

tion of the United States' external deficit. It is clear that in addition to the aforementioned unconditional liquidities (usable, that is, without conditions affecting the conduct of economic policy), the international monetary system has at its disposal a wide range of credit facilities. These contribute to the overall growth of international liquidity, both in the form of conditional liquidity (usable, that is, on condition that appropriate economic policies are pursued) and in the form of unconditional liquidity. In fact, the use of credit facilities by a deficit country results in the acquisition of a reserve asset by a surplus country.

The Study Group's discussions have made it clear that, at least in the long run, the demand for unconditional liquidity by the monetary authorities cannot be satisfied by the supply of conditional liquidity. This is because, in the present system of international economic relations, countries regard the preservation of a margin of autonomy — i.e., the disposal of means of payment without being subject to external controls over the management of their economic policy — as an attribute of their sovereignty. In the long run, therefore, there could be a need of a new form of reserve assets. The Group devoted its attention not so much to methods of creating reserves that could be applied only for financing external deficits but mainly to those which aim deliberately at creating new reserve assets for distribution " across the board ", that is, independently of the immediate foreign exchange or balance of payments' situation of individual countries, for the purpose of meeting the global needs of the world economy.

5. These methods are based on the assumption that aggregate reserves are inadequate. On the basis of present day knowledge, the adequacy of aggregate reserves cannot be measured by using any quantitative formula; probably it never will be. The experts were led to point out that an overall shortage would, in practice, be likely to show up first as a shortage in particular countries, but that certain circumstances could be regarded as warnings of a general inadequacy of reserves: a reluctance of countries to extend intergovernmental credit; an increasing propensity to seek credit, in preference to parting with reserve assets; a marked tendency to make maintenance, increase or reconstitution of reserves an overriding objective of economic policy, and so on.

Where a situation of this kind exists, the simultaneous wish of all to acquire reserves might create a deflationary spiral. Consequently the necessity arises of envisaging a mechanism for the creation of reserves that is independent of the further accrual of monetary gold, of the needs of individual countries however important they might be, and of the development needs of less developed countries; a reserve creation mechanism, that is, of a conventional character based on a compromise between the positions of the principal countries interested.

Existing types of reserve asset

6. Chapter II of the Report examines the existing types of reserve assets. A country's reserves are broadly defined as all those liquid assets held by its monetary authorities which can be used, directly or through assured convertibility into other assets, to support its rate of exchange when its external payments are in deficit.

There are three main categories of reserve assets: gold, currency assets, and claims on the International Monetary Fund (gold tranche, super gold tranche and G.A.B. — General Arrangements to Borrow — creditor positions).

7. Reserve assets other than gold have in common the characteristic of having originated in the giving and taking of credit in some form or other, although the bulk of them were not created by explicit credit transactions among monetary authorities, nor were such explicit credit transactions as did occur entered into with the primary purpose of increasing aggregate reserves. For example, although a central bank does not usually hold dollars on the basis of an explicit agreement with the U.S. authorities but of its own free choice, it actually grants credit to those authorities; by contrast, when dollars are held on the basis of a true and proper agreement (as happens as a result of the activation of a " swap "), this agreement has not necessarily been concluded with the purpose of increasing the volume of global reserves. Besides, reserve assets other than gold have in common the characteristic that they contribute to the formation of unconditional liquidity, since the interested countries apply the so-called " gross principle ", whereby the asset in question is counted as an asset in the reserves of the holder, whereas the

liability it represents for the reserve centre affected is not deducted from that centre's reserves. For instance, dollar holdings are counted in the reserves of the central bank of the country that holds them but are not deducted as a liability from the gold reserves of the United States.

Description of various proposals for the creation of reserve assets

8. Chapter III of the Report gives a detailed description of the various schemes examined by the Study Group.

The Report classifies them into three categories (see paragraph 25), following more or less the lines indicated in the Mandate (paragraph 2). The schemes are then re-classified in Chapter IV (paragraphs 104-113) in accordance with their main objectives: procedures designed to meet the balance of payments' deficit of an individual country; procedures having the deliberate aim of creating reserve assets in accordance with some agreed assessment of overall needs and distributing them " across the board ", i.e., independently of the immediate balance of payments' situations of individual countries; procedures designed to convert a currency which has already accrued to central banks into a different form of asset.

A summary of this Chapter would be superfluous. It is more useful to indicate, in connection with each proposal, the way in which the four fundamental questions listed in the Final Remark have been resolved (link with gold; width of membership; institutional questions; rules for decision-making).

9. *Collective Reserve Units* (CRU.s, paragraphs 28-43) would be distributed among the participating countries in proportion to their gold reserves; nevertheless, other methods of distribution are possible, e.g., on the basis of participants' total monetary reserves or according to a quota system. They would be held and used in a uniform ratio with gold in the participating countries' monetary reserves.

Participation in the C.R.U. scheme would be limited to a small group of industrial countries, which might or might not be larger than the Group of Ten.

The C.R.U.s would be created outside the IMF and administered by an Agent, which could be the Bank for International Settlements.

Finally, all decisions affecting the creation of reserve assets would be taken unanimously.

10. In the *schemes of the C.R.U. type but linked to the IMF* (paragraphs 44-56), this body would be associated with the creation of new reserve assets either as a simple book-keeping Agent, or as an administrator of the transfers of the units among participants.

Moreover, the rules for decision-making could be based on systems different from unanimity, for example, on a simple majority with each member being entitled only to one vote or with a system of weighted voting.

As regards the link of the new reserve assets to gold, the schemes of the C.R.U. type associated with the IMF envisage several variants, some of them linked to gold in the same way as the C.R.U., that is, both in distribution and in use; others linked to gold only in their use; others, finally, having a certain flexibility in the maintenance of the ratio of claims to gold. The variants not linked to gold envisage a distribution in proportion to global reserves or through a quota system (for example, IMF quotas, with or without the addition of G.A.B. credit lines), possibly with a limitation of the obligation of participants to accept them up to a predetermined amount.

11. In all the *schemes for the creation of reserve assets through the International Monetary Fund* (paragraphs 57-90), the institutional question is solved in the sense that this body would not only intervene as Agent with more or less wide functions, but it would take all the decisions concerning the creation and administration of new reserve assets. In other words, the Fund, besides carrying out its present function as a supplier of medium-term credits, would be given monetary functions.

In all these schemes the question of the link between gold and the new reserve assets is solved in a negative sense, as regards distribution as well as use, both of which are governed by a system of quotas, presumably correlated to the quotas of participation in the IMF.

The rules for decision-making would normally be those presently governing voting within the Fund; although other procedures might be adopted which, however, would not involve unanimity.

As regards the number of participants in the creation and distribution of new reserve assets, the schemes operating through the IMF would include, as a rule, all members of this body; however, a participation is also envisaged based on certain qualifying criteria (for example, a participation limited to countries whose currencies are convertible or have been utilized in previous drawings on the Fund), or else a participation based on a principle of automatic selection in the sense that the new reserve assets would be attributed only to those countries which at the time of distribution had a gold quota in the Fund not yet drawn on.

12. Regular gold tranches, super gold tranches, and G.A.B. creditor positions constitute reserves because the country holding them has the right to obtain needed currencies virtually automatically on demand. They are already regarded by many countries as an integral part of reserves; nevertheless their character of unconditional liquidity could be enhanced by more rapid and automatic drawing rights and payment of interest.

Reserve positions in the Fund can be created by normal transactions as well as by new operations which are already envisaged in the Articles of Agreement or which require amendment of those Articles.

13. Normal drawings in credit tranches by a country faced with balance of payments' difficulties (drawer) create reserve positions in the Fund to the benefit of the country whose currency is drawn (drawee) to the extent that the latter is in the regular gold or super gold tranche (paragraphs 57-61) (1).

If the Fund were to extend to the first credit tranche, or to a part of it, the automatic drawing rights that it currently recognizes

(1) Example. Let the quota in the Fund of the drawing member A be 100 million dollars, 25 millions of which subscribed in gold (gold tranche), and let the quota of the drawee B be 200 millions, 50 millions of which subscribed in gold. If both hold a position in the Fund equal to their initial one and member A draws 25 in the currency of B, world reserves do not increase because B has gained a super gold tranche of 25 millions and A has lost a gold tranche of equal amount. If member A makes a second drawing of 15 in B's currency in its first credit tranche, its reserves do not decrease while those of B increase because its super tranche becomes 40 millions, an amount that is added to its gold tranche of 50.

only in the case of the gold tranche, the result would be to increase the volume of reserve positions in the Fund and therefore the total reserves (paragraphs 62-67) (2).

The same thing would happen if, when there was a general increase of IMF quotas, the first 25 per cent of this increase, which normally should be subscribed in gold, were paid in the form of callable gold certificates, without, however, any change in the virtually automatic nature of drawings in the gold tranche. In this case the result would be an increase of total reserves because Fund members would maintain their gold reserves intact while their automatic drawing rights in the Fund would increase (paragraphs 68-72).

14. In addition to these schemes, which come within normal practice or imply a change in the Fund's policy, there are others that would probably necessitate amendment of the Articles of Agreement.

Among them are special currency operations by which the Fund could contribute to the increase of world reserves by investing — according to a pre-established plan, in all member countries or in a selected group of them, or else in some international institution such as the International Bank for Reconstruction and Development — currencies drawn from its holdings or from borrowing (paragraphs 75-84).

As a result of these operations, the reserve positions in the Fund of the countries whose currencies were utilized in this way would be increased, while the additional reserve assets created by the operations would accrue to the countries in which the investments were made (3).

(2) Example. In the preceding example, if the Fund extends automatic drawing rights up to 5 per cent of the first credit tranche, country A's reserve position in the Fund, which was 25, i.e., equal to the initial gold tranche, increases by 1.25 (5 per cent of the first credit tranche equal to 25 millions) and moves to 26,125. The volume of world reserves has increased.

(3) Example. Keeping always in mind the situation indicated in the first example, if the Fund invests in government securities of country A 10 millions of country B's currency, the reserve position in the Fund of the latter country would grow by 10 millions of super gold tranche or of G.A.B. creditor position, according to whether the amount has been drawn from the Fund's ordinary resources or borrowed, while its foreign exchange reserves would decrease because country A converts the currency received. A's reserves increase by an equal amount. World reserves are therefore increased.

If the Fund invests in country A 10 millions of A's currency, this country's reserves — and therefore world reserves — increase by an equal amount in the form of super gold tranche or G.A.B. position.

The Fund could also increase the volume of world reserves through special gold operations, i.e., by purchasing with gold, in member countries, foreign exchange that it would keep in a separate account, namely, that it would not include in its ordinary quota holdings (paragraphs 85-87).

Finally, world reserves could be increased through a system of deposits with, or special loans to the Fund for the financing of special credit operations (paragraphs 88-90).

15. Recognizing that the qualitative composition of reserves does not always correspond at present to the preferences of central banks, the Study Group also examined a series of proposals aimed not at deliberately increasing the volume of global reserves but at offering central banks an *alternative reserve asset* (paragraphs 91-103).

One of the procedures envisaged would be for a reserve centre to draw from the Fund the currency of countries holding reserve currencies and use the proceeds of the drawing to buy back the reserve currency from the holder country. This operation obviously assumes that the Fund holds a sufficient amount of the drawee member's currency: the scheme accordingly envisages that the latter country should undertake to make its currency available by lending it to the Fund (4). Another scheme designed for the same purpose is the "Mutual Currency Account" (M.C.A.), which represents a variant developed from the so-called Maudling plan. A member could deposit with the IMF in a special account the currency of any other member of the scheme in exchange for an asset denominated in M.C.A. units of account, equivalent of a given weight in gold.

16. The various schemes for the creation and distribution of new reserve assets described in Chapter III of the Report are based

(4) Example. Let us suppose that Italy wishes to convert 100 million dollars into a reserve position in the Fund instead of into gold. In this case the United States draw lire from the Fund against their gold tranche claim and use the lire to repay Italy for the dollars presented for conversion. The United States' gold tranche decreases, while Italy gains a super gold tranche. If the Fund did not hold sufficient lire, Italy would have to lend them, as provided by Art. VII of the Articles of Agreement; she would thereby gain a G.A.B. type reserve position.

on a process of giving and taking of credit, which corresponds to the two following alternatives:

(a) the placing at the disposal of the recipient country of actual balances; or

(b) the placing at the disposal of the recipient country of drawing rights; usable unconditionally, expressed in units of account or in national currencies, organised bilaterally or multilaterally through the Fund or other international monetary institution.

The nature of the process of creation and distribution of new reserve assets does not modify the fundamental economic process of transferring real resources, which is determined by the structure of the balance of payments. However, when new reserve assets are looked upon from the point of view of the country which holds them, the two alternatives have a widely different significance by reason of the political and psychological reactions they are apt to produce. Past experience shows that in a deficit situation monetary authorities resist any decrease of reserves, however high these may be in absolute terms or in relation to imports, when these reserves take the form of actual balances; but resistance is far less or ceases altogether when reserves take the form of claims accumulated against credit lines. When the European Payments Union was in operation, it was evident that creditor countries put up no resistance to the recovery of accumulated credits and, indeed, encouraged it; yet the process did not differ from the spending of reserves. This different political and psychological attitude deserves the closest attention whenever it comes to seeking a method of reserve creation which is flexible and responds to the needs of the world economy.

17. Whatever form they may take, all the new or additional reserve assets examined in the Report have in common the characteristic of being instruments not directly convertible into gold, even if as a rule they are assisted by an exchange guarantee and even if some of them must be used currently with gold. The Study Group's discussions revealed, in fact, that a direct convertibility into gold of the new assets would have increased the instability of the international monetary system. By contrast, they possess a gold-like quality: like gold they are a " final " reserve asset.

The acceptability of gold is based not only on the limited possibilities of production but also on the tacit convention that the main industrial countries are ready to convert it into their currencies — and therefore into real resources — on the basis of a fixed price. The acceptability of reserve currencies is based not only on their convertibility into gold at a fixed price but also on the circumstance that the issuing countries are important commodity, credit and capital markets.

Acceptability of new reserve assets that are not directly convertible into gold but are assisted by a value guarantee can only be based on the convention under which they are created; a convention which should indicate, in addition to the issue criteria, the maximum commitments for each creditor.

The new reserve assets differ from the present ones not only because of the existence of these ceilings but because they can be held only by central banks and cannot therefore be used to settle private or non-monetary public transactions, and also because they cannot be used for direct interventions in the exchange markets.

Horizontal analysis of the process of creating new reserve assets

18. Chapter IV of the Report contains a comparative analysis of the different proposals which has been carried out in such a way as to bring out the fundamental aspects of the process of creating new reserves, aspects that emerge in connection with any plan of monetary reform. It follows that although the experts, in accordance with their terms of reference, confined themselves to examining solely the types of proposal discussed the previous year by the Deputies of the Group of Ten and did not extend the investigation to other important plans formulated by professional economists, this fact in no way detracts from the usefulness of their discussions, since these have revealed aspects and problems of general validity.

19. The first of the questions examined was the *role of gold in the international monetary system.* The link between the new reserve assets and gold not only provides a basis for distribution (for example, the French proposal suggested that distribution of the Collective Reserve Unit could be made in proportion to participating countries' gold reserves), but constitutes an instrument for monetary discipline and for limiting a creditor's commitment: deficit countries are discouraged from embarking upon facile monetary policies and

surplus countries are not compelled to accumulate an indefinite amount of reserve assets not convertible into gold. Undoubtedly, however, the same aims can be achieved through the choice of criteria of distribution and use different from gold (these criteria would clearly be equally arbitrary), as are those based on the global volume of reserves or on a system of quotas correlated with the IMF quotas or calculated in other ways. The arguments in favour of or against a link of the new reserve assets with gold are given in paragraphs 114-116 of the Report.

20. The second fundamental question examined by the Group was the *width of membership appropriate to reserve-creating arrangements.* This question was considered both from the standpoint of the management and control of the process of creating new reserve assets and from the standpoint of their distribution. The diverse views were put forward that the aforementioned arrangements should be of a world-wide nature and therefore include all members of the IMF, or vice versa should be limited to a small group of industrial countries. Intermediate views were those which favour objective or self-qualifying criteria (countries with a convertible currency, countries whose currency has already been used in Fund drawings, countries that hold a net creditor position in the Fund, and so on).

The fundamental considerations that lie at the root of these questions are the following:

(a) any process of reserves creation implies the reciprocal granting of automatic drawing rights on members' real resources; this amounts in financial terms to automatic lines of credit or to exchange of balances in the respective currencies;

(b) in a process of this kind it is expected of participating countries that they should not fluctuate greatly away from balance of payments' equilibrium, since otherwise actual reciprocity in the obligations undertaken would in fact be lacking; in other words, if the new reserve assets were spent, they would have to be reconstituted within a reasonable period;

(c) any discrimination in the choice of participants is obviously absurd. But it is also absurd that countries should participate which, because of their past behaviour, do not provide adequate guarantees of financial solidity and solvency.

Arguments in favour of or against participation restricted to a limited group of countries are discussed in paragraphs 117-122 of the Report.

21. A third fundamental question, connected with the preceding one but not identical, concerns the *role of the IMF in the process of new reserve creation* (paragraphs 123-125). Although it was unanimously agreed that the Fund fulfils an irreplaceable function in the field of conditional liquidity, many were hesitant about giving to this institution powers to create new reserves; among the main arguments put forward in support of this thesis was that to empower the Fund to create and distribute at its initiative new unconditional reserve assets might impair its ability to perform its role of custodian of monetary discipline, a role that is based on the granting of conditional credits of limited duration. According to others, the Fund's prestige and experience would, vice versa, enable it to carry out simultaneously the two functions, which would offer the advantage of maintaining a proper balance between conditional lending and deliberate reserve creation. A possible solution might take the form of a scheme whereby the creation of new reserves would be carried out in close association with the Fund, but in such a way that the two functions would be kept strictly separate.

22. The discussions within the Group revealed that the drawing up in advance of objective rules can help to reduce to a minimum the number of decisions to be taken; but occasions will always arise where varying circumstances and changing conditions will call for decisions on both general policy and management. Obviously no voting system can work smoothly where there are deep underlying divisions of view and a country or group of countries is systematically outnumbered; in fact the most important decisions are taken unanimously. Nevertheless, provision should be made for resolving disputes — particularly in so new a field as that of the creation of reserve assets, where differences in attitude and policy among the participants are inevitable. To this end the Group examined the respective merits of four general rules of decision-making: unanimity; ordinary majority, each member having one vote; weighted voting with ordinary majority; special majority (paragraphs 126-129).

Selection between these alternatives is much more than a technical matter. Supporters of unanimity consider that this method offers

a sure guarantee against international inflation; the opposite view is that in the conflict of interests between countries with different economic policy objectives, different degrees of development and different employment levels, a system based on unanimity would not allow of any decision being taken. Others believe that the choice of voting method cannot be made in the abstract but depends on the institutional framework in which the problem of the creation of reserves is resolved: if in the Fund, the methods might be those of this institution or else methods similar to those of G.A.B.; if outside the Fund and with participation limited to a small group of countries, then unanimity would not be so ill-contrived an arrangement as it might be in another institutional framework and with different participation.

23. In the second part of Chapter IV an examination is made of the technical methods of the creation of new reserve assets (paragraph 131): by multilateral swaps, crossed deposits in gold, subscriptions in gold certificates on the occasion of IMF quota increases, extension of virtually automatic drawing rights in the Fund, special operations by the Fund, and so on. Obviously no great importance should be attached to these techniques for new reserve creation; once agreement has been reached on fundamental questions, any kind of technique might be adopted to attain the desired objectives. The sole consideration that might weigh in favour of the choice of one method rather than another would be its greater simplicity and comprehensibility for public opinion, which is becoming increasingly interested in the process of creating new reserves.

Examination is then made of *criteria for distribution of newly-created assets*, and the Chapter inevitably contains some repetition of considerations that were developed in the paragraphs concerning the function of gold. In addition, however, the creation of reserves in connection with development finance is discussed in some details. This scheme, which recalls the fundamental lines of the well-known Stamp plan, links the creation of reserve assets with the provision of devlopment finance, eventually in the form of investment of currencies — drawn from Fund members' quotas or borrowed — in securities or note issued by I.B.R.D., which would subsequently distribute the currencies received according to its financial policy. This technique, in the form in which it has been put forward, 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 I.B.R.D. The arguments in favour of and against the idea of combining reserve creation, i.e. a function eminently of a monetary character, with development finance, i.e. a function that is identified with the provision of capital on a medium- and long-term basis, are discussed in paragraphs 137 and 138 of the Report.

Another problem, mainly technical in character, is the *use of the new reserve asset*. First comes the problem of *transferability*, i.e. whether transfer should be direct and independent or assured through the methods currently followed in the Fund, which place at the disposal of the recipient country the currency it needs. The difference between the two methods is not a substantial issue, even if the choice implies also a decision on the form of the new reserve asset, i.e., whether it is to be a new international reserve unit or a right of the member to pay his own currency into an international institution in purchase of another member's currency.

Linked with the transferability problem is the *liquidity* problem, in the sense that the country acquiring the new reserve asset must supply its own currency, directly or indirectly, against it, and therefore ultimately provide real resources or claims to them. Creation of new reserve assets in and through the IMF raises a problem of the Fund's own liquidity, and this question is examined in an Appendix to Chapter III and again dealt with in paragraph 141. In all cases, the liquidity of a reserve asset depends upon the extent and nature of the creditor's commitment to accept it.

Limitation of the creditor's commitment to accept the new asset is a political problem; the form limitation might assume is a technical problem. Here again, discussion of the possible ways of limiting the creditor's commitment (predetermined ceilings, percentage of total reserves, percentage of transfers) led to some repetition, since the same differences of opinion emerged as were recorded on the subject of gold generally. At all events, it should be stated that with the methods operating through the Fund, the creditor country is protected not only by a quota limit but also by the administrative control over accumulation of claims in the hands of any one member which the Fund exercises through its policy on currencies to be drawn.

As to the *qualities of the new reserve asset*, it was widely felt that any new type of international asset not directly convertible into gold must be covered by some form of gold-value guarantee or a maintenance-of-value guarantee such as that currently provided by

the Fund, which in practice serves the same purpose as an outright gold-value guarantee while offering the advantage of being an existing and familiar feature.

As regards the payment of *interest*, the prevalent opinion was that where a gold-value guarantee is envisaged, the new reserve asset should be very low-interest-bearing.

The validity of a new reserve asset depends to some extent on what would happen to it in case of *liquidation* or of *withdrawal* by any one member. The report briefly examines these two questions and registers unanimous agreement that the relative rules should not be such as to enable a large creditor to exert undue pressure on the other members by threatening withdrawal on terms that would draw heavily and immediately on their reserves.

The relationship of the process of reserve creation to *multilateral surveillance* is also mentioned. The opinion held by some members that a harmonization under multilateral surveillance of present policies regarding the composition of reserves would facilitate a smooth transition to the use of an additional reserve asset was barely touched on, since the subject of the common reserves policy falls outside the scope of the Mandate.

24. Part 3 of Chapter IV examines the *effects of reserve creation on the aggregate volume of international reserves and on the adjustment process*. The close relationship existing between the volume of reserves and the functioning of the adjustment process is evidenced by the fact that when international reserves are plentiful, countries will be prepared to draw them down, and will react slowly to any deficit that would arise; moreover, in such conditions they should not have difficulty in obtaining credit. If, on the other hand, the aggregate level of reserves is too low, the opposite effects will result, and in these conditions countries would tend to carry out the adjustment process sooner and more drastically.

The question is not examined in relation to each proposal but to each group of proposals having differing primary objectives, as indicated at the beginning of Chaper IV.

25. Chapter V of the Report assembles the elements necessary for evaluating the respective proposals, as laid down in the Mandate. Chapter IV presented a comparative analysis in a " horizontal " manner; in Chapter V the analysis of the various proposals is presented in a " vertical " manner. This method has meant that much of the material already dealt with earlier in the Report has had to be presented in a different framework, but this drawback is largely compensated by the fact that in the case of each proposal there is a series of arguments for and against, which enables those who have to make decisions to be supplied with a full evaluation of all the relevant effects. An analogous method was adopted in the Report of the 32 Bellagio economists.

This having been said, it is clear to the reader that the Chapter speaks for itself and need not be summarized or commented on.

26. The Mandate given to the Study Group laid down that in elucidating the general economic and financial impact of the various proposals, the Group should take full account of their implications for the functioning of the present international monetary system and of the following considerations:

(a) compatibility with the evolution of the existing system;

(b) contribution to a greater stability of the international monetary system;

(c) ability to direct liquidity to the point of greatest legitimate need at any given time;

(d) ability to adapt the volume of reserves to global needs, as opposed to individual shortages;

(e) acceptability and soundness of the claims they offer as a reserve asset;

(f) machinery required for controlling the volume and distribution of reserves created;

(g) effect on relations of the Group with the rest of the world;

(h) desirability of a group approach, as opposed to a world-wide approach.

The experts have made an honest attempt to summarize the main questions debated and at the same time to discuss the considerations listed above. The result of that attempt was Chapter VI of the Report.

27. The Final Remark of the Report derives directly from the first part of Chapter IV. In this Remark the Group's experts have

made a point of underlining that they agreed in recognizing what are the fundamental aspects of the process of reserve creation. This by itself is an important result, even though it partly means that the experts were agreed about the points of disagreement.

Any process whatever of creation of new reserve assets substantially implies the reciprocal surrender of rights on real resources. It therefore implies choices of a political character. In the Final Remark these choices are indicated as follows:

(a) the question of a link between gold and a new reserve asset, the closeness of that link, and its effects on the existing system;

(b) the width of membership for purposes of management and distribution of the assets;

(c) the role of the IMF as regards deliberate reserve creation;

(d) the rules for decision-making concerning the creation of reserve assets.

The Ossola Report and the coming discussions

28. In a speech at Hot Springs on July 10, 1965, Mr. Henry Fowler, the Secretary of the United States Treasury, proposed that the possibility of holding an international monetary conference should be examined, adding that the conference must be carefully prepared and that before it was held there should be " reasonable certainty of measurable progress through prior agreement on basic principles ". These basic principles are evidently those contained in the Final Remark of the Report.

The French Minister of Finance on his side has voiced the contention that there must be a " minimum of agreement on the nature of the reform's objectives ". It is a question, that is, of establishing whether the new unconditional liquidity should continue to be created in accordance with gold production and balance of payments' deficits of the reserve-centre countries, or through a rational process of objective assessment of the liquidity needs of the international economy. The French Minister also stated that " before constructing a new monetary system, it is indispensable to restore to health the existing one ".

As to the first condition indicated by the French Finance Minister, it must be stated that the liquidity needs of the international economy is not a concept that belongs to the economic categories. This need cannot be assessed unless the desire of national monetary authorities to preserve a margin of autonomy in conducting their economic policy is taken into account. Those mainly interested in the solution of this problem are obviously the industrial countries which, being the major holders of real resources, have to weigh whether, and within what limits, they are prepared to grant one another reciprocally an automatic and unconditional right to draw on their resources. The problem is therefore essentially of a political nature. The experts can indicate the alternative solutions, their effects on the functioning of the international monetary system, and their significance in terms of shifts of real resources, a development underlying the monetary process. Obviously, however, they cannot make or propose any choice.

As to the second condition indicated by the French Minister, he made clear that the question is to ensure a lasting recovery of the balance of payments' equilibrium of the principal countries before the real needs of the world economy for means of payment can be estimated and satisfied. This condition, it is clear, is connected with the previous one. It could however arouse doubts that one of the objectives of the coming discussions is to construct a new monetary system instead of improving the existing one.

The general trend — including, it is believed, that of France too — is in favour of evolution. The efforts of those responsible for monetary policy in the various countries aim not so much at constructing a new monetary system as at imparting a conscious direction to the natural evolution of the present one. The innovations should be incorporated into the present system, the foundations of which are a fixed price for gold, fixed exchange rates and international monetary cooperation between Treasuries and central banks, through the IMF, the Working Group No. 3 of OECD, the Group of Ten, the Bank for International Settlements, the Committee of Governors, and the Monetary Committee of the EEC.

Any proposal or innovation should therefore make it possible for the new reserve assets to coexist with those currently in use, and reduce to a minimum changes in the propensities of the monetary authorities to hold one reserve asset rather than another. In other words, no matter what the declared object of a determined proposal may be (none of them aims at creating a reserve asset designed to replace existing reserve currencies), innovations should avoid causing

a psychological impact likely to modify the scale of the existing propensities. In this connection, some believe that the greater the extent of innovation, the greater the risk of a modification of this scale likely to lead to instability of the system and ultimately to a contraction of the volume of international liquidity; for others, however, it is extremely difficult to foresee the consequences of innovations.

The question, here, is not to state that any plan of reform that safeguards the position of the dollar as a reserve currency is necessarily rational. It is simply a question of drawing attention to the fact that, to the extent that a certain innovation leads to the substitution of dollars with other reserve assets, the result might be a decrease rather than an increase of the volume of international liquidity; and this independently of the political judgment whether the dollar should continue to fulfil a reserve function (a function that is obviously distinct from that of international currency used in the regulation and financing of international trade; in any case, this latter function will continue to be exercised).

29. The visit of Mr. Fowler to Europe in September this year has enabled the problem to be seen in its right perspective. This visit has revealed a wide measure of agreement on the need for the proposed conference to be well prepared, and on the first stage of this preparation taking place within the Group of Ten.

During this opening phase the interested countries will first have to tackle problems far more urgent than that of the creation of new reserves; for instance, the qualitative composition of reserves in individual countries, a problem which is substantially identified with the problem of avoiding a contraction of the global volume of reserves; regional distribution; and the strengthening of the adjustment process, i.e., the timely elimination of external disequilibria as they arise. These are problems that found little place in the Study Group's discussions.

Only after they have been solved will it be possible to tackle the more fascinating problem of increasing international reserve assets.

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