Deliberate Reserve Creation: an Interim Solution

1. The Ministers and central bank Governors of the Ten countries participating in the General Arrangements to Borrow met last July at the Hague to discuss the Report by their Deputies on possible improvements of the international monetary system, including arrangements for the future creation of additional reserve assets, as and when needed (see the communiqué of the Ministerial Meeting of the Group of Ten, dated July 26, 1966).

The Deputies' report was made public at the end of last August.

The Ministerial communiqué, drafted on the basis of the conclusive chapter of the report, indicates the area of agreement on essential points which has been reached within the Ten. The points of agreement are described in detail in par. 98 of the report and in par. 4 and 5 of the communiqué. Both these documents reveal that France has not been able to share the position of the other Nine, according to which it would be prudent to begin now preparing for a general scarcity of reserves and therefore to agree on a contingency plan for deliberate reserve creation to be activated, as and when needed, under certain conditions, namely, the attainment of a better balance of payments equilibrium between members and the likelihood of a better working of the adjustment process in future.

2. However, the Finance Ministers of the European Economic Community, who met in Luxembourg in September to discuss, among others, the international monetary problem, succeeded in formulating a common position of the Six on the following lines:

— on the one hand, France has considerably mitigated her hostility to contingency planning of reserve creation by accepting in

fact to be present at the work of the so-called second phase and by cooperating in the definition of the conditions of activation of any contingency plan;

— on the other hand, the remaining members of the Community have accepted a spelling out of the conditions of activation more precise than the formulation contained in the Hague communiqué, namely, by indicating that such activation should not take place before the elimination of deficits of reserve currency countries.

3. The conditions for the beginning of the so-called second phase appear, then, to be met. At the Hague, after consulting with the Managing Director of the Fund, the Ministers and Governors of the Ten recommended that the examination of the monetary problem, within the broader framework of the questions that affect the world economy as a whole, should take place through a series of joint meetings in which the Deputies would take part together with the Executive Directors of the Fund. A report on the subject is to be expected not later than the middle of 1967.

In Washington, in the next few days of this month, on the occasion of the annual meeting of the IMF, Ministers and Governors of the Ten will agree on the terms of reference of the new mandate to be given to the Deputies. At the same time, the Executive Directors will be authorized by the Managing Director to meet together with the Deputies with the aim of reaching a consensus on the monetary problems.

4. The main issue which could divide the Ten from the non-Ten (mainly the developing countries) during the discussions that will take place during the second phase is undoubtedly the control over the amount of the additional reserves and over the moment to create them. Industrial countries hold the view that, because of their economic importance, they have a particular responsibility in the working of the international monetary system, if only because they supply in fact the financial backing of any newly created reserve asset, whatever form the new instruments may take. One may add that while developing countries are by definition always in favour of the creation of new reserves, whatever the situation of the world economy, industrial countries are not systematically against it; on the contrary, it is likely that in a situation of stagnation they would

be the first to promote a positive decision. This particular responsibility should be recognized through a special decision-making procedure (first, a decision within the group, reached on the basis of a weighted qualified majority, then, a decision in the Fund; or else a decision in the Fund, to become effective when a sufficient proportion of members able to provide the resources to support the reserve creation have agreed to do so). The restricted group of countries which is to constitute the decision-making centre does not necessarily coincide with the present Group of Ten; it is possible that other countries will be included, both because of the amount of their reserves and because they have shown in the past the political willingness to operate the necessary adjustments in case of external disequilibrium. However, the non-Ten in general and the developing countries in particular hold the view that, because the new reserve assets are to be created within the Fund, the decision procedures should be those provided in the Articles of Agreement; in other words, they think that the decision should be taken with the IMF weighted majority. The weighted vote of the EEC countries within the Fund is about 17 per cent; therefore an important group of countries would risk being systematically overruled.

The insistence of the developing countries to be put on the same footing as the industrial ones in the process of decision-making may not appear logical if one considers that those countries have neither objected to previous mechanisms of reserve creation, such as the late European Payments Union, from whose benefits they were even excluded (whereas it is nowadays accepted that they will benefit like others from the distribution of new reserve assets, if and when created), nor to the massive creation of unconditional liquidity which takes place continuously within the framework of the reciprocal monetary agreements concluded by the Federal Reserve System ("swap") and within the support arrangements. For instance, the recent increase of the amount of facilities provided by the reciprocal monetary agreements from 2.8 to 4.5 billion dollars and the credit facilities established in favour of the United Kingdom last June and September have never been criticised by the developing countries. Yet, these agreements represent a massive creation of reserves within a restricted group.

The issue of control presents two aspects:

(a) first, whether a restricted group of countries should have a special position in the decision-making process;

(b) secondly, what, if the answer is yes, should be the composition of the restricted group.

This shows how the issue of control over the creation of new reserve assets, which is mainly of a political character, could represent a serious obstacle to a future agreement on reserve creation.

5. However, the difficulties in the way of reaching an agreement do not arise only because of the different appreciation of industrial and developing countries of the nature of the decision-making.

Within the group of industrial countries some consider that the deliberate creation of new instruments strongly resembles the issue of currency by national governments, and they therefore hesitate to engage in such an innovating process. In reality, whatever the form that the new reserve assets may take, the process is in substance a reciprocal granting of credit among creditworthy countries. However, fears and reticences subsist in face of a decision of that kind and they should be taken into account from a political point of view.

6. For all these considerations, therefore, it would perhaps be better, before treading the path of deliberate reserve creation, to go through an experimental stage during which reserve drawing rights in favour of the non-Ten would be created whereas among the Ten there would be a consolidation of the existing swap and support arrangements in multilateral reserve accounts to be opened on the books of a central institution.

Only after this experimental stage could deliberate reserve creation proper be undertaken, following one of the techniques which have been studied by the IMF or the Group of Ten.

7. The main lines of this scheme are the following:

(a) Adoption, with certain modifications, of the Fund proposal of creation of special reserve drawing rights (see par. 19-21 of the Annex of the Deputies' Report, published last August, and pages 19-21 of the Fund Report for 1966).

As will be remembered, according to this proposal, special reserve drawing rights (SRDR) would be created and distributed to all Fund members in approximate proportion to their IMF quotas. These reserve rights would be in addition to the automatic rights of the gold tranche and to the conditional rights of the credit tranches; therefore, unlike normal automatic drawing rights of the gold tranche type, they could be used at any moment and even after utilization of the conditional credits in the Fund. For these reasons they are called "floating" rights. The financing and transfer of reserves thus created would be provided through the opening in favour of the Fund by each member country of an unconditional credit line denominated in its national currency, for an amount equal to the respective allocation of special drawing rights.

This proposal could be agreed upon with the following variations:

— members of the Group of Ten would open the lines of credit necessary for the functioning of the system with the tacit understanding not to use the reserve rights allocated to them; thus, whereas all Fund members would be formally put on the same footing, the result of the operation would be the creation of new reserve assets to the sole benefit of the non-Ten. Therefore the actual creation of reserves would amount only to a fraction of the total decided upon;

— consequently, the financing of these special reserve drawing rights would in fact be provided only by industrial countries.

(b) Consolidation of all or part of the liquidity created through the reciprocal monetary agreements and support arrangements in a monetary union among the Ten (Atlantic Payments Union, APU; Atlantic Monetary Union, AMU; ecc.).

The system would work as follows:

i) each country would be entitled to a quota determined on the basis of the facilities granted or received within the reciprocal monetary agreements or the support arrangements. The global amount of the quotas would not exceed the amount of the facilities contained in these agreements as they now exist, and the latter would be terminated.

ii) Each member country would open a reserve account, denominated in units, on the books of a central institution which could be an affiliate of the International Monetary Fund or the Bank for International Settlements. Each account could be credited with units up to an amount equal to twice the individual quota and debited in units up to an amount equal to the quota. Each debit or credit transaction will have as counterpart a purchase or a sale of national currency by the member.

iii) Each debit or credit transaction in the reserve accounts will be accompanied by a payment or a receipt of gold for an equal amount. However, the country buying units will have the option of giving up its rights to a gold transfer.

iiii) Units will be backed by an outright gold guarantee.

(c) The contingency plan adopted according to this scheme should indicate the amount of unconditional liquidity to be created under the form of special drawing reserve rights and within the monetary union among the Ten. The decision to activate the system should be taken under the well-known conditions (see par. 98/8 of the Deputies' Report) and, as far as point (a) is concerned, according to the formula suggested in the Fund proposal, to which it has previously been referred, i.e. with the weighted majority provided by the Fund Articles of Agreement and as soon as a sufficient proportion of members whose currencies have been used by the Fund in the last few years have agreed to do so.

8. The scheme outlined above is not intended to be a final solution of the problem of deliberate creation of new reserve assets. It represents only a first step in this direction, aiming at the following objectives:

— it is a very simple proposal on which, for the very reason of its interim character, it should not be difficult to reach an agreement among the Ten and between the Ten and the non-Ten;

— the scheme aims at eliminating any misunderstanding between the Ten and the non-Ten by giving priority to the solution of the liquidity problems of developing countries;

— the actual creation of liquidity is of a very modest amount. In effect, the amount of liquidity created among industrial countries participating in the monetary union is equal to that provided by the reciprocal monetary agreements and by the support arrangements, which will be terminated. One may add that the present network of agreements of this type is a one-way system because, in fact (in the relations with the United States) or by right (in the relations with the United Kingdom), it is functioning mainly or exclusively for the benefit of the two reserve centres;

— the scheme enables an experiment to be made in the process of deliberate reserve creation, from which experience could be gained in view of the preparation of a final plan;

— the fundamental problems relating to control by all participants or by a restricted group and relating to the composition of this group are shelved for the time being. Anyway, the question of the amount would be decided at the stage of contingency planning. Finally, a not negligible advantage would be to calm down the impatience which has been building up among interested countries and in public opinion and to allow the negotiation to be continued in a more serene atmosphere.

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