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**AMENDMENTS OF THE BRETTON WOODS
AGREEMENTS ACT**

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HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE

OF THE

COMMITTEE ON

BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

H.R. 13955

**TO PROVIDE FOR AMENDMENT OF THE BRETTON WOODS
AGREEMENTS ACT, AND FOR OTHER PURPOSES**

AUGUST 27, 1976

Printed for the use of the
Committee on Banking, Housing and Urban Affairs

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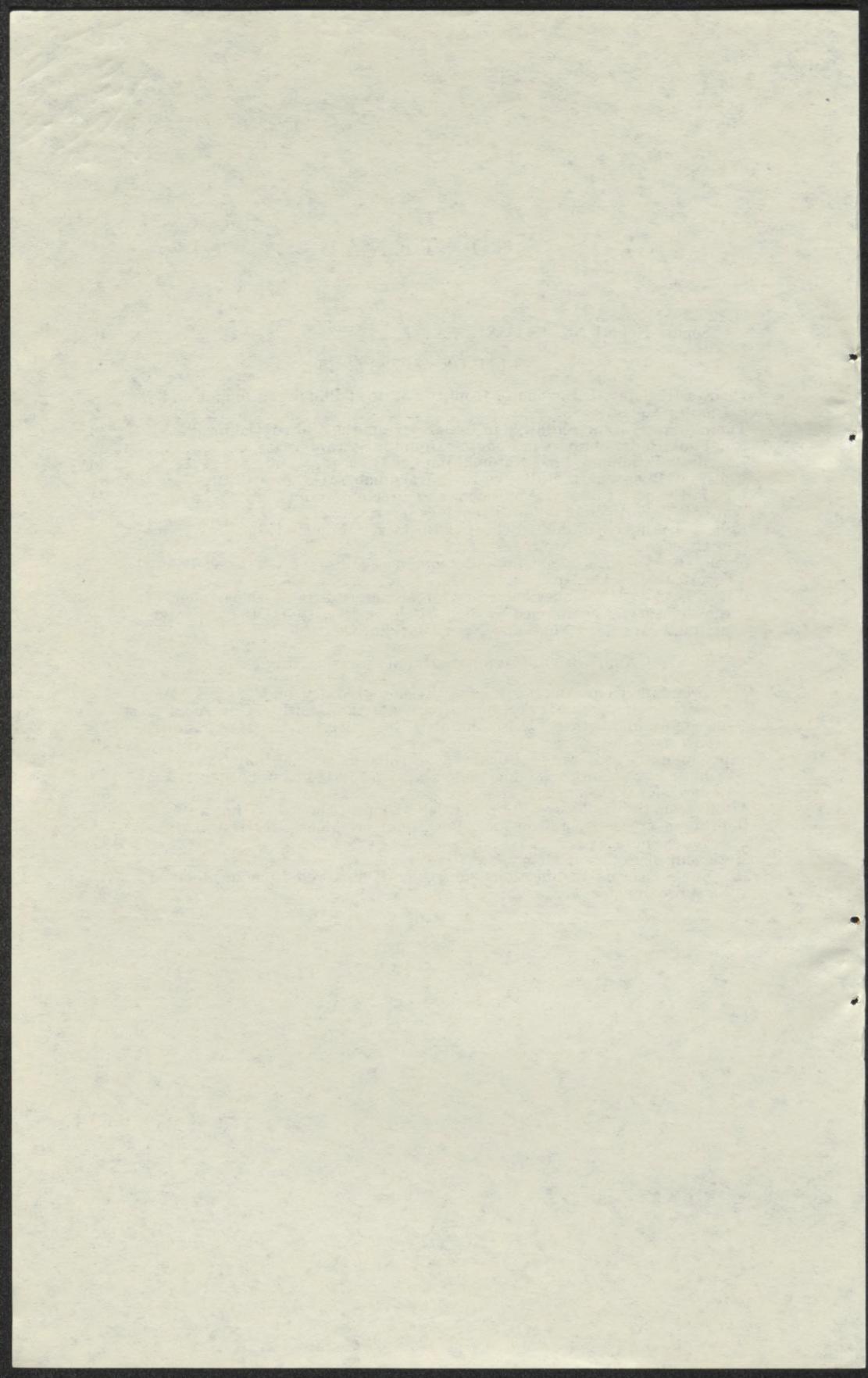
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AMENDMENTS OF THE BRETTON WOODS AGREEMENTS ACT

FRIDAY, AUGUST 27, 1976

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
Washington, D.C.

The subcommittee met at 10:10 a.m. in room 5302 of the Dirksen Senate Office Building; Senator Adlai Stevenson, chairman of the subcommittee, presiding.

Present: Senators Stevenson, Proxmire, Tower, and Helms.

Senator STEVENSON. The meeting of the Subcommittee on International Finance will come to order.

The purpose of this hearing is to consider H.R. 13955, a bill to authorize the U.S. acceptance of certain amendments to the Articles of Agreement of the International Monetary Fund, and an increase of the U.S. quota.

The amendments would legitimize floating exchange rates. The immediate issue is whether the Congress should approve this authorizing legislation, but the larger question is whether the amendments, the quota increase, and other so-called reforms instituted in recent years fulfill the U.S. objective of moving toward a stable noninflationary international monetary order.

We are fortunate to have with us this morning a distinguished group of witnesses, all of whom are well qualified to testify to this large complex subject.

The first is our colleague from Illinois, the distinguished senior Senator, Charles H. Percy.

OPENING STATEMENT OF SENATOR TOWER

Senator TOWER. This morning we meet for hearings on a most important matter—the structure and functioning of the international monetary system. Since 1973, most major currencies have—to a large extent—been allowed to float. An international monetary system based on floating exchange rates, however, constitutes a technical violation of the Bretton Woods Agreements and the articles of the International Monetary Fund. This is most important because it means that the IMF cannot develop a consensus on “rules of the game” for our floating-exchange-rate world and act as an umpire for those rules.

Without a consensus on rules of the game and an international organization to enforce those rules, the danger is increased that one or more countries will attempt to manipulate the price of their currencies on foreign exchange markets to give their exporters an unfair competitive

advantage. This, of course, would put American producers at an unfair competitive disadvantage. To avoid such an eventuality, I urge the committee to give prompt attention to H.R. 13955.

STATEMENT OF CHARLES H. PERCY, U.S. SENATOR FROM THE STATE OF ILLINOIS, ACCOMPANIED BY CHARLES MEISSNER

Senator PERCY. Thank you, Mr. Chairman. I am very pleased to be with the subcommittee this morning, Senator Proxmire and my distinguished colleague, Senator Helms, and my colleague from Illinois.

You have a very distinguished panel following.

We have a vote coming along fairly soon, so I will be brief.

I ask your unanimous consent to submit the entire testimony that I am presenting this morning in the record at this stage.

Senator STEVENSON. Without objection.

[Complete statement of Senator Percy, a copy of H.R. 13955 as reported by the Committee on Foreign Relations, and a reprint of Senate Report No. 94-1148 follow:]

PREPARED STATEMENT OF SENATOR CHARLES H. PERCY

Mr. Chairman, I thank you for the opportunity to appear before you. It is always a pleasure to deal with my fellow colleague from Illinois.

I strongly support the passage of H.R. 13955 as passed by the House and reported by the Senate Foreign Relations Committee. I agree with the Committee's conclusion that in renegotiating the Bretton Woods Agreement the Administration has achieved U.S. objectives and effectively protected U.S. interests. In the process of accomplishing this task, numerous compromises were made, none of them in my opinion are damaging to basic U.S. interests.

My purpose in appearing this morning is not to speak as an advocate for H.R. 13955, but to explain to you the purpose and thought behind my own amendment to H.R. 13955. The amendment appears as Section 4 in the bill and amends Section 14 of the Bretton Woods Agreements Act by adding a paragraph (b). The amendment is short but very significant. It reads as follows:

The President shall, upon the request of any committee of the Congress with legislative jurisdiction over an international financial institution or economic organization of which the United States is a member, transmit promptly to such committee any appropriate information furnished to any department or agency of the United States by such institution or organization.

The purpose of the amendment is to improve the potential of Congressional oversight of U.S. governmental activities regarding U.S. participation in the international monetary system and U.S. foreign economic policy. The growth of economic interdependence and the increasing size of the international sector of the U.S. economy necessitate greater Congressional concern to these policy areas. For example, in this Congress we have dealt with Bretton Woods, commodity agreements, energy problems and the OECD financial safety net.

The international monetary system and the International Monetary Fund (IMF), as the central institution of that system, form the cornerstone of U.S. foreign economic policy. Yet the switch from fixed to floating exchange rates limits Congressional access to the policy process associated with the monetary system or the IMF. With fixed exchange rates, adjustments in the balance of payments were handled through controls on trade, financial flows, military offset payments, etc. Congress had to approve these actions and could express its policy concern.

However, under floating rates the adjustment process takes place in the rate itself, in the market place with no Congressional input. The system will be run through the IMF and the financial organizations of the OECD and G-10. Without some access to the papers and analyses of these bodies, Congressional oversight of the new Bretton Woods Agreements will be minimal.

Secondly, because of the expanding role of economics, there is a growing need by Congress for international economic information. One major center of reliable economic data is the staff and secretariats of international financial

institutions and economic organizations. The executive branch uses this material in the formulation of policy on both bilateral and multilateral economic problems. I believe Congress should also have access to this economic information if we are going to review policy options intelligently.

In the past, we have tried to get this information, and for the most part, I think members of the Committee and staff of Senate Foreign Relations have been successful because they have "friends" at Treasury or State who are willing to "help." But on the more sensitive documents, I must admit that I find it annoying to be told: "Well, you can certainly read the documents; we will bring them to your office and you can read them while we wait." This is really a slight to Congress. I don't see how we can exercise adequate oversight on a basis that maybe we can see them and maybe we can't. We must have access to information and, in turn, must be held fully accountable for the documents and policies we approve.

The amendment has some key words in it that must be explained. First, it is directed to the President because the responsibility for development of foreign economic policy is shared mainly between the Secretary of State and the Secretary of the Treasury. However, other agencies such as the Federal Reserve, the Council on International Economics, the Economic Policy Board, the Special Trade Representative, the Council of Economic Advisors and the Office of Management and Budget, all contribute and in some cases represent the United States in international bodies.

Secondly, the amendment does not demand all documents, but only those requested by a committee. The word committee is important because the amendment is not seen as applying to personal requests by members of Congress. It deals with committee business and oversight responsibilities.

The most significant modifier in the amendment is the word appropriate which appears in the phrase "... transmit promptly to such committee any appropriate information . . .". This word was very thoughtfully inserted by our colleague Jacob Javits to avoid a constitutional clash over the issue of Congress requesting documents from the President and having him refuse. The word provides a buffer for reasons of vagueness in that gray area of the Constitution on the separation of powers. The Committee, however, made clear that it would not accept a decision that sensitivity or classification of a document defined that document as inappropriate.

The Department of Treasury is in opposition to this amendment. Their concerns are twofold. First, they believe that there is a right of executive privilege that this amendment may violate. This is difficult to accept. The amendment deals only with information provided to the executive branch from an external source and given to all other international members. Second, Treasury objects to the amendment on the basis of confidentiality of the material. They argue that material is provided to an international organization on a confidential basis and should be held as closely as possible. I don't accept the position that exposure to Congress is tantamount to public disclosure. This body handles classified documents daily without mishap. Certainly, on the Senate Foreign Relations Committee all reports printed publicly which may have classified information included are cleared by the executive branch. Furthermore, the executive branch does not have an untarnished record in this area either.

One other objection has been raised, that is the issue of germaneness. H.R. 13955 deals only with the IMF and the IBRD (World Bank). Those opposed to my amendment believe it to be too broad in its scope, applying to all institutions and economic organizations. I disagree. A close reading of Section 14 of the Bretton Woods Agreements Act shows that the drafters of that Act, even 30 years ago when the international economy was of much less importance than today, recognized the interdependence of various aspects of the international economy. The major objectives outlined were to "facilitate the expansion and balanced growth of international trade and promote the stability of international economic relations." The Congress directed the U.S. representative of the Fund and the Bank to formulate policy taking into account all the various aspects of our economic relations. I don't see how Congress in its oversight role can ask any less of itself.

I urge this Committee to study my amendment closely and give its stamp of approval. Congress must have information if it is to do its job adequately. There is no reason why we must duplicate the executive branch in size and staff to effectively formulate policy options for this country. We are one government, not two. There is no reason we cannot share the information provided to our government resulting from U.S. participation in an international institution or organization.

Calendar No. 1081

94TH CONGRESS
2D SESSION**H. R. 13955**

[Report No. 94-1148]

IN THE SENATE OF THE UNITED STATES

JULY 28, 1976

Read twice and referred to the Committee on Foreign Relations

AUGUST 10, 1976

Reported by Mr. SPARKMAN, with amendments

[Omit the part struck through and insert the part printed in *italic*]

AN ACT

To provide for amendment of the Bretton Woods Agreements Act, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That the Bretton Woods Agreements Act (22 U.S.C. 286-
4 286k-2) is amended by adding at the end thereof the fol-
5 lowing new sections:

6 “SEC. 24. The United States Governor of the Fund is
7 authorized to accept the amendments to the Articles of
8 Agreement of the Fund approved in resolution numbered
9 31-4 of the Board of Governors of the Fund.

10 “SEC. 25. The United States Governor of the Fund is
11 authorized to consent to an increase in the quota of the United

1 States in the Fund equivalent to 1,705 million Special Draw-
2 ing Rights.

3 "SEC. 26. The United States Governor of the Fund is
4 directed to vote against the establishment of a Council
5 authorized under Article XII, Section 1 of the Fund Arti-
6 cles of Agreement as amended, if under any circumstances
7 the United States' vote in the Council would be less than
8 its weighted vote in the Fund."

9 SEC. 2. Section 3 of the Bretton Woods Agreements Act
10 (22 U.S.C. 286a) shall be amended as follows:

11 (1) section 3 (c) shall be amended to read as fol-
12 lows:

13 "(c) Should the provisions of Schedule D of the Ar-
14 ticles of Agreement of the Fund apply, the Governor of the
15 Fund shall also serve as councillor, shall designate an alter-
16 nate for the councillor, and may designate associates.";

17 (2) a new section 3 (d) shall be added to read as
18 follows:

19 "(d) No person shall be entitled to receive any salary
20 or other compensation from the United States for services
21 as a Governor, executive director, councillor, alternate, or
22 associate."

23 SEC. 3. The first sentence of section 5 of the Bretton
24 Woods Agreements Act (22 U.S.C. 286c) is amended to
25 read as follows: "Unless Congress by law authorizes such

1 action, neither the President nor any person or agency shall
2 on behalf of the United States (a) request or consent to any
3 change in the quota of the United States under article III,
4 section 2 (a), of the Articles of Agreement of the Fund; (b)
5 propose a par value for the United States dollar under para-
6 graph 2, paragraph 4, or paragraph 10 of schedule C of the
7 Articles of Agreement of the Fund; (c) propose any change
8 in the par value of the United States dollar under para-
9 graph 6 of schedule C of the Articles of Agreement of the
10 Fund, or approve any general change in par values under
11 paragraph 11 of schedule C; (d) subscribe to additional
12 shares of stock under article II, section 3, of the Articles
13 of Agreement of the Bank; (e) accept any amendment
14 under article XXVIII of the Articles of Agreement of the
15 Fund or article VIII of the Articles of Agreement of the
16 Bank; (f) make any loan to the Fund or the Bank; (g)
17 approve the establishment of any additional trust fund
18 *whereby resources of the International Monetary Fund*
19 *would be used* for the special benefit of a single member, or
20 of a particular segment of the membership, of the Fund.”.

21 *SEC. 4. Section 14 of the Bretton Woods Agreements*
22 *Act is amended as follows:*

23 (1) *Immediately after “SEC. 14.” insert “(a)”.*

24 (2) *At the end thereof add the following new sub-*
25 *section:*

1 “(b) The President shall, upon the request of any com-
2 mittee of the Congress with legislative jurisdiction over an
3 international financial institution or economic organization
4 of which the United States is a member, transmit promptly
5 to such committee any appropriate information furnished to
6 any department or agency of the United States by such
7 institution or organization.”.

8 SEC. 4 5. The first sentence of section 17 (a) of the
9 Bretton Woods Agreements Act (22 U.S.C. 286e-2 (a)) is
10 amended to read as follows: “In order to carry out the pur-
11 poses of the decision of January 5, 1962, of the Executive
12 Directors of the International Monetary Fund, the Secretary
13 of the Treasury is authorized to make loans, not to exceed
14 \$2,000,000,000 outstanding at any one time, to the Fund
15 under article VII, section 1 (i) , of the Articles of Agreement
16 of the Fund.”.

17 SEC. 5 6. The Special Drawing Rights Act (22 U.S.C.
18 286n-r) is amended by:

19 (1) deleting “article XXIV” in section 3 (a) and
20 inserting in lieu thereof “article XVIII”;

21 (2) deleting “article XXVI, article XXX, and arti-
22 cle XXXI” in section 3 (b), wherever it appears, and
23 inserting in lieu thereof “article XX, article XXIV, and
24 article XXV”;

1 (3) deleting "article XXIV" in section 6 and in-
2 serting in lieu thereof "article XVIII";

3 (4) deleting "article XXVII (b)" in section 7 and
4 inserting in lieu thereof "article XXI (b)".

5 SEC. 6 7. Section 2 of the Par Value Modification Act
6 (31 U.S.C. 449) is hereby repealed.

7 SEC. 7 8. Section 10 (a) of the Gold Reserve Act of
8 1934 (31 U.S.C. 822a (a)) is amended to read as follows:

9 "SEC. 10. (a) The Secretary of the Treasury, with the
10 approval of the President, directly or through such agencies
11 as he may designate, is authorized, for the account of the
12 fund established in this section, to deal in gold and foreign
13 exchange and such other instruments of credit and securities
14 as he may deem necessary to and consistent with the United
15 States obligations in the International Monetary Fund. The
16 Secretary of the Treasury shall annually make a report on
17 the operations of the fund to the President and to the
18 Congress."

19 SEC. 8 9. Section 14 (c) of the Gold Reserve Act of
20 1934 (31 U.S.C. 405b) is amended to read as follows:

21 "The Secretary of the Treasury is authorized to issue gold
22 certificates in such form and in such denominations as he
23 may determine, against any gold held by the United States
24 Treasury. The amount of gold certificates issued and out-

1 standing shall at no time exceed the value, at the legal stand-
2 ard provided in section 2 of the Par Value Modification Act
3 (31 U.S.C. 449) on the date of enactment of this amend-
4 ment, of the gold so held against gold certificates.”.

5 SEC. 9 10. The amendments made by sections 2, 3, 4,
6 5, 6, 7 and 7 8 of this Act shall become effective upon entry
7 into force of the amendments to the Articles of Agreement
8 of the International Monetary Fund approved in Resolution
9 Numbered 31-4 of the Board of Governors of the Fund.

Passed the House of Representatives July 27, 1976.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

Calendar No. 1081

94TH CONGRESS }
2d Session

SENATE

} REPORT
No. 94-1148AMENDMENT OF THE BRETTON WOODS AGREEMENTS
ACT

 AUGUST 10, 1976.—Ordered to be printed

Mr. SPARKMAN, from the Committee on Foreign Relations,
submitted the following

REPORT

[To accompany H.R. 13955]

The Committee on Foreign Relations, to which was referred the bill (H.R. 13955) to provide for amendment of the Bretton Woods Agreements Act and for other purposes, having considered the same, reports favorably thereon with amendment and recommends that the bill as amended do pass.

PURPOSE OF THE BILL

The purpose of the bill H.R. 13955 is threefold. First, the bill authorizes the U.S. Governor of the International Monetary Fund (IMF) to sign for the United States the amended Articles of Agreement of the Fund. The new amendment IMF Articles of Agreement are printed in House of Representatives document no. 94-447. (The corresponding pages of the old Articles of Agreement are printed on the opposing pages of the House document.) Second, the bill authorizes an increase in the United States quota to the IMF by 1,705 million Special Drawing Rights (SDR) or approximately \$2 billion with the SDR valued at 1 SDR—\$1.16 U.S. Third, H.R. 13955 amends three other acts of relevant financial legislation to reflect the changes in the amended IMF Articles of Agreement.

COST OF THE BILL

There are no budgetary implications in this bill. The expansion of the U.S. quota at the IMF is treated as an exchange of assets between the Fund and the U.S. Government. Such an exchange must be authorized but not appropriated since there is no uncompensated expenditure of fiscal resources.

HISTORICAL BACKGROUND

The international monetary system as it has been experienced over the last three decades in the creation of the Bretton Woods Conference in 1944. The conference agreement was authorized by the United States and the United Kingdom. The objective of the system was to provide financial stability in international markets. This was achieved by fixing exchange rates, by setting an official price for gold, by guaranteeing the conversion into gold of major currencies, and by forming the IMF to oversee the system and provide it with the credit facilities to stabilize the currencies of countries having balance of trade difficulties.

The dissolution of the monetary system created by the Bretton Woods Agreements can be traced to the early 1960s. The monetary system during this time period made a de facto transition from a "gold standard" to a dollar standard. The continuing annual balance of payments deficits of the United States, which were seen as a blessing in the 1950s when the new post-war monetary system was starved for liquidity, produced a dollar glut abroad by the early 1960s. There were more dollars abroad than the U.S. had gold. The U.S. commitment to redeem international dollars for gold became a physical impossibility. The reality of dollar convertibility ended. The strength of the dollar and the U.S. economy became the base for the system, as major trading countries were forced to hold their international monetary reserves in dollars.

Continuing U.S. balance of payments deficits through the 1960s meant the U.S. was providing more monetary paper for the real resources it bought from abroad. The dollar was overvalued in relation to other major currencies. The inflation generated by the Vietnam War expenditures further accelerated both the flow of dollars abroad and the overvaluation. However, during the 1960s, devaluation of the dollar was not politically acceptable in the United States nor desired abroad by our trading partners. A number of actions during the 1960s marked the U.S. efforts to help relieve pressures on the monetary system. The interest equalization tax (IET) and regulations on capital flows were instituted. Military offset agreements were negotiated. Agreements were made between the largest 10 countries on gold holdings, the price of gold and foreign dollar holdings. A system of currency swap arrangements between the major central banks came into being to help stem short-term speculative flows against major currencies. U.S. Export-Import Bank activities were expanded in the hopes of reducing the deficit and the domestic international sales corporation (DISC) authorized to further stimulate exports.

By the late 1960s, major pressures were building for change. The monetary system was not serving the objectives of major interest groups. The Europeans became sensitive to U.S. purchases of European firms with overvalued dollars. U.S. labor felt that jobs were being shipped abroad at the same time that imports were competing easily with domestic production because of the overvalued dollar. U.S. exporters were losing overseas markets and finding it difficult to compete with European firms in third country markets. Studies by the OECD (Organization for Economic Cooperation and Development)

began to show that under a fixed exchange rate system, the U.S. had exported to Europe and the world its own inflation. The Europeans argued that the dollar had two functions, one as a domestic currency and one as an international currency. The United States was accused continually of opting for domestic political considerations rather than fulfilling its international responsibilities as a reserve currency country.

The system had been faltering for a decade, but the benchmark date of the collapse is put at August 15, 1971. On this day, President Nixon reversed U.S. international monetary policy by officially declaring the non-convertibility of the U.S. dollar into gold and unilaterally imposing a 10 percent surcharge on all imports. The latter act represented a 10 percent devaluation of the dollar. The August 15 declaration led to the Smithsonian Agreement of December, 1971, which realigned the exchange rates between the dollar and other major currencies in the world. As part of the agreement, the dollar was devalued by 8 percent in relation to gold, while such currencies as the Deutsche mark and the Japanese yen were appreciated substantially.

The Smithsonian Agreement was an attempt to hold together the monetary system under the Bretton Woods structure of fixed exchange rates and currencies denominated in gold at official prices. But economic pressures in the United States, in the face of continuing balance of payments deficits, forced the United States to unilaterally devalue again by 10 percent in January, 1973. This devaluation signaled the end of the Smithsonian Agreement and the demise of the fixed rate exchange of Bretton Woods. By March of 1973, all of the major trading nations, with few exceptions, were floating their currencies and allowing world exchange markets to set currency values. While sanctioned by the IMF, the float was in technical violation of the Bretton Woods Agreements and the Articles of the International Monetary Fund.

The 1973 float of currencies eventually ended IMF efforts to structure a new monetary system on the principle of fixed exchange rates. The focus of reform was redirected to structuring a new system reflecting the realities of the floating rates. During the summer of 1974, the Interim Committee of the IMF was formed to negotiate this change. The major industrialized countries are represented directly on the Committee, with other members of the IMF selecting representatives that each represent a group of countries. The representatives are of ministerial rank. The Interim Committee was set up with the basic idea that the finance ministers have the capacity to make the political decisions necessary to reach the compromises needed to form a consensus on the shape of a new international monetary system.

There were three major issues facing the Interim Committee when it began negotiations in September 1974. These three issues were: the future role of gold in the new monetary system, the changes in the IMF quota structure to reflect the changes in economic wealth in the world, and the structure of the exchange rate system in the new monetary system.

The basic political compromise on the issue of gold was reached between the French and Americans at the bilateral summit meeting in

Martinique, December, 1974. President Ford met with President Giscard d'Estaing, with finance ministers William Simon and Jean-Pierre Fourcade present. The agreement, accepted by the Interim Committee in August, 1975, abolished an official price for gold, allowed each nation to value its gold reserves at market price if it so wished, and advocated the sale of IMF gold assets. It seemed to indicate substantial withdrawal by the French from their long-held position that gold should remain central to the monetary system. Yet it is argued by some that the agreement may allow gold actually to come back into the system in the future. The United States advocates that the Special Drawing Right (SDR) replace gold in the system. The U.S. also surfaced the proposal at Martinique that the IMF might sell a portion of its gold, the profits from the sale being placed in a fund to be used by less developed countries to help with special balance of payment problems. This proposal evolved into the idea of the new IMF Trust Fund.

The second question before the Interim Committee, that of changing quotas in the IMF, was approved on August 31, 1975, at the Committee's meeting in Washington, D.C. It was decided to expand the total quotas of the IMF by one-third. Almost all countries will increase their quotas by an absolute amount but a limited number of countries will increase their quotas by a larger percentage than others. This will result in a change in the relative percentage of national participation in the IMF. The most significant relative increase in participation was an expansion of the OPEC (oil-exporting) nations' percentage from 5 percent to 10 percent, with the U.S. and other OECD nations reducing their cumulative percentage by 5 percent.

On the third issue—exchange rates—the main differences were between the French position advocating fixed rates and the American position promoting floating rates. The issue was not resolved at the September, 1975, IFM/IBRD meeting, but a consensus was reached among the industrial countries that if the French and the Americans could solve their differences, the others would accept the compromise. Accordingly, the U.S. took advantage of the opportunity to work with the French to design the foundation of the new international monetary system. The drafting was carried on in relative secrecy until the French-U.S. agreement surfaced at the November, 1975, economic summit conference at Rambouillet, France. The other countries attending Rambouillet had no previous knowledge of the document, although they were cognizant of the French-American negotiating effort.

The negotiations began with both countries committed to the same objective, the reestablishment of stability in the international monetary system. It was the French belief that this stability could be imposed by the central governments. The Americans countered with the argument that the central governments did not have the resources to stabilize the market without each economy reaching its own internal equilibrium. The French came to accept this position.

The actual document still remain classified as secret. However, U.S. Treasury Under Secretary for Monetary Affairs, Edwin Yeo, III, dis-

cussed the contents of the document as follows before the Senate Foreign Relations Committee on June 22, 1976:

The understandings at Rambouillet came in two forms: one, an agreement between the French government and ourselves which dealt with our mutual perception of the shape of international monetary reform. In other words, we had a number of points on which we had been unable to agree, and the understanding dealt with those disagreements.

The second aspect of the understanding of Rambouillet involves, again between the French and ourselves, an agreement to collaborate to (sic) consult between Treasuries and central banks regarding exchange rate developments—specifically an agreement to counter disorderly market conditions, which has been our policy for some time.

The other participants at Rambouillet associated themselves not with the understanding per se, but with the communique which came out of that understanding . . .

While it is publicly known that the agreement contained a working draft of the key compromise on a new Article IV of the IMF Articles of Agreement, the second aspect of the Rambouillet Agreement mentioned by Under Secretary Yeo has received minimal public attention. From his statement, it must be concluded that a process involving national treasuries and central banks has been put into place to oversee the management of the new monetary system. The Rambouillet Agreement, therefore, takes on a longer term significance than just a compromise on the issue of the structure of the exchange rate system.

The Rambouillet compromise on the structure of the exchange rate system formally was accepted by the other members of the IMF at the Interim Committee meeting in January, 1976, in Kingston, Jamaica. With this key decision made, it was possible for the Governors of the Fund to vote on resolutions expanding quotas and accepting the amendments to the Articles of Agreement. The amended agreements enter into force upon signature of three-fifths of the members having four-fifths of the weighted voting power.

The Secretary of the Treasury, as U.S. Governor of the Fund, cast a favorable vote on the quota resolution in March, 1976, and a favorable vote on the amendment resolution in April, 1976. These votes did not constitute acceptance by the United States of the resolutions. Under Section 5 of the Bretton Woods Agreements Act, Congressional authorization is necessary prior to U.S. acceptance of amendments to the Articles of Agreements or of the expansion of quotas. The necessary legislation was transmitted to the Congress and introduced on May 19, 1976, in the Senate as S. 3454 and on May 21, 1976 in the House as H.R. 13955.

COMMITTEE ACTION

The bill to amend the Bretton Woods Agreements, S. 3454, was introduced (by request) by Senator Sparkman on May 19, 1976. The Committee held two days of hearings on S. 3454. On June 22, 1976, the Committee heard Under Secretary of the Treasury Edwin H. Yeo III. Senator Sparkman also introduced into the record a letter in support

of the bill on behalf of the Atlantic Council from former Secretary of the Treasury Henry Fowler. On June 29, 1976, the Committee invited a panel of three Brookings Institution economists to comment on the implications of S. 3454: Edward R. Fried, William Cline and Philip H. Trezise. The Committee also took testimony from Eugene A. Birnbaum, Vice President and Chief Economist of the First National Bank of Chicago and Patrick M. Borman from the Institute for Economic and Legal Analysis in New York City. The Committee held the record of the hearings open for two weeks for those parties who wished to submit statements for the record. Statements were received from Deputy Assistant Secretary of State for International Finance and Development Paul H. Boeker and from Irving S. Friedman from Citibank of New York City.

On July 27, 1976, the House of Representatives passed H.R. 13955 by a vote of 289 yeas and 121 nays, and that bill was referred to the Committee on Foreign Relations on the following day. The Committee took H.R. 13955 under consideration on August 3, 1976. The staff reviewed for the Committee the House amendments. These amendments are identified in the section-by-section analysis of the bill. The Committee had no objection to the House amendments except for one technical point which was amended.

The technical amendment was made to Section 5 of the Bretton Woods Agreements Act. Section 5 specifies certain actions which neither the President nor any person or agency can take on behalf of the United States unless authorized by Congress. The House amended Section 5 by adding paragraph (g) which prohibits U.S. approval of the establishment of any additional trust fund at the IMF which would provide special benefits to a single member or group of members. This language limited the U.S. Governor from approving IMF management of national trusts without Congressional approval. Such services are authorized under Article V, Section 2(b) of the IMF Articles of Agreement. The Committee amended this amendment by inserting the phrase "whereby resources of the International Monetary Fund would be used." This phrase makes it clear that the amendment deals with IMF financial resources and not national or multinational resources being managed by the IMF on a contractual basis. The amendment has the approval of the Department of the Treasury.

The Committee further amended H.R. 13955 on a motion by Senator Charles Percy by inserting a new Section 4. Section 4 adds a new subsection (b) to section 14 of the Bretton Woods Agreements Act which would require the President, upon the request of a Congressional committee with proper jurisdiction, to transmit promptly to such committee any "appropriate" information furnished to any United States department or agency by any international financial institution or economic organization of which the United States is a member. The quoted word was an amendment to Senator Percy's amendment and carries special significance as later noted.

The Committee believes that this amendment will improve Congressional oversight with regard to United States participation in the international monetary system. More effective oversight is required by the change to floating exchange rates. In the past, under the system of par values or set rates, exchange management was carried out by

means of controls over trade, financial flows, offset payments, and other activities requiring Congressional approval. The move to floating rates has eliminated many such oversight tools, however, while at the same time increasing the need for reliable information on how well the new system is functioning. Growing economic interdependence has added to that need.

The provision also strengthens Congressional oversight over United States foreign economic policy. The staffs and secretariats of the international economic institutions and organizations produce significant economic research on national economies and international economic issues which they distribute to their members. This information is available to the Executive Branch and it is the opinion of the Committee that it should be available to the appropriate legislative committees of Congress.

The provision should not create constitutional difficulties. It requires the transmittal only of "appropriate" information. It would not require the transmittal of confidential communications between departments or agencies of the Executive Branch. Rather, it relates to information furnished the Executive Branch by external sources. In this regard, it is roughly analogous, constitutionally, to the "Case Act", which requires the transmittal to the Congress of international agreements to which the United States is a party.

The Committee recognizes that there will be cases where the appropriate information involved may be sensitive. But it notes that such information is now disseminated to 20 directors of the IMF representing over 100 countries. Access to such information, most Committee members believe, is essential for the proper performance of legislative functions. Nothing in this provision is to be construed as limiting any Committee's subpoena power.

A portion of Senator Percy's proposal which would have imposed criminal penalties for unauthorized disclosure of sensitive information was dropped because of uncertainty regarding its effect on activities protected by the Speech or Debate Clause, Article I, Section 6, clause 1 of the Constitution. Such action was taken, however, without prejudice to consideration of a penalties provision on the Senate floor.

During its consideration of this amendment, the Committee heard the testimony of Mr. Sam Y. Cross, U.S. Executive Director of the IMF. Mr. Cross expressed concern over the amendment, especially the transfer of highly sensitive economic information to Congress.

Thereafter, the Committee by voice vote and without dissent on August 3 passed H.R. 13955 as amended and ordered it reported favorably to the Senate.

SECTION BY SECTION ANALYSIS OF H.R. 13955, AS AMENDED

H.R. 13955 passed the House of Representatives on July 27, 1976, and was referred to the Senate on July 28, 1976. The bill—which replaces S. 3454—as amended in the House and by the Committee on Foreign Relations, has ten sections. The first five sections of H.R. 13955 amend the Bretton Woods Agreements Act, the next four sections amend other relevant legislation, and the last section deals with the date the amendment will become effective.

The first section of H.R. 13955 amends the Bretton Woods Agreements Act by adding Sections 24, 25 and 26 to the Act. Section 24 is the key section. It authorizes the U.S. Governor of the International Monetary Fund, the Secretary of the Treasury, to accept the amendments to the Articles of Agreement of the Fund. These amendments to Articles are contained in the IMF Board of Governors resolution 31-4. It is this document that contains the provisions that move the exchange rate system from a fixed rate system to a floating rate system, substantially reduce the role of gold in the international monetary system, expand the quotas of the Fund by 33.6 percent, establish a Trust Fund and more lenient access to the Fund's resources, and modernize the operations of the Fund to include authority to create a Fund Council. The Council would be composed of finance ministers and would replace the current Interim Committee.

Section 25 specifically authorizes the increase in the U.S. quota in the IMF. The increase is 1,705 million Special Drawing Rights (SDR) or approximately \$2 billion. The SDR value is based on an average daily value of 16 international currencies and fluctuates daily. Presently, the U.S. quota is SDR 6,700 or approximately \$8 billion. The U.S. quota expansion is less than the general one-third expansion of the Fund's resources, therefore the U.S. percentage in the Fund drops from 22.93 percent to 21.53 percent. Roughly every five years since 1958-59, the Fund's resources have been increased to keep in step with the growth of international monetary resources and trade. This one-third increase is the fourth expansion.

Section 26 was added on the floor of the House of Representatives. It instructs the U.S. Governor to the IMF to vote against the formation of the new IMF Council if the Council will not follow the practice of weighted voting. Weighted voting provisions of the Fund are stated in Article XII, Section 5, They apply to all organs of the Fund and all votes. The addition of Article 26 has the effect of expressing the sentiment of the Congress that weighted voting in the Council is desirable.

Section 2 of H.R. 13955 was inserted by House Committee action and amends Section 3 of the Bretton Woods Agreements Act. Section 3 deals with the "Appointment of Governors, Executive Directors, and Alternates." The amendment anticipates the formation of the IMF Council by stipulating that if the Council is formed, the U.S. Governor of the Fund will serve as Councilor and have the authority to designate an alternate and associates. The second part of the amendments prohibits the Councilor, his alternate or associates from receiving salary or other compensation from the U.S. Government. This is standard language for all U.S. legislation on international financial institutions. The U.S. Secretary of the Treasury receives no compensation for representing the United States. The other positions are paid by the institution. The provision prohibits double salary payments.

The third section is a House provision which amends Section 5 of the original Act. Section 5 prohibits specific acts of the Executive Branch without prior Congressional authorization. H.R. 13955 amends Section 5 by adding part (g). Part (g) will prohibit the U.S. Governor to vote for the establishment of any new trust funds at the IMF without the prior approval of the Congress. The amendment reflects House sentiment that the Trust Fund, with its concessional lending

to specified poor members, is an economic aid mechanism and past U.S. Executive support for such a fund without the consent of Congress has been seen as a circumvention of Congressional authority. Similar concerns have been expressed in the U.S. Senate. The Committee on Foreign Relations amended the House amendment, inserting a technical phrase allowing the U.S. Governor to vote without Congressional authority on trust funds that might be managed by the IMF but would not include financial resources of the Fund. This initiative is explained fully in the section of this report titled Committee Action.

The Committee amended H.R. 13955 to insert a new Section 4 and consecutively renumbered House sections 4 through 9 to 5 through 10. Section 4 amends Section 14 of the Bretton Woods Agreements Act by designating the present language of Section 14 as paragraph "(a)" and adding a new paragraph lettered "(b)". The new paragraph provides legislative authority for the committees of Congress with legislative jurisdiction over international financial institutions or economic organizations to request from the President that he furnish any appropriate information provided by these institutions or organizations to any department or agency of the United States Government. The intent of the Committee in amending the legislation in this manner is explained in the section of this report entitled "Committee Action."

Section 5 of the bill, reflecting House Committee action, amends Section 17(a) of the Bretton Woods Agreements Act. The section deals with U.S. obligations under the 1962 General Agreements to Borrow. The amendment changes the IMF Article reference to the appropriate paragraph in the new IMF Articles. It also deletes the last sentence of 17(a) which stated that any loan must take into consideration the U.S. balance of payments and reserve position. This provision was logically consistent with a fixed exchange rate system where reserves were needed to defend the par value of the dollar. Under a floating rate system, the reserves play a much smaller role in the adjustment mechanism.

Section 6, dealing with amendments to the Special Drawing Rights Act, and Section 7, dealing with the par Value Modification Act, contain a series of technical amendments that change appropriate references from the old IMF Articles of Agreement to the new amended Articles, or delete language that is inconsistent with the new Articles.

Sections 8 and 9 reflect House amendments to the Gold Reserve Act of 1934. These are technical amendments, with the exception of the amendment of Section 10(a). Section 10(a) of the present Act authorizes the Secretary of the Treasury to use the resources of the Exchange Stabilization Fund (ESF) "for the purposes of stabilizing the exchange value of the dollar." The amendment deletes this language since under the amended IMF Articles of Agreement there is no obligation to stabilize the dollar at a par value. The new language directs the Secretary of the Treasury to use the ESF "as he may deem necessary to and consistent with the United States obligations in the International Monetary Fund."

Section 10 of the bill states that the amendments made in Section 2, 3, 5, 6, 7, and 8 of the bill will become effective upon entry into force of the amendments to the IMF Articles of Agreement.

IMPLICATIONS OF THE AMENDMENTS TO THE BRETTON WOODS
AGREEMENTS ACT

The amended Bretton Woods Agreements Act authorizes the United States Governor of the IMF to accept the amended IMF Articles of Agreement and authorizes the expansion of the U.S. IMF quota. Authorizing these two actions will have a broad impact in five major areas of the international monetary system: the exchange rate system, the role of gold in the system, the expansion of IMF quotas, the expansion of access to IMF resources, and the formation of the IMF Council. In discussing these five areas, it is important to realize that the amendments of the IMF Articles and the expansion of quotas were negotiated as one package. The compromises which made this package a reality took place over a two-year period. They were achieved among the industrial nations, as well as between the industrial nations and the developing countries. The package is the result of both economic and political craftsmanship. It is the opinion of the Committee that the basic U.S. negotiating objectives were achieved and U.S. national interests protected.

Exchange Rate System

Of all the changes in the Fund, the agreement sanctioning the floating exchange rate system is the most significant. Moving to a floating exchange rate for international commerce means that private enterprises and not the central governments bear the risk of currency fluctuations. It also means that trade restrictions such as fixed tariff schedules are of less importance, since the exchange rate should compensate to a degree for these impediments. Variable tariffs and non-tariff barriers will remain as effective impediments to trade. It is also felt by some that floating rates will complicate domestic monetary policy because interest rate changes may affect international capital flows which, in turn, will affect exchange rate levels.

The negotiations on the exchange rate structure centered on how the system would be managed, not whether the system would be managed. A fixed rate system is managed by direct government involvement in the money markets, as well as by controlling certain items in the balance of payments that affect the demand and supply of a currency on foreign currency markets. A floating system is managed by individuals in the market responding to economic stimuli that influence decisions to buy or sell foreign currency. These incentives register themselves through price or interest rates. In the first case, the central government provides guidance to the market. In the second case, this guidance is provided by forces in the market which encourage or inhibit economic activity. Adjustment takes place in the exchange rate and the national economy rather than through government regulation of trade or capital flows. Governments enter the foreign exchange market only to stabilize the market in cases of erratic fluctuations.

The exchange rate decision that is incorporated in the amendment to Article IV of the IMF charter is not a straightforward declaration. The article in fact allows for the simultaneous existence of numerous systems of exchange rates. It does not state that a floating system is

authorized but implicitly states that the system presently in force is sanctioned. It also states that on the vote of 85 percent of the members' quotas, the IMF can return to a fixed exchange system. The agreement allows coordinated floats such as the European "snake", as well as tied floats where one currency is fixed to another that is floating. For example, Mexico could affix its currency to the dollar. Its exchange rate with the dollar would remain constant while its exchange rate with other major currencies would float as these currencies floated against the dollar. The wording very effectively allows all parties in the proceeding to save face. Its central importance for the U.S. position is that the present floating system is sanctioned and the U.S. has veto power over any move to adopt another system.

To help assure that governments do not secretly enter the foreign exchange market to influence the exchange rate of national currencies, the IMF members have accepted the following obligations. First, all nations commit themselves to foster domestic economic policies which assure reasonable price stability and which assure a monetary system reasonably free of erratic disruptions. Secondly, all nations pledge not to manipulate exchange rates other than short-term market action to stabilize market disruptions. The success of the effort will rely on the integrity of the countries involved to live by the spirit of the agreement.

The Role of Gold

The compromise on the future role of gold in the monetary system was reached, except for some decisions on beneficiaries of distributions, at the August 1975, IMF Interim Committee meeting. The decision was to remove gold from the international monetary system. It has long been reasoned that gold is not a good "numeraire" for the system. There are many long dissertations on this issue, but the basic argument is that the supply of gold is determined by factors outside the monetary system. Liquidity in relation to the needs of the system is critical for its stable operation. In the past, gold supply has not kept pace with the need for international liquidity. Furthermore, the use of gold as a central part of the system favors those nations with large reserves, mainly South Africa and the Soviet Union. Finally, there are competing uses for gold as a commodity, the demand for which influences the structure of the monetary system—an influence that is not seen as productive.

To remove gold from the international monetary system necessitated a decision on how to remove from the IMF its store of 150 million troy ounces which had been contributed to it by member countries as part of their quota obligations. The decision was to sell this gold. However, it was realized that any massive sale of gold would collapse the world gold market. The first two sections of the accord set up a procedure for the IMF to divest itself of one-third of its gold leaving two-thirds of the gold to be handled at some later date at the discretion of the IMF.

The gold at the IMF is officially valued at SDR 35 or approximately \$42 per ounce. The present world price of gold is near \$120 per ounce. It was decided that in any distribution or sale of gold, the Fund would keep the figure of SDR 35 per ounce so that the IMF's assets

would not be depleted. The benefits to members from the redistribution of IMF assets (described below) made the gold arrangement acceptable to promote a larger consensus.

The first part of the compromise is the restitution of one-sixth of the IMF gold holdings to IMF members on the basis of their quotas in the Fund. The main beneficiaries of the restitution are the developed countries who hold the major portion of the Fund's quotas. This restitution to the developed countries was seen as a quid pro quo to France which has opposed for a long time the removal of gold from the monetary system. The countries will pay the IMF the official price for the gold, \$42.00, in an exchange of assets. Should these countries wish to sell this gold on the open market, they would realize the profits.

The second part of the compromise deals with the sale on the world market of the second one-sixth of the IMF gold, the profits from this sale to benefit the less developed countries. Sales of this gold have already commenced and will continue over the next four years. The profits generated are to be placed in a Trust Fund which will provide concessional lending to less developed countries who need loans for balance of payments support. Although Treasury officials deny that a five-year grace period and five years to repay. Those countries with a loan program that will provide loans at one-half of one percent with a five-year grace period and five years to repay. Those countries with a per capita income of less than SDR 300 or approximately \$350 will be eligible to use the Trust Fund. The Trust Fund is to make about \$750 million available each year for the next four years. This figure will vary depending on the world market price of gold.

Another aspect of the sale of the second sixth of gold is referred to as the "direct access" question. A number of Fund members which consider themselves less developed countries do not wish the profits from the sale of their gold in the Fund given to other less developed countries (LDC). Of the 25,000 troy ounces to be sold, 7,000 or 28 percent is LDC gold. As part of the agreement on the second one-sixth sale, seven twenty-fifths of the profit will be given by quota share directly to the less developed countries as their share of the profits of the sale. Only eighteen twenty-fifths or 72 percent of the profit will go into the Trust Fund. This hidden restitution benefits the more wealthy LDCs who have larger quota shares.

The third aspect of the gold compromise deals with the role of gold within the structure of the international monetary system. The agreement eliminates the official price for gold and the obligation of central banks to use gold in transactions between central banks or between central banks and the Fund. To insure that no central bank moves to hoard gold sold on the open market, it is still illegal for a central bank to purchase gold at more than SDR 35 per ounce. Furthermore, the G-10¹ adopted a set of rules to minimize the possibility of any central bank not adhering to the agreement.

While it is the expressed intent of the IMF to move gold out of the international monetary system, there are vast numbers of legal and psychological mechanisms still in evidence in the system that will

¹ Members of the G-10 are: Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, U.K., and U.S., with Switzerland as an associate member in attendance.

perpetuate some role for gold. By ending the practice of having a percentage of IMF quotas paid in gold and eliminating gold transactions between the Fund and central banks, the Fund has taken direct actions to eliminate gold from the system. However, as with most institutional acts, it is the concurrence and sincerity of the daily actions of members which will determine the success of the effort.

The Expansion of Quotas

The expansion of the IMF quotas was agreed upon at the annual IMF meeting in Washington in August, 1975. Quotas are the actual exchanges of monetary assets by member states with the IMF. These assets represent the capitalization of the Fund. The U.S. has a claim to its quota should the IMF ever be liquidated. These assets are "purchased" from the IMF by member states for short-term balance of payment needs. Present interest rates on these "purchases" are 4 to 6 percent with maturities of 3 to 5 years.

As a result of the agreement on expanded quotas, assets held by the IMF will increase by \$12 billion over the next two years. This represents an increase by one-third in the Fund's resources. The actual figures are denominated in SDRs: SDR 29.2 billion rising to SDR 39 billion. This change will be reflected in an increase in quotas of almost all members of the Fund. The U.S. quota will rise from SDR 6.7 billion to SDR 8.405 billion. However, on a relative basis, some countries will expend their percentage of the IMF's total assets more than others. The major shift will be an increase in the OPEC nation quotas from 5 percent of the Fund to 10 percent. The United States and the OECD countries will reduce their relative share to allow this expansion. The U.S. quota will be reduced from 22.93 to 21.53 percent.

This relative change in percentage of the total assets will shift national voting power in the Fund. Votes in the Fund are weighted in relation to quotas as a percentage of total assets. Each member receives 250 votes plus one vote for each 100,000 SDR of its quota. The drop in U.S. quota relative to the total assets will reduce the U.S. voting share from 20.75 percent to 19.96 percent.

By controlling 19.96 percent of the vote, the United States has veto power over the important decisions in the Fund. In the past, important decisions of the Fund required an 80 percent majority. In the amended Articles of Agreement, this percentage has been raised to 85 percent. This change will allow the United States a continuation of its veto power even if there are more relative shifts in the voting power among Fund members.

Expansion of Access to IMF Resources

As part of the broader compromise in the negotiation, it was agreed to temporarily expand each of the four available credit tranches from 25 percent to 36.25 percent of the quota. This expansion is designed to allow temporarily more access to the Fund's resources. With four expanded tranches, a country can now "purchase" 145 percent of its quota. This temporary expansion will be in effect until the new IMF quotas are ratified. The conditions on each succeeding credit tranche remains as they have been in the past. In a system that is already replete with liquidity this agreement adds some inflationary pressure to the total system. However, the \$3 billion of new liquidity created

is only 1.5 percent of something more than \$200 billion plus in official international reserves held by Fund members.

The liberalization of the Compensatory Financing Facility (CFF) of the IMF is another measure designed to provide more access to the Fund's resources. This was agreed upon in December, 1974, and is already operational. The Facility is for the use of members "facing balance of payments difficulties arising from temporary shortfalls in export receipts resulting from circumstances beyond their control." The liberalization expands the use of the CFF from 25 percent of quota to 50 percent of quota in a 12-month period. The formula for calculating shortfalls was also changed in a manner that provides for larger sums to be made available. "Purchases" from the CFF carry the same interest rate and maturities as regular credit tranche "purchases", but do not affect the members' access to other facilities of the IMF. It is estimated that this liberalization will provide an extra \$1 billion for those qualifying.

The IMF Council

There are numerous technical changes in the amendments to the IMF Articles designed to improve the operation of the IMF. The only major institutional change included in the amendments is an enabling provision which would permit the Board of Governors, by an 85 percent majority vote, to create an IMF Council. The Council would be a new, permanent organ of the IMF composed of members of ministerial or equivalent rank. The Council is seen as a successor to the Interim Committee. It would provide the Fund with a deliberative forum whose members would have the political authority to make the decisions necessary to supervise and adopt the international monetary system to changing circumstances. The authority to make these decisions would be delegated by the Board of Governors.

Summary

In summary, the new quotas and the amended Articles of Agreement are a pragmatic reform of the Bretton Woods Agreement of 1944. The amendments, for the most part, sanction what already is being practiced. They authorized three major systemic reforms: a monetary adjustment process based on a floating exchange rate, the elimination of gold, and a one-third expansion in IMF quotas. They created for the less developed countries some \$3 to \$4 billion in new credits through liberalization of the Compensatory Financing Facility, the Trust Fund and a temporary expansion of drawing rights from the Fund.

The agreements do not guarantee a trouble-free system. Numerous problem areas still remain. There must be close oversight of the system to guarantee national obligations are being fulfilled on exchange rate performance as well as the role of gold. Control of international liquidity has yet to be dealt with effectively. Distribution of international reserves is badly skewed, causing a growth of international indebtedness and critical problems in access to international credit. Economic interdependence, fostered by an effective international monetary system, will bring new problems for domestic and international economic policy determinations. Finally, there is a great need to view the monetary system as an integral part of a larger whole, an inter-

national system of political economy. These are all issues in which Congress must play an important part in its oversight role in respect to United States foreign economic policy.

COMMITTEE COMMENTS

The Committee believes that it will be difficult for the United States Government to know whether the amended Articles of the IMF are being adhered to by other members. Both of the key aspects of the amended Articles of Agreement, the floating exchange rate and the elimination of gold, depend on the good faith of other nations to operate within the accepted commitments. Congress, not being directly involved in daily decisionmaking, will have an even more difficult time carrying out its assessment of the new system and U.S. policy toward the system. Furthermore, the move from fixed to floating rates has placed a much heavier emphasis on personal, monetary diplomacy. The understandings reached through these diplomatic contacts will help determine the short-term objectives of international monetary management. These short-term decisions will come to define longer-term goals which will encompass, by necessity, political and economic considerations.

Therefore, the Committee expresses a strong desire to improve formal and informal consultations on international monetary issues with the Department of Treasury and other departments and agencies. Senator Clifford Case emphasized that such consultations must be initiated, in many instances, by the Executive Branch, since Congress cannot know of all major decisions facing the Administration. It is the opinion of the Committee that the Executive Branch must be more forthcoming in its provision of information to Congress on the issues and policy choices facing the United States in international monetary policy. Without effective consultation and cooperation of this sort, there can be little meaningful oversight by Congress in this critical policy area. For this reason, the Committee supports Senator Percy's amendment, Section 4 of H.R. 13955, which provides legislative authority for the request of information provided to the Executive Branch by international financial institutions and economic organizations.

One area that remains poorly defined is the role of the Federal Reserve in international monetary policy formation and implementation. The Committee informally asked the Federal Reserve Board to send a Member to testify during the Committee's hearings. The Board deferred to Treasury and did not appear. Yet Under Secretary of Treasury Edwin Yeo, during his testimony on June 22, 1976, did state that there is a recognized role for central banks outlined in the Rambouillet agreement. It is the Committee's intention to carry out its oversight role in relation to the total operation of the international monetary system and it will not limit its interests to one department or agency, or a limited number of more public forums.

The Committee strongly recommends the passage of this legislation to legalize the status quo, to provide a new set of agreed operating procedures, to institute a degree of flexibility in the international

monetary system, and to promote world-wide economic growth and interdependence. However, the Committee wishes to express caution on the underlying assumption of the Administration that since a little economic interdependence is good, a lot will be much better. Interdependence has placed all the industrial democracies on the same business cycle. The last major recession was deepened by this new phenomenon. While the Committee recognizes the benefits of economic integration, it also recognizes the difficulties in overseeing a system that is as large and as complex as that now being created. It suggests that thought be given to what limits the United States wishes to promote economic integration and that analyses be done as to the potential costs and returns to the United States associated with various degrees of commitment to this concept.

CHANGES IN EXISTING LAW

In compliance with paragraph 4 of Rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman) :

BRETTON WOODS AGREEMENTS ACT

* * * * *

APPOINTMENT OF GOVERNORS, EXECUTIVE DIRECTORS, AND ALTERNATES

SEC. 3. (a) The President, by and with the advice and consent of the Senate, shall appoint a governor of the Fund who shall also serve as governor of the Bank, and an executive director of the Fund and an executive director of the Bank. The executive directors so appointed shall also serve as provisional executive directors of the Fund and the Bank for the purposes of the respective Articles of Agreement. The term of office for the governor of the Fund and of the Bank shall be five years. The term of office for the executive directors shall be two years, but the executive directors shall remain in office until their successors have been appointed.

(b) The President, by and with the advice and consent of the Senate, shall appoint an alternate for the governor of the Fund and an alternate for the governor of the Bank. The President, by and with the advice and consent of the Senate, shall appoint an alternate for each of the executive directors. The alternate for each executive director shall be appointed from among individuals recommended to the President by the executive director. The terms of office for alternates for the governor and the executive directors shall be the same as the terms specified in subsection (a) for the governor and executive directors.

[(c) No person shall be entitled to receive any salary or other compensation from the United States for services as a governor, executive director, or alternate.]

(c) *Should the provisions of Schedule D of the Articles of Agreement of the Fund apply, the governor of the Fund shall also serve as councillor, shall designate an alternate for the councillor, and may designate associates.*

(d) *No person shall be entitled to receive any salary or other compensation from the United States for services as a governor, executive director, councillor, alternate, or associate.*

* * * * *

CERTAIN ACTS NOT TO BE TAKEN WITHOUT AUTHORIZATION

SEC. 5. Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United

States (a) request or content to any change in the quota of the United States under article III, section 2(a), of the Articles of Agreement of the Fund; (b) propose [or agree to any change in the par value of the United States dollar under article IV, section 5, or article XX, section 4, of the Articles of Agreement of the Fund, or approve any general change in par values under article IV, section 7; (c) subscribe to additional shares of stock under article II, section 3 of the Articles of Agreement of the Bank; (d) accept any amendment under article XVII of the Articles of Agreement of the Fund or article VIII of the Articles of Agreement of the Bank; (e) make any loan to the Fund or the Bank.] *a par value for the United States dollar under paragraph 2, paragraph 4, or paragraph 10 of schedule C of the Articles of Agreement of the Fund; (c) propose any change in the par value of the United States dollar under paragraph 6 of schedule C of the Articles of Agreement of the Fund, or approve any general change in par values under paragraph 11 of schedule C; (d) subscribe to additional shares of stock under article II, section 3, of the Articles of Agreement of the Bank; (e) accept any amendment under article XXVIII of the Articles of Agreement of the Fund or article VIII of the Articles of Agreement of the Bank; (f) make any loan to the Fund or the Bank; (g) approve the establishment of any additional trust fund, whereby resources of the International Monetary Fund would be used for the special benefit of a single member, or of a particular segment of the membership, of the Fund. Unless Congress by law authorizes such action, no governor or alternate appointed to represent the United States shall vote for an increase of capital stock of the Bank under article II, section 2, of the Articles of Agreement of the Bank, if such increase involves an increased subscription on the part of the United States.*

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FURTHER PROMOTION OF INTERNATIONAL ECONOMIC RELATIONS

SEC. 14. (a) In the realization that additional measures of international economic cooperation are necessary to facilitate the expansion and balanced growth of international trade and render most effective the operations of the Fund and the Bank, it is hereby declared to be the policy of the United States to seek to bring about further agreement and cooperation among nations and international bodies, as soon as possible, on ways and means which will best reduce obstacles to and restrictions upon international trade, eliminate unfair trade practices, promote mutually advantageous commercial relations, and otherwise facilitate the expansion and balanced growth of international trade and promote the stability of international economic relations. In considering the policies of the United States in foreign lending and the policies of the Fund and the Bank, particularly in conducting exchange transactions, the Council and the United States representatives on the Fund and the Bank shall give careful consideration to the progress which has been made in achieving such agreement and cooperation.

(b) *The President shall, upon the request of any committee of the Congress with legislative jurisdiction over an international financial institution or economic organization of which the United States is a member, transmit promptly to such committee any appropriate in-*

formation furnished to any department or agency of the United States by such institution or organization.

* * * * *

SEC. 17. (a) In order to carry out the purposes of the decision of January 5, 1962, of the Executive Directors of the International Monetary Fund, the Secretary of the Treasury is authorized to make loans, not to exceed \$2,000,000,000 outstanding at any one time, to the Fund under article VII, section [2(i)] 1(i), of the Articles of Agreement of the Fund. Any loan under the authority granted in this subsection shall be made with due regard to the present and prospective balance of payments and reserve position of the United States.

(b) For the purpose of making loans to the International Monetary Fund pursuant to this section, there is hereby authorized to be appropriated \$2,000,000,000, to remain available until expended to meet calls by the International Monetary Fund. Any payments made to the United States by the International Monetary Fund as a repayment on account of the principal of a loan made under this section shall continue to be available for loans to the International Monetary Fund.

(c) Payments of interest and charges to the United States on account of any loan to the International Monetary Fund shall be covered into the Treasury as miscellaneous receipts. In addition to the amount authorized in subsection (b), there is hereby authorized to be appropriated such amounts as may be necessary for the payment of charges in connection with any purchases of currencies or gold by the United States from the International Monetary Fund.

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SEC. 24. *The United States Governor of the Fund is authorized to accept the amendments to the Articles of Agreement of the Fund approved in resolution numbered 31-4 of the Board of Governors of the Fund.*

SEC. 25. *The United States Governor of the Fund is authorized to consent to an increase in the quota of the United States in the Fund equivalent to 1,705 million Special Drawing Rights.*

SPECIAL DRAWING RIGHTS ACT

AN ACT To provide for United States participation in the facility based on Special Drawing Rights in the International Monetary Fund, and for other purposes

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SEC. 3. (a) Special Drawing Rights allocated to the United States pursuant to article [XXIV] XVIII of the Articles of Agreement of the Fund, and Special Drawing Rights otherwise acquired by the United States, shall be credited to the account of, and administered as part of, the Exchange Stabilization Fund established by section 10 of the Gold Reserve Act of 1934, as amended (31 U.S.C. 822a).

(b) The proceeds resulting from the use of Special Drawing Rights by the United States, and payments of interest to the United States pursuant to [article XXVI, article XXX, and article XXXI] article XX, article XXIV, and article XXV of the Articles of Agree-

ment of the Fund, shall be deposited in the Exchange Stabilization Fund. Currency payments by the United States in return for Special Drawing Rights, and payments of charges or assessments pursuant to [article XXVI, article XXX, and article XXXI] *article XX, article XXIV, and article XXV* of the Articles of Agreement of the Fund, shall be made from the resources of the Exchange Stabilization Fund.

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SEC. 6. Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States vote to allocate in each basic period Special Drawing Rights under article [XXIV] *XVIII*, sections 2 and 3, of the Articles of Agreement of the Fund so that allocations to the United States in that period exceed an amount equal to the United States quota in the Fund as authorized under the Bretton Woods Agreements Act.

SEC. 7. The provisions of article [XXVII(b)] *XXI(b)* of the Articles of Agreement of the Fund shall have full force and effect in the United States and its territories and possessions when the United States becomes a participant in the special drawing account.

PAR VALUE MODIFICATION ACT

AN ACT To provide for a modification in the par value of the dollar, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. This Act may be cited as the "Par Value Modification Act".

[SEC. 2. The Secretary of the Treasury is hereby authorized and directed to take the steps necessary to establish a new par value of the dollar of \$1 equals one thirty-eighth of a fine troy ounce of gold. When established such par value shall be the legal standard for defining the relationship of the dollar to gold for the purpose of issuing gold certificates pursuant to section 14(c) of the Gold Reserve Act of 1934 (31 U.S.C. 405b).]

SEC. 3. The Secretary of the Treasury is authorized and directed to maintain the value in terms of gold of the holdings of United States dollars of the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association, and the Asian Development Bank to the extent provided in the articles of agreement of such institutions. There is hereby authorized to be appropriated, to remain available until expended, such amounts as may be necessary to provide for such maintenance of value.

SEC. 4. The increase in the value of the gold held by the United States (including the gold held as security for gold certificates) resulting from the change in the par value of the dollar authorized by section 2 of this Act shall be covered into the Treasury as a miscellaneous receipt.

SEC. 5. It is the sense of the Congress that the President shall take all appropriate action to expedite realization of the international monetary reform noted at the Smithsonian on December 18, 1971.

GOLD RESERVE ACT OF 1934

AN ACT To protect the currency of the United States, to provide for the better use of the monetary gold stock of the United States, and for other purposes

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SEC. 10. (a) [For the purpose of stabilizing the exchange value of the dollar, the] *The* Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to [carry out the purpose of this section. An annual audit of such fund shall be made and a report thereof submitted to the President] *and consistent with the United States obligations in the International Monetary Fund. The Secretary of the Treasury shall annually make a report on the operations of the fund to the President and to the Congress.*

(b) To enable the Secretary of the Treasury to carry out the provisions of this section there is hereby appropriated, out of the receipts which are directed to be covered into the Treasury under section 7 hereof, the sum of \$2,000,000,000, which sum when available shall be deposited with the Treasurer of the United States in a stabilization fund (hereinafter called the "fund") under the exclusive control of the Secretary of the Treasury, with the approval of the President, whose decisions shall be final and not be subject to review by any other officer of the United States. The fund shall be available for expenditure, under the direction of the Secretary of the Treasury and in his discretion, for any purpose in connection with carrying out the provisions of this section, including the investment and reinvestment in direct obligations of the United States of any portions of the fund which the Secretary of the Treasury, with the approval of the President, may from time to time determine are not currently required for stabilizing the exchange value of the dollar. The proceeds of all sales and investments and all earnings and interest accruing under the operations of this section shall be paid into the fund and shall be available for the purposes of the fund.

(c) All the powers conferred by this section shall expire two years after the date of enactment of this Act, unless the President shall sooner declare the existing emergency ended and the operation of the stabilization fund terminated; but the President may extend such period for not more than one additional year after such date by proclamation recognizing the continuance of such emergency.

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SEC. 14. (a) * * *

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(c) The Secretary of the Treasury is authorized to issue gold certificates in such form and in such denominations as he may determine, against any gold held by the [Treasurer of the] United States Treasury. The amount of gold certificates issued and outstanding shall at no time exceed the value, at the legal standard *provided in section 2 of the Par Value Modification Act (31 U.S.C. 449) on the date of enactment of this amendment*, of the gold so held against gold certificates.

Senator PERCY. I have with me Dr. Charles Meissner, member of the staff of the Foreign Relations Committee. I am not here to testify on the full scope of H.R. 13955. I do strongly support its passage as passed by the House and reported by the Senate Foreign Relations Committee.

I agree with the committee's conclusion that in renegotiating the Bretton Woods Agreement the administration has achieved U.S. objectives and effectively protected U.S. interests.

My purpose in appearing this morning is not to speak as an advocate for H.R. 13955, but to explain to you the purpose and thought behind my own amendment to H.R. 13955. The amendment appears as section 4 in the bill and amends section 14 of the Bretton Woods Agreements Act by adding a paragraph (b). The amendment is short but very significant. It reads as follows:

The President shall, upon the request of any committee of the Congress with legislative jurisdiction over an international financial institution or economic organization of which the United States is a member, transmit promptly to such committee any appropriate information furnished to any department or agency of the United States by such institution or organization.

The purpose of the amendment is to improve the potential of congressional oversight of U.S. governmental activities regarding U.S. participation in the international monetary system and U.S. foreign economic policy.

For example, the Senate Foreign Relations Committee had two staff members who were in and out of Vietnam a great deal trying to assess the situation there and trying to determine the need for another \$700 million aid program.

The administration furnished information to the committee, but it was the committee's understanding that the IMF had an assessment of Vietnam and its economic outlook that differed somewhat from the administration point of view.

This IMF report was available and it was in the administration's hands. The committee wanted access to that information. It was given to the U.S. Government.

The executive branch had it. We couldn't get it. We wanted to analyze and study those differences in appraisal of the situation. They just invoked executive prerogative. It was never officially given to the committee. We had one other more recent illustration where Senator Humphrey's Subcommittee on Foreign Aid was analyzing the debt structure of LDC's in relationship to the energy crisis; what their cash position was, what their balance-of-payment deficit might be, and how these figures related to their current and future needs for energy. The IMF had an analysis and study of the less developed countries on this issue. Our own Treasury Department did as well. They differed considerably. The committee commissioned the Congressional Research Service to do this study. The IMF furnished the report directly to the CRS upon its request. However, the Treasury intervened and said the material could not be used publicly. This was the material that the IMF had released to the CRS, that IMF had furnished to us. It took 6 months of negotiations to finally get that report material printed. But during this time we couldn't have open debate on this material.

I don't think Congress, when it has an oversight responsibility, when it is asked to appropriate huge sums of money, when it is asked to

establish policy in laying out programs, should be in the position of begging for information and have the cloak of confidentiality or executive privilege thrown over it. When it is an IMF agency, financed in part by ourselves, and any of these agencies, where we contribute, the Congress and the executive branch should have equal access.

You can't say that Congress can't handle matters confidentially. We handle things confidentially all the time. I don't deny that there have been security leaks from Congress. There is leakage in the Congress, occasionally. There is just as much leakage on the other side of the fence downtown. We certainly didn't give the "deep backgrounders" attributed only to a high government official.

I simply do not see how we can operate and do our work, if we are deprived of this material.

The reason we direct this amendment to the President is that both the Secretary of State and the Secretary of the Treasury participate as lead representatives in certain of our international economic organizations and institutions. Therefore, we direct it to the President, simply because we don't want to direct it separately to several Cabinet heads.

I have given the arguments in my statement. They are contained also in the committee report. We had a thorough discussion of this in the Foreign Relations Committee.

One aspect of it that would be particularly interesting, I think, to this particular subcommittee is the necessity in our oversight responsibilities of adjusting to new conditions in international economic relations.

The international monetary system and the International Monetary Fund (IMF) as the central institution of that system, form the cornerstone of U.S. foreign economic policy. Yet the switch from fixed to floating exchange rates limits congressional access to the policy process associated both the monetary system and the IMF. With fixed exchange rates, adjustments in the balance of payments were handled through controls on trade, financial flows, military offset payments, and so forth. Congress had to approve these actions and could express its policy concerns.

However, under floating rates the adjustment process takes place in the rate itself, in the marketplace with no congressional input. The system will be run through the IMF and the financial organizations of the OECD and G-10. Without some access to the papers and analyses of these bodies, congressional oversight of the new Bretton Woods Agreements will be minimal.

Second, because of the expanding role of economics, there is a growing need by Congress for international economic information. One major center of reliable economic data is the staff and secretariats of international financial institutions and economic organizations. The executive branch uses this material in the formulation of policy on both bilateral and multilateral economic problems. I believe Congress should also have access to this economic information, if we are going to review policy options intelligently.

Some years ago, I put a bill in to create a full-time Undersecretary of State for Economic Affairs. Previously the one Undersecretary alternated between political and economic issues. Anyone today would realize that economics is a full-time job and full-time responsibility.

We now have such a position. It was filled first by Chuck Robinson, who is now the Deputy Secretary.

Increasingly, our committee and this committee, are working on foreign economic policy matters. We shouldn't have to be in a position of going to friends in various agencies, a friend in the State Department, a friend at IMF, to try to get this kind of information.

We can't be expected to exercise our oversight, if we are deprived of the very kind of information needed to perform that function. Ultimately, when we battle, we win the battle. We get the information, somehow or other. But we just simply shouldn't be put in the position where we are required to go after it in demeaning ways. I should say, and also, if it is put in the statute and transmitted to us officially, we are officially held accountable for it, as we are other matters.

I would point out the Treasury Department opposed this amendment as they have officially opposed giving us access to this kind of material. But I simply disagree, respectfully, with the Treasury Department's position on this, and I think it is about time the Congress is treated as a full partner in these international economic matters.

I would like to point out that one word was added to the amendment by Senator Javits. In my original amendment I did not have the words "appropriate information."

He wisely added the word "appropriate," which was accepted unanimously on the basis that there is enough vagueness about "appropriate," that if there is a real argument by the Treasury Department or State Department, that something is so highly sensitive that it would do damage, then they can argue that it is not appropriate. Also in the case that a committee goes on a fishing trip and goes beyond its jurisdiction, then certainly you could say that the word "appropriate" means only those things absolutely essential and necessary.

So, with the balance of my statement in the record, Mr. Chairman, I would urge acceptance by the Banking Committee of this amendment which was unanimously approved by the Foreign Relations Committee.

Senator STEVENSON. Thank you Senator Percy.

For myself, I think you make very good points.

I had two questions, both of which are somewhat technical in nature.

One you have just addressed yourself to, and that was the word "appropriate." In the last analysis, it would be the executive branch which determined what was appropriate, would it not?

Senator PERCY. Well, in that they possess the documents; and we would be trying to get them; yes, they can argue it is not appropriate. Therefore, the burden of proof would be on us to prove that it is appropriate.

I think it would remove 95 percent, or more, of the disagreements we have had over a period of years as to whether the Congress of the United States has the right to have documents that are prepared. And we must remind ourselves these documents are furnished to all other member nations.

If they are saying we can't maintain security, they have to take into account there may be 100 copies of these in the hands of other governments. Each government can decide where those documents go. We have no idea where they are in all of these other countries.

Here is the ludicrous part of it. They say that we can't be trusted to see a document. But finally, after argument, they agree you can see one of the documents but they will put it in a way we all recognize. They say we can't let it out of our hands, so we will come up and bring it up to you and sit there while you read it.

That, to me, is a really demeaning position for a member of the U.S. Senate to be put in, to stand there, to have someone standing there while a Senator is reading a document. They let him see the information but won't trust the Congress of the United States to have that document while the exact same document may be in the files of 50 other countries. I don't know how many copies might be scattered around the executive branch of our own Government.

I think it is just time we stopped that kind of foolishness and be looked upon as full partners with a full oversight responsibility that can't be exercised unless we have information.

Senator STEVENSON. The other question I had is about the reference to any committee of Congress with legislative jurisdiction over an international institution. As you well know, especially for a member of this committee, the Banking Committee, generally speaking, has jurisdiction over monetary matters. It has jurisdiction, generally speaking, of the Federal Reserve Board.

It might be argued, however, that that reference to a committee with legislative jurisdiction over international financial institutions would exclude the Banking Committee and refer, instead, and exclusively, to the Committee on Foreign Relations.

What is the intention? Is it the intention to exclude the Banking Committee? Would there be some objection to language, at least report language, if not statutory, to make it clear that the accountability lies not only to the Foreign Relations Committee, but also to the committee with general jurisdiction over monetary matters, namely, the Banking Committee?

Senator PERCY. It would not, in any way, expand the jurisdiction of any committee. It is not intended to alter that whatsoever.

Senator STEVENSON. Well, that is not exactly my question.

And I recognize, also, that the jurisdictions are a bit confused at the moment. As a matter of fact, I have the responsibility as chairman of the committee on reorganization of the committee system to do something about the jurisdictions of the Senate committees.

At one point, before I came to the Senate, this committee had clearly the jurisdiction over the IMF. That was when Senator Fulbright was a member of the committee.

But by some device or other, he took it with him to the Foreign Relations Committee.

I am not suggesting that jurisdiction of any committee, including this committee, be enlarged. I am suggesting that it is very difficult for the Congress to exercise responsibly its oversight responsibility for money, monetary affairs generally, is to be artificially divided between committees; one, because it has a jurisdiction surreptitiously acquired over international financial institutions, and another committee which has general jurisdiction over monetary institutions.

Senator PERCY. Obviously, I think if the Bretton Woods Agreement is referred to the Foreign Relations Committee and the Banking Committee, then there is joint jurisdiction.

Senator TOWER. The bottom line is, we want a piece of the action.

Senator PERCY. As I understand it, that has been established and settled; you have it.

We are simply saying, when both committees have concurrent jurisdiction in an area, both committees ought to have access. If there is a clear area where one committee has jurisdiction, then that committee and that committee only would have a right to ask for appropriate information, in order to function and carry out its oversight responsibilities.

Senator STEVENSON. Senator Proxmire.

Senator PROXMIRE. There is one part of the amendment that concerns me.

I want to congratulate you, Senator, on what you have done. Absent your amendment, there would be no access by any Member of Congress, as I understand it. It is a positive step I believe all of us can join you in supporting.

I believe you said that was adopted unanimously.

Senator PERCY. That's right, with the addition of that one word, which I accepted immediately, because I saw the wisdom of it.

Senator PROXMIRE. It does appear the way this is worded that this committee would be excluded, and I think that would be a mistake. Senator Stevenson has stated the case; this is the credit committee of Congress; we do have responsibility with respect to monetary policy.

Dollar value of gold, for instance, we have the jurisdiction to inspect the export-import and Export Administration Act.

I think the Congress would be better served if it were made clear, somehow, we could add an amendment making it clear we could have jurisdiction whenever, as you say, the legislation would be jointly referred, could be referred to us.

I would agree we don't want to act in this particular bill to change jurisdiction. Shouldn't do it.

Senator Stevenson is on the committee. Are you chairman of the committee?

Senator STEVENSON. Yes.

Senator PROXMIRE. His subcommittee is responsible for determining jurisdiction, recommending at least a change in jurisdiction.

Senator PERCY. I would have no objection at all and would support language that would make it clear that, when concurrent jurisdiction exists, that both committees should have access.

Senator PROXMIRE. You wouldn't object to that?

Senator PERCY. I have no objection to that at all. The full intent and purpose of the amendment is to legislatively establish the right of congressional access to information provided to the executive branch by these international economic organizations and institutions.

Senator STEVENSON. Senator Tower.

Senator TOWER. I have no questions, Mr. Chairman.

I ask unanimous consent that my opening statement be inserted prior to the testimony of the Senator from Illinois.

Senator STEVENSON. Without objection.

Senator Helms.

Senator HELMS. No questions.

Senator STEVENSON. Thank you, Senator Percy.

We do have a vote. In fact, we have two votes.

So the committee will recess until we can vote.

[Recess.]

Senator STEVENSON. The next witnesses will comprise a panel, and it includes two colleagues from the other body, from the House of Representatives, Congressman Ron Paul and Congressman Tom Rees.

Do you gentlemen want to go first? You probably have schedule problems.

**STATEMENT OF THOMAS REES, REPRESENTATIVE IN CONGRESS
FROM THE STATE OF CALIFORNIA**

Mr. REES. We appreciate that Mr. Chairman. I will keep my statement mercifully short. I did want to testify for a short period as I was the sponsor of the legislation.

Senator STEVENSON. Congressman Rees.

Mr. REES. Thank you, Senator.

The legislation was approved by the House of Representatives by a vote of 289 to 121. It authorizes the U.S. Representative to the IMF to vote in favor of the proposed changes that were agreed to at the Jamaica Conference.

It also authorizes an increase of the U.S. quota by 1.705 SDR's, which is around \$2 billion. This is not an appropriation. It is a call and if the money is called by the IMF it is really an exchange of assets and gives the United States a draw on a hard currency, so that it is not an appropriation.

The overall quota increase was about 30 percent. There was a change in terms of percentages. The U.S. percentage went down and the percentage of the OPEC countries went up in terms of what they are putting in as quotas.

Our share dropped from 20.75 percent to 19.96 percent. We also changed the rules so that any change of the IMF agreements has to be made by an 85-percent vote of the members which gives the United States the power to veto any change.

The most important thing as far as I am concerned, and I am concerned because I was an exporter by profession, is that we legitimize the float.

As you know, we had a fixed system of parities under the original Bretton Woods Act. But because of pressure on the dollar, the dollar was floated several years ago.

The problem with a fixed dollar was that the dollar was over valued. It was estimated by economists from the Brookings Institute that the over valuation of the dollar probably resulted in a loss of up to 750,000 jobs in the United States because our exports were over valued and the imports were undervalued.

Because of this terrible pressure on the U.S. economy, I think it was absolutely necessary to float the dollar. This legitimizes the float.

But even more than that, it will set up some ground rules on the float.

The chairman of the Banking Committee in the House, Mr. Reuss, gave a speech on the floor yesterday stating that the Japanese had been purchasing dollars in order to keep the dollar high, vis-a-vis the yen so that Japanese exports would be undervalued and more able to penetrate the export market.

We have to pass this legislation to legitimize what we are already doing because then and only then can we set down the ground rules that are necessary to see that the float is a legitimate float and is not

an illegitimate float where one currency is manipulated to keep it undervalued.

There has been a great deal of discussion recently about the IMF auctions of gold. The IMF is auctioning off around 750,000 ounces of gold every 6 weeks.

These profits are put into a trust fund. The purpose of the trust fund is to make loans to the poorest countries, that have a GNP of \$200 per capita per person.

This bill has nothing to do with that. What the IMF is doing now is what they can legally do under the present Bretton Woods Agreement. So this has no relationship to the sale of gold by the IMF.

Many people get the two subjects confused, but under the present IMF rules what the IMF is doing now, selling its gold, with the proceeds to be used for the trust fund, is perfectly legal.

I could go on into some of the technicalities of the bill, but I suspect that you might have some questions.

I would be very happy to answer them.

Senator STEVENSON. Congressman Rees, thank you, not only for appearing here this morning but for all your efforts in the other body.

Just one question from me with respect to your reference to other trust funds. Doesn't this legislation prohibit the establishment of any additional trust fund whereby resources of the International Monetary Fund would be used for the special benefit of a single member, et cetera, isn't that, that provision, section 5, basically it strikes me as inconsistent with what you just said about the establishment of additional trust funds.

Mr. REES. Well, the trust fund that now exists now exists.

It was felt by the Banking Committee that Congress should approve further trust funds. It did not refer to the trust fund that already exists.

The language is section G, that unless Congress by law authorizes such action, the U.S. representative will not approve the establishment of any additional trust funds for the special benefit of a single member or a particular segment of membership of the fund.

So that if there were a proposal to create another trust fund, that would first have to be approved by Congress, authorizing our representative to the IMF to vote for it.

Senator STEVENSON. Could additional resources of the IMF be allocated to existing trust funds without congressional approval under this language?

Mr. REES. Under this language, the IMF can continue to sell gold in the open market and use the proceeds for that specific trust fund.

I seriously doubt if the IMF could take their other assets, for example, the quota money, and put that into the trust fund.

I think that would take an 85-percent vote of the members.

Senator STEVENSON. You can't sell more than what is it, one-third of the gold?

Mr. REES. Yes; I think that the purpose of the trust fund was to take care of some very serious balance-of-payments problems that now exist for the poorest countries who have been so severely hit by the 400-percent increase in the cost of petroleum.

I would suspect that the attitude of the IMF is that this is really a temporary problem that will exist maybe for 4 or 5 years, and that

by then we should come up with different approaches to handling the balance-of-payments problems of the very poorest countries.

I know that the IMF has been discussing this problem and they would like to set some long-term permanent solutions.

This really, I think, is regarded as a temporary solution to take care of one problem which was the run-up in the cost of petroleum.

Senator STEVENSON. Senator Proxmire?

Senator PROXMIRE. Mr. Rees, I join Senator Stevenson in congratulating you on the work you have done on this and especially congratulate you on the way you have presented this this morning.

You have a marvelous knack of making complicated matters simple and also making matters that seem kind of irrelevant to the important activities of our life very relevant to them.

Mr. REES. Thank you.

Senator PROXMIRE. What I am concerned about, however, is a couple of things.

No. 1, you said that this shouldn't be in the budget because it is an exchange of assets.

Of course, there are all kinds of things that are exchanges of assets that are put in the budget.

When we exchange cash for mortgages, we require that to be listed as an expenditure, and has a budget effect and has to go through the appropriations process.

Now, I recognize that in this case it would probably be a mistake to try to subject this to appropriation discipline for many reasons.

However, I do think that when you exchange assets as you put it here, you are incurring perhaps a greater risk.

Perhaps you are acquiring an asset that will deteriorate more rapidly.

I think that the reason why we can make an exception of this is because of the liquidity involved and the short-term nature of whatever obligations you get.

But it seems to me that the fact that we don't go through the appropriation process here should make it all the more important that both Banking Committees in the House and Senate have access to information which, under the way this is drafted now, only the Foreign Relations Committee might have.

So I think that this is a reason why we should follow this very closely and assume full responsibility for it and recognize that unlike other financial transactions in the Federal Government this is something that we aren't checked on by another jurisdiction.

Mr. REES. I can understand your concern.

I went into this in great detail because I was concerned also.

What happens, when they draw down dollars, is that we then have a reserve position with IMF. And at any time, automatically, without condition, without any condition, we can then draw down other convertible currencies such as, say, the German mark, which is right now a very strong currency. So that it really is not an expenditure. It is something we can automatically draw down.

Now, you take the Eximbank. As you know, Senator, I didn't want the Eximbank in the budget because I felt that it was not an expenditure, it was a loan and you took it into accounts receivable.

Senator PROXMIRE. That is true of most of our loan programs, most of our housing programs. You can discount the mortgages, too.

Mr. REES. Yes. But when you take back an accounts receivable there are conditions on them. Let's say it is a 10-year loan and you can't call it for 10 years. But here there is an automatic without condition draw by the United States, so there is a great deal of difference.

They can do it just like that.

Senator PROXMIRE. As I say, I am not stressing that. I feel very strongly Export-Import Bank ought to be in the budget and I think a lot of other things ought to be. But I am not saying at the moment this should be.

I am saying this is another reason why we should have effective oversight, follow this closely because it would not be a regular opportunity through the appropriation process, that discipline which we are required to determine what happens to the funds of our Government, and for that reason it seems to me we ought to be fully informed.

Mr. REES. Well, I certainly agree with you on that.

I am a great believer in oversight.

Senator PROXMIRE. Are you familiar with the amendment as adopted in the Foreign Relations Committee after it came over from the House?

Mr. REES. I just received a copy. I think there is a problem of germaneness, in that the amendment of Senator Percy covers a far broader mix of agencies than just the IMF.

For the bill to be germane to a House bill, it would have to be limited specifically to the IMF.

Senator PROXMIRE. That is good to know. Maybe we can improve that in this committee.

Mr. REES. That is a horseback opinion. I have not talked to the Parliamentarian.

I do think that it would be considered ungermane.

Senator PROXMIRE. Thank you.

Senator STEVENSON. Thank you, Congressman Rees.

Mr. REES. Thank you very much for the opportunity.

Senator STEVENSON. Congressman Paul?

STATEMENT OF RON PAUL, REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. PAUL. Thank you, Mr. Chairman.

I have a written statement that I would like to submit, but I would like to make a few comments.

Senator STEVENSON. Without objection, it will be entered in the record.

Mr. PAUL. In the Banking Committee I was the one who voted against this bill. It was a 24-to-1 vote.

By the time it got to the floor, 10 members of the Banking Committee voted against this bill. So I think this goes to show that there were some reconsiderations and second thoughts on this bill.

It was stated in our committee that these were some technical changes in the Bretton Woods Agreement.

This is the size of it, and I would like to emphasize this. This is more than technical.

The Senate statement in one of the introductions I read said that they were fundamental changes, and I would have to agree with that,

that these are fundamental changes, that we are going through fundamental changes in the International Monetary Fund.

I feel as though a vote for this bill is a vote for inflation, especially on an international level.

I do not agree with the sale of the gold. I do not think that is the proper way to handle this.

I think what they are doing also with the profits from this gold, funds that they get, they are using this to give to the Third World nations is truly foreign aid and should be under control of the Congress and not through some international body.

I believe in international monetary issues, we find a good bit of ignorance floating about.

I think there are several reasons for this. It is boring to many people. They do not involve themselves in the issues. And it is also a non-political issue. You don't gain votes by talking about IMF back in your district.

So for this reason people do not interest themselves in a political sense and there is disinterest in subjects such as this.

We have had statements made in the past on monetary policy that disturb me. I think they reflect the disinterest they have.

At one meeting Kennedy walked into, he said, "Tell me again; how does the Federal Reserve System finance our debt." He was confused about exactly how the financing worked.

Mr. Johnson one time said that, "We will see that there is so many silver half-dollars in circulation that nobody will hold them," not understanding that bad money drives out good money. So he produced more half-dollars in 1 year than had been minted in approximately 100 years. Yet the silver half-dollars disappeared. He could not defy the laws of economics.

I understand on one of the Watergate tapes Mr. Nixon said, "Don't bother me with devaluation. Just take care of it. Do what you have to do." To him it was unimportant.

But I do believe that this is a general problem. There is a good bit of economic ignorance that floats around.

After the Smithsonian agreement, which was in 1971—it was heralded by the President, "The greatest monetary agreement in the history of the world." It lasted a little over a year.

People are heralding this as a fundamental basic good change. I don't think it will be any better than the changes made in the Smithsonian agreement.

This bill, in essence, ratifies floating, phasing out the gold, increases quotas, and establishes a new powerful executive council.

I think the phasing out of the gold problem is a continual harassment and continual hostility toward sound money, honest money, commodity money, and I disagree with this.

The opposite of honest commodity money is inflation, inflation either at a local governmental/national level or on a scale such as we are talking about later in the IMF.

The sales of gold, I consider illegal. This was backed up by a statement from the Library of Congress; they use the scarce currency clause to sell this gold. If anybody knows anything about dollars these days they are not too scarce so they are really stretching the point about the scarce currency clause.

And the method they are using in selling the gold, by first giving it to the Treasury for \$42, then the Treasury resells it to the Fund at \$42 and the Fund sells it at market price using the profit for foreign aid. They have disrupted the market so much that the price of gold has been driven down to such a degree that what it is trying to accomplish it is not doing because they are not having near the funds they once thought they would accumulate for these foreign aid projects.

I think what they don't want is the discipline and integrity of an honest money system. This is the reason that they must go and be on record and be registered saying that we do not want to have anything to do with gold and restraints and disciplines.

On the subject of quotas; I disagree that it is a transfer of assets. If the American taxpayer wants those \$2 billion, he cannot get them back. It is only under very special circumstances that we can benefit once that \$2 billion gets into the fund. I think it should be in the budget.

I know Mr. Proxmire has always been concerned about budgetary matters and watches fiscal policy and I would hope he would agree it must be put into the budget because I think it is dereliction of our duty if we do not.

It was in the budget up until 1969 and it should be put back. The Executive Council bothers me. You mentioned your concern about getting information and materials from the IMF. Let me tell you, when this goes into effect, the information is going to go in one direction. It is going to go from us to the IMF.

Mr. Simon stated the amendments "provides broad new authority for the IMF to oversee the compliance of each member with its obligation. This authority for fund surveillance gives the fund the tactic of applying a global perspective to action of those members that cause adjustments or other problems for other nations."

"Members are obliged to provide the fund with information necessary for surveillance of these exchange rate policies." The other thing that is very important here, it isn't only the deficit countries they want to control and tell them what to do with their fiscal and monetary policies, it is the surplus countries.

If we ever went back in this country to sound monetary policy and sound fiscal policy, and had a sound dollar and did not inflate, we could become a surplus country again. Even if we kept our house in order under these arrangements, they will have the right to come in and supervise our fiscal policy so that they can take the benefits we have had in this country from good monetary policy and export them to somebody such as England or Italy that may be needing some help due to an inflationary policy.

This act also ratifies floating. We have been floating since 1973, officially. We do not need an IMF to float. The float evidently is necessary as a market adjustment for different nations inflating at different rates. We cannot go back to arbitrarily fixed rates.

The only way you could get a fixed rate is if you related each individual currency to some relatively fixed commodity such as silver and gold. So you cannot arbitrarily set fixed rates but to try to supervise floating rates and set up a lot of rules and regulations and then you have England inflating at a certain rate and us at another rate. It's doomed to failure.

The devaluation that everybody heralded as a tremendous help to us a couple years ago has not really helped. Devaluation in this way is a temporary device that helps just for a short time. Right now, if you look in the papers in the Wall Street Journal, it shows our deficits in, our balance of trade was up over \$800 million last month.

Just because you lowered the cost of exports, the cost of imports go up. It also increases demands because your prices went down temporarily. With the increase in demands and increase in the cost of your imports, you go back to the need for higher prices in your country and then a need and incentive to inflate the currency again.

Switzerland hasn't belonged to the IMF. They have a relatively sound currency. They do not have inflation. They do not have this kind of problem. To think that a system, an international system can work on floating is like arguing for 50 currencies in this country.

If we can realize that the benefit of the sound currency or one currency that we can relate to in 50 States, then we can realize why we need one currency of soundness throughout the world. The problem here is a moral problem as well as an economic problem.

The problem is that of inflation. The unwillingness of nations to pay for what they are spending. We inflate because we have a deficit, \$75 billion, \$80 billion a year because we pass out to people things that they want and we don't have the guts and the courage to tax them if that is what truly is necessary.

So, what do we do, we increase the monetary supply and that is inflation. Now, we are planning to condone it and do it on an international scale. I am convinced it will not work. Within a few years we will know that I don't think there is any doubt that we cannot defy the laws of economics.

Sound money has always been the rallying point, 5,000 years of history has proven that. Even though we have gotten away with this for a good many years, even though we arbitrarily kept the dollar related to gold at \$35 an ounce, it was because we were so wealthy that we got away with it. Eventually the system fell apart and now we are in worse shape than we have ever been.

We do not have a store of wealth like we had before. We have an economy that is very shaky. Nobody is sure that we will completely get out of this recession that we have just gotten over. How can we support an unsound dollar and unsound currency and an international monetary scheme that we are working on here now, I say that we have serious considerations for what is going on and it is our obligation and duty as Representatives in this Nation to study it closely.

Thank you very much.

[Complete statement follows:]

PREPARED STATEMENT OF RON PAUL, REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman and Members of the Committee, I wish to thank you for the privilege of testifying before you today on this very important piece of legislation. The bill before you, H.R. 13955, represents the most sweeping revision of the agreements governing America's international monetary affairs in over thirty years. I have spent a great deal of time studying it and believe very strongly that it should not be passed.

THE JAMAICA AGREEMENTS

The bill before you is only five pages long. This is very deceptive because it makes it appear as though there is not much to this bill. However the first sec-

tion of it says: "The United States Governor of the Fund is authorized to accept the amendments to the Articles of Agreement of the Fund approved in resolution numbered 31-4 of the Board of Governors of the Fund."

These are the agreements made in Jamaica last January and the printed version of them runs to several hundred pages. These agreements were not delivered to the members of the House Committee on Banking, Currency and Housing until the very day that this bill was marked up. I am certain that none of the members of the House were able to digest this huge mass of material before the final vote on July 27.

FLOATING EXCHANGE RATES

Among other things, these agreements will legalize many arrangements which currently exist outside the existing law. For example, floating exchange rates, which have been in existence for several years already, are illegal under the Bretton Woods Agreement as it now stands. The Congress, however, has never had the opportunity to decide on the desirability of floating until now. Therefore, I think it is an appropriate time to ask whether it is really a good idea or not.

In terms of the pre-1971 fixed exchange rate system, which broke down so dramatically, floating is certainly superior. However this is only because the dollar was greatly overvalued in 1971 as a result of considerable domestic inflation. The dollar needed to be brought into line with its true value. But to say that floating is a panacea which solves all international exchange problems is clearly not true.

One can well imagine the difficulties which would be encountered if each one of the United States was to have its own currency, even if there were freely floating exchange rates. Obviously, this would be a large barrier to commerce which would make the United States a poorer nation. The fact that the dollar has been the common currency of all the states is certainly one of the unheralded secrets of American prosperity.

THE GOLD STANDARD

The classical gold standard operated in much the same way on a world-wide scale. Gold was, in fact, the world currency and it made international trade and investment possible on a scale which would have been impossible otherwise.

The Bretton Woods system essentially replaced gold with the dollar as an international currency. Unfortunately, this new system lacked one of the principal virtues of gold: there were no longer any external or automatic forces restraining the creation of more and more money. An increase in the supply of gold is obviously dependent on the profitability of producing gold and limited by the scarcity of gold itself. There are no such limits on the issuance of paper money.

As long as the number of dollars in existence was tied to a limited amount of gold, there was restraint imposed upon the domestic monetary authorities from outside. This, in turn, led to unprecedented price stability and prosperity. As long as some semblance of fixed exchange rates remained, this also imposed some restraint. With floating, however, almost all barriers to the unlimited issuance of paper money are now gone. This fact was brought out clearly in testimony by Professor Arthur Laffer of the University of Chicago before the Subcommittee on International Trade, Investment and Monetary Policy:

"While much is made of preventing imported inflation by having floating exchange rates, little is made of the disciplinary aspects of fixed exchange rates and limited international reserves. Under fixed exchange rates that are to be maintained, central banks have little leeway to run excessively expansive monetary policies. If a country's money supply grows excessively, it will lose reserves and threaten the maintenance of the fixed exchange rate. The threat of balance of trade deficits, reserve losses and, ultimately devaluation of the currency is an important restraint on rapid money growth.

"Under floating exchange rates, excessive monetary expansion entails no deficit, no reserve loss, and a tolerated, if not encouraged, depreciation of the currency. Under floating rates, there is less reason, or perhaps even excuse, for not restraining money growth. If for any reason, be it economic or political, the monetary authority feels it expedient to expand money growth, the excuse of maintaining the par value will not impede their actions."

CURRENCY MANIPULATION

Floating also makes it easier for governments to artificially manipulate the value of their currency on money markets in order to gain short-run trade ad-

vantages. The Japanese, for example, are notorious for holding down the value of the yen in order to promote their exports. This has become known as a "dirty" float and would be prohibited if the Jamaica Agreements are ratified. Secretary Simon has said that agreements on this principle at Jamaica was a "victory" for the United States and the main reason why this bill should be passed.

If we look a little deeper, it can be seen that the Japanese don't really gain anything in real terms over the long run. They are able to keep the value of the yen down in terms of dollars only to the extent that they have a continuous supply of dollars to buy. In this sense, therefore, they are doing the United States a favor by soaking up excess dollars and thereby holding down price inflation in the United States. In an editorial on August 3, 1976, the Wall Street Journal went on to say:

"How many times does Britain have to sink the pound and Italy the lira before the bitter-enders concede that devaluations do not bring prosperity, only price inflation? Japan should be left alone, to fix or float against the dollar according to its own calculations. Even if there are policymakers in Japan who hold to obsolete mercantilist trade theory, and believe they can steal resources from their trading partners through exchange-rate policy, the experience of history and of recent history in particular says they are wrong."

Thus in return for a meaningless pledge that will probably not be honored and can't be enforced anyway, the United States would commit itself to acceptance of many other potentially harmful provisions of the Jamaica Agreements.

THE IMF COUNCIL

Article XII, for example, establishes a new council within the International Monetary Fund. The general functions of this council are defined as "the supervision and adaptation of the international monetary system, including the continuing operation of the adjustment process and developments in global liquidity; and in this connection the Council must review developments in the transfer of real resources to developing countries."

To me, this sounds very ominous. Any council with powers such as this would, in effect, become an international Federal Reserve Board. If so, this would place a tremendous amount of power in the hands of people with no allegiance to the United States. While it is not clear that there is danger in this, it certainly deserves further investigation.

FOREIGN AID

Another section repeals the Par Value Modification Act. As innocuous as this may sound, it is essential for the continuation of the IMF's gold selling and trust fund operation. This too exists illegally, according to Article VII, Section 2 of the IMF articles, As the Library of Congress put it:

"There is no authority, either directly or indirectly, outside of a scarce currency situation, for the IMF to sell gold on and for its own account under that clause. Particularly would this seem to be the case for the use of proceeds to set up a trust fund for the developing nation members."

As you all know, the IMF has sold 780,000 ounces of its gold on two separate occasions and is scheduled to sell another 780,000 on September 15. The profits from this sale are then to be used to aid developing nations with balance of payments problems.

In order to get around the legal restrictions on selling its gold, the IMF has created an artificial scarce currency situation regarding the dollar. By declaring that there is a world-wide shortage of dollars, the IMF is free to sell its gold to the U.S. Treasury at the official price of \$42.22, ostensibly to obtain dollars in order to relieve the shortage. Secretary Simon then obligingly sells the gold back to the IMF Trust Fund at the same price. The Trust Fund is now free to resell the gold for whatever the market will bring. So far, this has been in the range of \$122 to \$126 per ounce. Thus the U.S. Treasury is a direct party to the sale of this gold and responsible for losing the profits of its sale. These profits legitimately belong to the people of the United States because the U.S. contributed most of the IMF gold after World War II for the sole purpose of stabilizing international exchange rates and not for a back-door foreign aid scheme. Furthermore, Professor Laffer noted:

"As a method of helping poor nations develop, this method is noted for its inefficiency. Far preferable schemes exist, some of which even benefit the U.S. directly. Examples of these include tariff cutting, reduction of quotas, and the removal of other artificial trade barriers. These measures provide direct incentives

to development. By working harder and more efficiently, less-developed countries would be able to sell more goods to the developed nations."

One should also consider the fact that the recipients of IMF aid include many countries that are very unfriendly to the United States. Among those eligible nations one finds Cambodia, Laos, South Vietnam, and Uganda. In addition, of the 61 nations listed as eligible recipients, over one half supported the recent United Nations resolution equating Zionism with racism.

CENTRAL BANKS

Another disturbing aspect of this gold sale is the strong possibility that much of this gold is being bought by foreign central banks. This fact was admitted to me in a letter from Secretary Simon on July 20. He said that the Treasury Department was fully aware that France had announced the purchase of one ton of IMF gold through the intermediary of the Bank for International Settlements. This would seem to be in clear violation of Article IV, Section 2 of the IMF articles. Secretary Simon, however, said he is not concerned about this, although he is the American governor of the IMF.

My concern is that this gold may hang like a sword of Damocles over the United States. I frankly do not believe that the present international monetary system will hold up for long. A system which accommodates and encourages inflation so easily can only lead to greater and greater instability. Eventually there will be a demand for the return to sound money. This may lead some country or group of countries to unilaterally restore gold convertibility. There is no doubt in my mind that this would put the dollar in about the same class as the Polish zloty.

INCREASED RESERVES

Lest you scoff at such a notion, consider another provision of H.R. 13955 which authorizes an increase in the quota of the United States in the IMF equivalent to 1,705 SDR's. This is approximately \$2 billion which will leave the U.S. Treasury. On top of our already bloated Federal budget, how can this be justified?

Proponents of this bill will argue that this is simply an exchange of assets since we can call upon the resources of the IMF in times of monetary crisis. I would remind you, however, that this money is still leaving the Treasury the same way it does for any other expenditure. Consequently, up until 1968 such payments to the IMF were treated as regular appropriations subject to the normal appropriations process. Then, in an effort to disguise the true level of the Federal deficit, this appropriation was taken off the budget and treated as though it were simply a bank deposit. This is obviously not true because the U.S. can only get this money back by actually dissolving the IMF or by having an international monetary crisis.

There is also no reason to believe that an increase in IMF reserves is justified anyway. The IMF was established and given its reserves in order to stabilize international exchange rates within the limits set by Bretton Woods. Yet as long as we have floating, this function no longer exists. The whole IMF is, in my opinion, an anachronism as a result. I believe that this is the true reason behind the establishment of the IMF Trust Fund; the IMF bureaucrats were just trying to find some new way to justify their existence.

In closing, I would simply urge my colleagues in the Senate to reject H.R. 13955, or at least delay passage long enough so that a fuller investigation of its consequences might be made before it is too late.

Senator STEVENSON. Thank you, Congressman Paul.

I would certainly agree with your first proposition that this legislation can't masquerade as both fundamental reform and as a technical change. I suspect the truth lies somewhere in between.

I have just one quick question. No one would quarrel with your objective, sound money, honest money as you put it. But if the foundation of the monetary system is gold, and the value of gold is linked to the vagaries of the gold market, and the control which certain gold suppliers have in that market, most particularly the Soviet Union, what leads you to conclude that that is the way to achieve your objective or to make it a sounder method of achieving that objective?

Mr. PAUL. I think it is very easy to, because I think gold production whether it is in South Africa, America, or Russia comes very slowly. It comes at a certain cost which is the market cost of producing gold. Russia and South Africa's production of gold is not the problem.

It is the government. The government is the problem, international governments, the International Monetary Fund dumping gold, American hostility to gold, and the threat of sales. This is the problem. It is only government interference in the market that has caused these tremendous fluctuations. Also the tremendous fluctuation in the discrepancies between currencies and the way the different countries are inflating is the real problem.

If you take a period of history in the 19th century when the British Empire was developing and was at their peak, they had tremendous growth and prices actually dropped. They were on the gold standard. So you do not need to have anything other than the government out of the manipulation of the gold market and not inflating, in order to have reasonable stability. The other alternative is to trust politicians and paper (fiat) money—and history is certainly against a stable monetary system under those circumstances.

Senator STEVENSON. Do you have any evidence to corroborate that statement that it's been sales by governments, and by the IMF of gold, as opposed to sales by the Soviet Union and South Africa, that have caused recent fluctuations in the value of gold?

Mr. PAUL. I could probably corroborate this with others' opinions because you know you can see a sale of gold and threat of the sale of gold, then, you can see what happens to the particular price of gold following these sales. You can listen to what the Swiss bankers say and what the American bankers say and commodity market people, and I don't think there is any question in anybody's mind that for the past 1½ years the disruption has been the sales of the gold from the International Monetary Fund, plus the threat of sales of gold by our Government. So, I don't think there is any question. But as far as me proving this, that's another question. I think it comes down to opinions of different economic experts and in making your own decision.

Senator STEVENSON. Well, there may be a combination.

Senator PROXMIRE.

Senator PROXMIRE. Congressman Paul, why did nine members of the House Banking Committee change their position? You mentioned that. That is a good point. You were the only one you say, then on the floor, nine changed their position.

Mr. PAUL. Whether or not they all changed, I don't know—

Senator PROXMIRE. I understand that.

Mr. PAUL. To tell you the truth, I didn't talk to them personally, but I did a lot of letter writing and sending out information. I would have to hope that, influencing them with an idea and some arguments might have swayed them but I really can't say.

Senator PROXMIRE. Is that a bipartisan group?

Mr. PAUL. Yes, four Democrats and five Republicans, who came over. I think they were less concerned about the depth of what this means than I was. I think they were more concerned about whether or not it was legal to sell gold. We get a lot of letters back about, you know, it is American gold, that we are selling and giving away the proceeds. It is a political issue.

The other thing is the issue of foreign aid. People despise foreign aid these days. They are out there, and they can't buy groceries and here we are giving foreign aid underhandedly.

I would say this had some influence.

Senator PROXMIRE. I understand there were two votes on the House, one on suspension and I can understand there might have been some resistance to that on the grounds the report hadn't been filed, they didn't know enough about it; then, there was a vote on final passage. Was the vote on final passage, was there that much opposition at that point?

Mr. PAUL. The 10 votes I refer to was on final passage. We had more votes against the bill, just as you expected, on suspension. There were 147. Then it went down to about 121. Those people probably were those you mentioned, concerned about the rushing through of the bill.

But on the final passage, there were 10 banking members who voted against the bill.

Senator PROXMIRE. You are anxious, I understand, to get the Government out of the purchase of gold, you say that is one of the problems you have.

Mr. PAUL. Purchase and sale.

Senator PROXMIRE. Purchase and sale, is that right?

Mr. PAUL. As far as International Monetary Fund, my belief is that it came from governments. It should just be given back to the contributing governments and then those countries themselves can decide what they want to do with the gold. If our policy is antigold, then they should sell the gold to the American people. It is going to be—

Senator PROXMIRE. You see if you get the governments out of this, then gold isn't a monetary item, is it?

Mr. PAUL. No, but that is the decision we have to make. So far our policy has been to demonetize the gold. So, I would say if it goes back to America and the United States decides to sell it, we can express our opinions but if they sell it, sell it to the American people but they should not underhandedly sell it and give the profit to some international body for foreign aid.

Senator PROXMIRE. If you get the governments out of this, then what is your honest currency?

Mr. PAUL. I don't think we will have one. We will have fiat money totally, which we really have now.

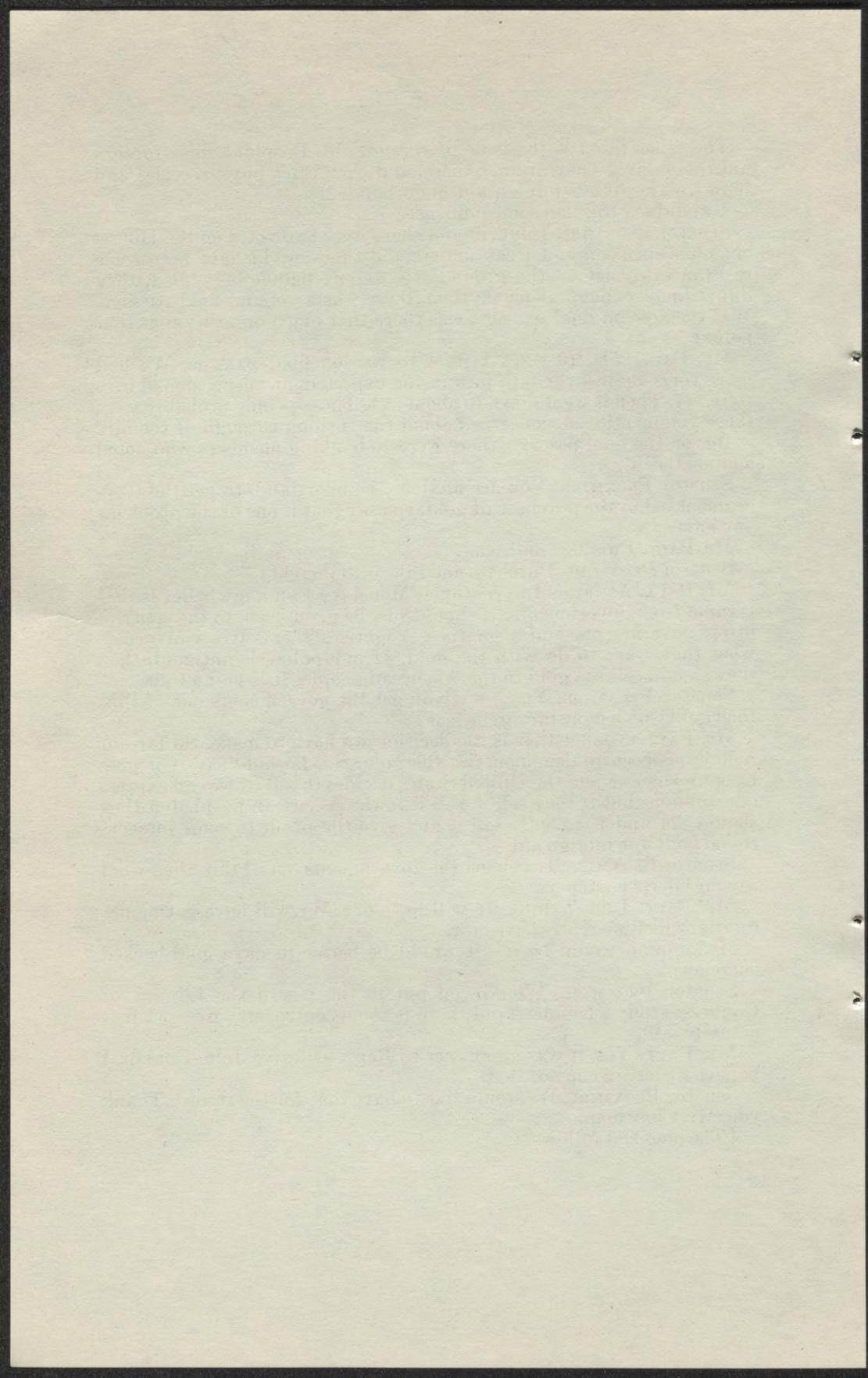
My opinion would be to—it would be better to have gold-backed currency.

Senator PROXMIRE. Would you put in the record the Library of Congress study? I understand there is some controversy over what it actually said.

Mr. PAUL. Yes, it was an answer to Representative John Conlan. I believe we have a copy of that.

Senator PROXMIRE. We would like to have that for the record. Thank you. Mr. Chairman.

[The material follows:]





THE LIBRARY OF CONGRESS
Congressional Research Service

WASHINGTON, D.C. 20540

June 10, 1976

To: Honorable John Conlan
Attention: Louis C. Gasper

From: American Law Division

Subject: Authority of the Board of Governors to Sell Gold Under Art. VII, Sec. 2 of the Articles of the International Monetary Fund

This memorandum is submitted in response to your request for an analysis of the authority of the Board of Governors of the International Monetary Fund (IMF) under Art. VII, Sec. 2 of the Articles of the International Monetary Fund (3 Bevans 1351) with reference to the disposition of one-third (or 50 million ounces) of the IMF's present gold holdings as one of the first steps to phase gold out of the international monetary system, and with half of that amount (25 million ounces) to be sold at public auction with the profits to finance a Trust Fund to provide balance of payments assistance to the developing countries. Specifically, you have asked;

1. Is Art. VII (2)(i) sufficient authority for the Governors to act, without seeking ratification by Member Countries?
2. It appears that this transaction was never contemplated by Members of the IMF at the time the original Articles were adopted.

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Is there an "elastic clause" that specifically permits such an expansion of scope? If not, is such "elasticity" assumed?

Thus, it would appear that the gist of your first question has two aspects. First, does Art. VII, Sec. 2 give authority for the disposition of gold by sale for such a purpose as to phase gold out of the international monetary system? Second, can proceeds from such a disposition be used under existing authority to set up a trust fund for the developing nations? While this might appear to be a relatively simple and narrow area for analysis, it should be noted that the opposite is true. This matter is rather complex and would appear to be subject to varying interpretations and opinions. Due to the haste in which this response was needed, no in-depth study could be made of these problems, and no detailed or definitive analysis could thereby be made. None of the voluminous background and historical documents in the IMF's creation was examined. The comments that appear herein are presented solely on the basis of the text of the articles and material gleaned from selected law review articles, and should only be read as a general overview of the situation.

Art. VII, Sec. 2 is a provision in the Scarce Currencies part of the Articles of the IMF. It is apparently referred to as the "scarce currency clause" or the "replenishment" provision. Support for its use in the gold proposal has been stated by Secretary of the Treasury, William E. Simon, in a letter to Rep. Reuss dated January 26, 1975 as follows:

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The method proposed for mobilizing the IMF's gold is based on IMF precedent and specifically has the sanction of the IMF legal staff. The technique to be used is the familiar one of "replenishment," whereby the IMF, to the extent it has a need for currencies, exchanges gold for those currencies, at the official price, and uses the currencies in its operations. The difference between past uses of IMF gold for replenishment and that proposed for the trust fund is that, in this case, the "profits" on the gold used in replenishment will accrue to the proposed trust and thus to the developing countries. . . . It is important to note, in this regard, that it is the IMF which has legal title to the gold to be sold. The member countries that paid gold to the IMF as part of their subscriptions, receiving in return drawings rights in the IMF, transferred title to the gold to the IMF and have no legal claim to it. In fact, the gold in the IMF was always intended as a source of usable currencies under the replenishment provisions and the IMF has, on a number of occasions in the past, sold gold for this purpose. Thus the sale of gold to obtain usable currencies is in no way novel or a departure from past practices. . . .

Hearings on The IMF Gold Agreement
Before the Subcomm. on International
Economics of the Joint Economic Comm.,
94th Cong., 1st Sess. (1975), at
78-80.

Two of these past practices referred to probably include a 1956 interpretation and the 1961 borrowing arrangement. "In an interpretation of January 25, 1956, the Executive Directors decided that the Fund had an implied power to sell a portion of its gold for dollars in order to invest the proceeds in short-term United States Government securities. The purpose of the investment was to earn income that would offset the

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capital impairment resulting from the excess of administrative expenses over income. . . . In 1961, the Fund deemed it appropriate to make arrangements under which it could call for advances of the currencies of ten members The purpose of the arrangements was to ensure that the Fund would be able to supplement its resources in order to meet the requests of the ten members involved to purchase each other's currency from the Fund. The new conditions of widespread convertibility had made it possible that there would be requests of a magnitude that the Fund would not be able to meet readily without supplementary resources, and that without such resources it would not be able to forestall or cope with an impairment of the international monetary system." Gold, Interpretation by the International Monetary Fund of its Articles of Agreement - II, 16 Int'l & Comp. L.Q. 289, 303, 320 (1967).

A strict reading of Art. VII, Sec. 2, however, does not appear to give the specific or implied power for the proposed disposition. It merely provides for two steps that the Fund can take institutionally as it deems appropriate to "replenish its holdings of any member's currency". It is evidently addressed to the problem of a balance of payments equilibrium. Meier, The Bretton Woods Agreement - Twenty-five Years After, 23 Stanford L. Rev. 235 (1971). There is no authority, either directly or indirectly, outside of a scarce currency situation, for the IMF to sell gold on and for its own account under that clause. Particularly would this seem to be the case for the use

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of proceeds to set up a trust fund for the developing nation members. There are no provisions in the Articles of Agreement that draw a distinction between developed and developing countries, and there is a legal principle that governs the activities of the IMF known as the principle of uniformity. "The principle is referred to as uniformity, but it really consists of two elements. One element is that, with certain exceptions, the Articles of Agreement establish the same rights and obligations for all member countries of the Fund, and the other element is that the policies of the Fund apply equally to all members. The principle can be regarded, therefore, as one that prevents discrimination in favor of, or against, particular members, without regard to their economic strength or weakness or any other characteristic." Gold, Uniformity as a Legal Principle of the International Monetary Fund, 7 Law & Policy in Int'l Bus. 765 (1975).

Yet, even if one might be able to sustain an argument that Art. VII, Sec. 2 does not contain sufficient authority for the Board of Governors to dispose of gold for the purposes contemplated without an amendment to the Articles, it would seem that there is such a broad authority within the Articles themselves for the interpretation by the IMF of such Articles and for carrying out the purposes of the IMF, that not only would it seem that such an interpretation might otherwise be supportable but also that there might be no forum to assert a successful legal challenge to it. The machinery for final interpretation of the

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basic instrument of the IMF has been termed "remarkable and unusual" because the function of authoritative interpretation rests with the executive organ of the institution, because the exercise of the interpretive function is not limited to decisions on actual disagreements but is also used to resolve doubts in the interpretation and thus to prevent controversies, and because the executive organ has exclusive jurisdiction to decide on questions of interpretation of the instrument that may arise between the organization and its members or between members themselves. Hexner, Interpretation by Public International Organizations of Their Basic Instruments, 53 Am. J Int'l L. 341, 343-344 (1959). While Art. XVIII only speaks of interpretations of the provisions between any member and the IMF or between members, a considerable number of interpretations have been made outside that Article in order to enable the IMF to function efficiently. See, M. Whiteman, Digest of International Law, Vol. 14 (1970), at 522-529. All of this would have to be read in conjunction with the broad purposes of the IMF set forth in Art. I (not in a Preamble but actually part of the Articles) that is to guide the IMF in all of its decisions.

ARTICLE I

PURPOSES

The purposes of the International Monetary Fund are:

- (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

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(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

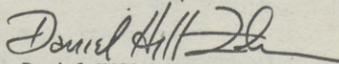
(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its decisions by the purposes set forth in this Article.

Further, there seems to^{be} authority to the effect that such interpretations are considered to be binding on the courts. See, Gold, Interpretation by the International Monetary Fund of its Articles of Agreement - II, 16 Int'l & Comp. L.Q. 289, 312-318 (1967). Thus, in effect, one might say that the entire Articles of the IMF are "elastic".



Daniel Hill Zafren
Legislative Attorney

Senator STEVENSON. Thank you, Congressman. It is helpful to have these conflicting opinions.

Mr. PAUL. Thank you.

Senator STEVENSON. The next witnesses are Eugene Birnbaum, First National Bank of Chicago; Robert Roosa, now a partner in Brown Brothers, Harriman & Co.; Jack Bennett, senior vice president, Exxon; Walter Salant, senior fellow, Brookings Institution; Prof. Robert Aliber, Graduate School of Business Administration, University of Chicago; and Sidney Brown, vice president and economist, editor of the Deak-Perera Report, Deak & Co.

Gentleman, we are grateful to all of you for joining us this morning. If you have prepared statements, you have an opinion of either reading them or if you prefer to summarize, I would be happy to enter them in the record.

Unless there is any objection, why don't we start in that order, with you, Mr. Birnbaum?

STATEMENT OF EUGENE BIRNBAUM, FIRST NATIONAL BANK OF CHICAGO

Mr. BIRNBAUM. Thank you, Mr. Chairman. It is a privilege to have been invited to testify concerning S. 3454, a bill to amend the Bretton Woods Agreement Act.

I do have a prepared statement, and in the interest of time, I would appreciate having it entered in the record and then simply highlighting some of its points.

Senator STEVENSON. Without objection, the full statement will be entered in the record. I believe, if there is no objection, what we will do is go through all of the statements and then come back to the panel with questions.

Mr. BIRNBAUM. I have appended to my prepared statement a section entitled "Supplementary Remarks." It refers to questions raised by you, Mr. Chairman, on the Senate floor, as published in the Congressional Record of August 5, 1976.

Senator STEVENSON. Thank you for doing that, and they too will be entered in the record.

Mr. BIRNBAUM. Thank you, Mr. Chairman.

I fully support the proposed amendments to the IMF Articles of Agreement, but will later suggest that additional steps be taken to insure a more orderly world monetary system.

When I testified previously with respect to this bill—at the hearings of the Senate Foreign Relations Committee on June 29—I commented that it was unclear how the currently floating SDR could be adopted as a future standard for the international monetary system in the event that a high majority of the membership of the IMF should eventually desire to shift from floating exchange rates to a new par value system based on the SDR.

Having completed further research on this issue, I now conclude that the proposed revisions of the IMF articles contain nothing explicit to preclude the possible future adoption of a reconstituted, redefined SDR, including an SDR that could even be defined on the basis of fixed official par values of national currencies. Accordingly, my earlier concerns regarding this matter are no longer pertinent.

I should like now to comment on some other important issues. In doing so, however, I shall try to avoid unnecessarily duplicating my previous testimony before the Senate Foreign Relations Committee.

I think it is important that Congress not expect too much in relief from the present international monetary turmoil if the new IMF arrangements are adopted.

In my judgment, the currently existing international monetary system is unsatisfactory. Indeed, the present regime is significantly inferior to the system that existed before August 15, 1971, although that former system was not perfect by any means.

Until the onset of floating exchange rates in 1973, countries had enjoyed much faster rates of expansion of their sales abroad than sales to their home markets.

Foreign trade was, therefore, a major propulsive force in world economic growth.

Now, however, the risks and uncertainties in creating new investment capacity to produce goods for export have become an important factor in the worldwide erosion of long-term business confidence, and hence, in explaining the slowdown of global economic expansion. I, therefore, am not sanguine about future prospects for a resumption of sustained economic growth and steadily rising world living standards.

I believe Lenin was right when he reportedly said that the best way to destroy the capitalist system is to debauch the currency. I also think that that principle applies to the global market economy.

The world market too requires a relatively stable world money. Although a world money doesn't literally exist, we can approach an effective substitute if we establish long-term confidence in the relative stability of exchange rates between the most important currencies of the noncommunist world.

I would include in that list at least the dollar, the German mark and the Japanese yen.

Given that kind of confidence, these currencies would serve as close substitutes for one another and, in the aggregate, they would function as the basic monetary standard of the world market system.

In the absence of greater exchange rate stability between these major currencies, the noncommunist world will inevitably face inadequate economic progress and increased political divisions. I believe the relative stability of major exchange rates is therefore essential to the continued preservation of freedom and democracy in the world.

No international monetary regime, whether founded on fixed or floating exchange rates, can function satisfactorily unless the United States itself restores internal economic conditions of reasonable stability and noninflationary growth.

This is the sine qua non of an orderly world monetary system. If we achieve sound economic conditions in the United States, other countries will find it in their interests to manage their economic policies in such a way as to be consistent with relatively stable exchange rates between their currencies and the dollar.

Other countries, more than ourselves, understand the importance to their economic development of maintaining relative stability of their exchange rates vis-a-vis the currencies of the world's major markets. The most important of these is, of course, the U.S. market—the largest

single market of the world economy—along with other markets which are already closely linked with that of the United States.

The United States is not a closed economy; only the world is a closed economy. When we surprised the world by devaluing the dollar in February 1973 for the second time in 14 months, we undermined foreign confidence in the commitment of this country to maintain foreign exchange value of our currency. In the eyes of foreign countries, in the eyes of the outside world—as Lenin might have observed—we debauched our currency.

Foreigners then shifted the composition of their financial asset portfolios from instruments denominated in dollars into instruments denominated in currencies they continued to trust, for example, the German mark, the yen and the Swiss franc.

As a result, Eurodollar interest rates shot up and the effects were transmitted to our own borders. U.S. interest rates quickly followed suit, stock market values sank, and the current era of generalized monetary and financial uncertainty began.

We have yet to fully recover from this trauma.

This experience illustrates the fact that the dollar is a global money, and the Federal Reserve cannot neglect that fact. Yet, many leading economists continue to recommend easy money policies, as if the Federal Reserve can wholly neglect possible feedback effects that arise from the rest of the world.

Should the Federal Reserve unilaterally ease U.S. monetary policy, the world financial markets would tend to lose confidence in our commitment to combat inflation, relative to the confidence that it holds in the anti-inflationary commitment of other major countries. As a result, the currency composition of worldwide financial asset portfolios would reflect such a shift. There would be a depreciation of the dollar—which is inflationary—and the further consequence of exacerbating the already excessive global monetary and financial uncertainty which, as I have mentioned, undermines business confidence and investment in the world.

So we would get slower economic growth, fewer productive jobs, more inflation, and, of course, increased political pressures for ever more interference by government in the economic system. This is a vicious circle which can inevitably lead to chaos and totalitarianism.

We urgently need to understand the fact that the exchange rate between the dollar, the mark, and the yen is the most important price relationship in the world. It is too little understood that our national interest in achieving a sound domestic price and economic performance is closely intertwined with the relative stability of the dollar's foreign exchange value in terms of other major currencies. This reality implies a limit on the scope for independence of U.S. monetary policy.

Turning now to U.S. fiscal policy, we should also realize that the concept of a full-employment surplus, or deficit, is a dangerous one. The main reason is that we simply have not found a viable way to wind down or fine-tune Government tax and spending programs in a timely fashion.

As a result, interest yields on fixed interest-earning assets, such as Government securities, are more attractive to savers than the prospective profits from inherently more risky productive investments, and at such time as the private economy would otherwise resume higher

credit demands for financing additional investment capacity they are "crowded out."

Accordingly, instead of a rebound into productive economic growth, we generate further inflation and either subsequent or simultaneous recession.

Over many years our tax reforms and spending programs have responded to the demands of war and the compassionate concerns of the American people. We have increased the tax burdens borne by the earnings and profits of the most productive elements of our economy—both labor and business—while we also, in effect, have increasingly subsidized less productive sectors.

When you tax work or production, you get less of it. When you subsidize nonwork you get more of it. So the long-term impact of our fiscal policy approach has also contributed importantly to slower economic growth. I am sure that the Congress is well aware that our productive investment is now falling far short of what is required to insure the sustained rise of living standards for America's posterity.

A case in point is that of Britain. The Bank of England's Quarterly Bulletin of March 1976 shows that from 1960 to 1974 the before- and after-tax real rates of return on capital employed in the British economy plummeted from 13 percent to 4 percent per annum on a pretax basis, and from about 10 percent to a negative 4 percent per annum on an after-tax basis.

The commitment to invest requires the reward of profit. In the case of Britain we need search no further to understand why the United Kingdom has just reported its highest postwar unemployment rate—in spite of the so-called "social contract" which holds down wages—while its inflation rate remains in the double-digit range.

To avert such a future scenario in our own country, we should reduce the taxes that Government takes away from American producers, and we will thereby provide incentives to increase the national output. At the same time, however, we must remain cautious concerning the extent to which we permit U.S. credit conditions to ease so as to restrain inflation.

Accordingly, I believe that the ideal policy mix for the United States involves a combination of reduced tax rates, targeted in such a way as to provide increased incentives to work, to invest, and to save; and to maintain a reasonable degree of monetary policy restraint so as to reinforce domestic and foreign market confidence in the commitment of our authorities to eliminate inflation.

Such a U.S. policy approach could more readily be harmonized with that of Germany; it is, indeed, basically the same as the policy approach of that country. I am confident that such a U.S. approach would lead toward the further result that the foreign exchange performance of the dollar would also improve. I might note that this policy-mix formula is the precise opposite of that which was recommended by our economic minisummit in late 1974.

In conclusion, I respectfully recommend that the Congress approve the proposed amendment of the IMF Articles of Agreement. However, I also urge that the Congress insert new language in the bill, S. 3454, which instructs the administration and the U.S. Governor of the Fund to assign a very high priority to the achievement of new understandings and cooperative arrangements between ourselves and major coun-

tries, so as to improve the coordination and commonality of stable domestic economic conditions along with a more orderly international monetary performance.

As Treasury Secretary Simon and others have correctly testified, a steadier exchange rate performance requires an underlying international convergence of internal economic conditions. However, a further indispensable requirement is the restoration of a reasonably sound U.S. economic performance. The attainment of this twofold fundamental condition is a necessity to maintain reasonable stability of exchange rates regardless of whether the international monetary system is based on a fixed exchange rate or a floating exchange rate regime.

In time, and with a reasonable degree of success in this very important endeavor, I believe that a new par value system centered on a fixed SDR might then be established which the world marketplace would endow with credibility.

Thank you, Mr. Chairman.

[Complete presentation of Mr. Birnbaum follows:]

STATEMENT OF EUGENE A. BIRNBAUM, VICE PRESIDENT AND CHIEF ECONOMIST,
THE FIRST NATIONAL BANK OF CHICAGO

Mr. Chairman and member of the International Finance Subcommittee of the Senate Banking Committee, it is a privilege to have been invited to testify concerning S. 3454, a bill to amend the Bretton Woods Agreement Act. I fully support the proposed amendments to the IMF Articles of Agreement, but will later suggest that additional steps be taken to ensure a more stable world monetary order.

When I testified previously with respect to this bill at the hearings of the Senate Foreign Relations Committee on June 29, I commented that it was unclear how a floating SDR could be adopted as a future standard for the international monetary system in the event that a high majority of the membership of the IMF should eventually desire to shift from floating rates to a par value system based on the SDR.

Having completed further research on this issue, I now conclude that the proposed revisions of the IMF Articles contain nothing explicit to preclude the possible future adoption of a substantially redefined SDR, including even an SDR that conceivably could be defined on the basis of fixed official par values of national currencies.

I should now like to comment on some other important issues:

First, the Congress should not expect too much in relief from the present international monetary turmoil if the new IMF arrangements are adopted.

Second, in my judgment, the currently existing international monetary system is unsatisfactory. Indeed, the current regime is significantly inferior to the system that existed before August 15, 1971, although that former system was not perfect by any means.

Until the onset of floating exchange rates in 1973, countries had enjoyed much faster rates of expansion of their sales abroad than sales to their home markets. This made foreign trade a major propulsive force in economic growth. Now the risks and uncertainties in creating capacity to produce goods for export have become an important factor in the worldwide erosion of long-term business confidence and, hence, of economic expansion. As a result, I cannot be sanguine about future prospects for sustained economic growth and the continuation of steadily rising world living standards.

Third, I believe that Lenin was right when he said that the best way to destroy the capitalist system is to debauch the currency, and that the principle also applies to the global market economy. The world market system also requires a relatively stable "world money." While it is true that a world money does not literally exist, we can approach such a condition if it is possible to establish long-term confidence in the relative stability of exchange rates between the most important currencies of the non-Communist world. I would include in this list at least the dollar, the German mark, and the Japanese yen. Were such confidence to exist in these exchange rates, these currencies would serve

as close substitutes for one another, and, in the aggregate, would then function as the basic monetary standard of the world market system. In the absence of greater exchange rate stability between these major currencies, the non-Communist world will inevitably face increased political divisions. I believe that market confidence in the relative stability of major exchange rates is essential to the continued preservation of freedom and democracy in the world.

No international monetary regime, whether founded on fixed or floating exchange rates, can function satisfactorily unless the United States itself restores internal economic conditions of reasonable stability and noninflationary growth. Few would quarrel with this judgment, but there are wide differences of view as to the correct policies to attain it. I should therefore like to present my views on what I believe is a proper policy approach for restoring the U.S. economy to a sustained healthful condition.

With respect to monetary policy, I believe that the monetary policy recommendations made by the economic summit of leading American economists in the Fall of 1974 were wrong because, by implication, they were premised on an invalid assumption that the United States is a closed economy. Many leading economists continue to recommend easy money policies as if Fed operations can wholly neglect possible feed-back effects that arise from reactions of the rest of the world. The U.S. is not a closed economy; only the world is a closed economy.

When we surprised the world by devaluing the dollar in February, 1973 for the second time in 14 months, we undermined foreign confidence in the commitment of this country to maintain the foreign exchange value of our currency. In the eyes of foreigners, as Lenin might have observed, we debauched our currency. Foreigners then shifted the composition of their financial asset portfolios from dollars into instruments denominated in currencies they continued to trust, e.g., the German mark, the yen, and the Swiss franc. As a result, Eurodollar interest rates shot up and the effects were transmitted to our own borders. U.S. interest rates quickly followed suit, stock market values sank, and the current era of generalized monetary and financial uncertainty began. We have yet to fully recover from this trauma.

This experience is but one illustration of how the international repercussions of unilateral U.S. policy decisions can be perilous. The fact is that the dollar is a global money, and that Federal Reserve monetary policy is not at liberty to neglect that fact. Should the Fed unilaterally ease monetary policy, the world market would tend to lose confidence in the U.S. commitment to combat inflation relative to the confidence it holds in other major currencies. The currency composition of financial asset portfolios would reflect this shift, with the consequence of a depreciation of the dollar—which is inflationary—and the further consequence of greater global monetary and financial uncertainty which, as I have mentioned, undermines business confidence and investment on a world scale. So we get slower economic growth, fewer productive jobs, more inflation, and, of course, increased political pressures for more government interference in the market economy.

This is a highly complex subject, and I feel obliged to limit my testimony. However, if the Subcommittee will permit, I should like to insert in the record at the conclusion of my prepared statement a brief analysis concerning problems of measuring the U.S. money supply under floating exchange rates, which was published in the Wall Street Journal of May 19, 1976.

Turning now to the bottom line of what I believe our monetary policy should be based upon, I suggest that under floating exchange rates we no longer focus as much attention on arbitrary statistical measurements of what we define as the money supply. Rather, our monetary policy actions should air more directly toward the stabilization of the price level. This, too, involves measurement problems, but we must avoid attaching too much importance to the increasingly unreliable performance of the so-called domestic monetary aggregates.

We need to understand that the exchange rate between the dollar, the mark, and the yen is the most important price relationship in the world. If this relationship can be effectively restored to a condition of relative stability it would, among other things, also correspondingly improve the reliability of measurements of the money supply as targets for economic policy. It is too little understood that our domestic price and economic performance is closely intertwined with the relative stability of the dollar's foreign exchange value in terms of other major currencies.

Our internal monetary policy should be harmonized more closely with at least that of Germany and Japan. We need to aim for a commonality of internal monetary conditions within this massive economic area. It is only if such a condition

can be achieved that the maintenance of relatively stable exchange rates between the dollar, the mark, and the yen can be attained, along with our own requirement for a satisfactory domestic price and economic performance.

If our internal growth, employment, or price performance should prove unsatisfactory, we shall have to approach these problems in cooperation with our major economic trading partners and allies. This may at times require some difficult compromises, particularly if the national political policy requirements of the major nations are significantly disparate. Nevertheless, compromise we must; since the alternative may well be to undermine financial, business, and consumer confidence and, thereby, to create a remedy even worse than the disease.

Turning now to U.S. fiscal policy, we must realize that the concept of a full employment surplus (or deficit) is dangerous. The main reason is that we simply have not found a viable way to wind down or fine-tune government tax and spending programs in a timely fashion. As a result, at such time as the private economy may begin to resume higher credit demands for financing productive investment, lingering budget deficits may "crowd it out." Accordingly, instead of resuming productive economic growth, we may generate further inflation and either subsequent or simultaneous recession.

Over many years our tax reforms and spending programs have responded to the demands of war and compassionate concerns of the American people. We have increased the tax burdens borne by the earnings and profits of the most productive elements of our economy—both labor and business—while we also, in effect, have increasingly subsidized less productive sectors. When you tax work and production, you get less of it. When you subsidize non-work, you get more of it. The end result contributes to slower economic growth, with productive investment now falling far short of what is required to ensure rising living standards for posterity.

A case in point is that of Britain. The Bank of England's Quarterly Bulletin of March 1976 shows that from 1960 to 1974, and before- and after-tax real rates of return on capital employed by industry plummeted from 13.4 percent to 4.0 percent on a pre-tax basis, and from about 10 percent to a negative 4 percent on an after-tax basis. There is little need for further explanation as to why Britain has just recorded its highest postwar unemployment rate in spite of the so-called "social contract" which holds down wages, while inflation remains in the double-digit range.

To avert such a future scenario in this country, we should reduce the taxes that we take from producers. At the same time, however, we must remain cautious concerning the extent to which we may permit credit conditions to ease so as to restrain inflation.

I believe it follows from the above analysis that the ideal policy mix for the U.S. involves the combination of reduced tax rates, targeted in such a way as to provide increased incentives to work, to invest, and to save; and to maintain a reasonable degree of monetary policy restraint so as to reinforce market confidence in the commitment of our authorities to eliminate inflation. Such a policy approach could be readily harmonized with that of Germany, with the further result that the foreign exchange performance of the dollar would also improve. It might be noted that this policy formula is the precise opposite of that which was offered by our economic mini-summit in late 1974.

In conclusion, I respectfully recommend that the Congress approve the proposed amendment of the IMF Articles of Agreement. However, I would also urge that new language be inserted in the bill (S. 3454) to instruct the Administration and the U.S. Governor of the Fund to assign a very high priority to the development of new understandings and cooperative arrangements between major countries so as to improve the coordination and commonality of domestic monetary conditions. If this can successfully be achieved, we may hope to see more stable exchange rate relationships between the non-Communist world's most important currencies. With greater experience, these arrangements might then be extended so as to encompass a more broadly based area in the effort to attain global monetary stability.

As Secretary Simon and others have correctly testified, a steadier exchange rate performance requires an underlying convergence of internal economic conditions. This holds true regardless of whether the international monetary system is based on a fixed exchange rate or a floating exchange rate regime. In time, and with a reasonable degree of success in this very important endeavor, I believe that a new par value system centered on a fixed SDR might then be established which the world marketplace would endow with credibility.

SUPPLEMENTARY REMARKS BASED ON QUESTIONS RAISED BY SENATOR STEVENSON
PERTAINING TO HEARINGS ON S. 3454, AS PUBLISHED IN THE CONGRESSIONAL
RECORD OF AUG. 5, 1976

1. HOW TO "MANAGE" FLOATING EXCHANGE RATES

The IMF Executive Directors have issued guidelines concerning the management of floating exchange rates. In essence, the guidelines constitute a generalized statement of good international monetary conduct. However, the statement is largely devoid of clear rules or standards against which the actual conduct of countries can be effectively judged.

Much is made of a need for "firm multilateral surveillance" by the Fund in the proposed revision of the IMF Articles. However, it remains to be seen whether there is any meaningful way to apply such surveillance. If you have a world in which some countries are intervening to steady their exchange rates while others are not, what criterion can there be to determine whose rate may perhaps have moved out of line? I know of no method by which to make meaningful judgments in this regard. Further, even if the IMF somehow makes such determinations, what sort of action could it then effectively implement? At this point at least, not much is really known about how the floating exchange rate regime should be managed.

2. THE FUTURE ROLE OF GOLD

The future of gold as a monetary asset represents another question mark. In principle, it might be nice to be able to do without the barbaric relic of the past, though a lot of thoughtful people are not convinced that we can, in fact, do a better job in its absence. The fact that the Group of Ten limited its agreement not to peg the price of gold to a period of only two years reflects the existence of a divergence of views concerning the role of gold in the world monetary system. Another manifestation of this basic policy difference was the purchase of gold from the IMF by the Bank for International Settlements (BIS), which it then resold to a member country of the Fund. I am told that this was done under an interpretation which holds that since the entire international monetary system constitutes an accumulation of legal violations, some countries feel they can do what they please with respect to gold.

Some gold holding and gold producing countries may have a vested interest in preventing the private price of gold from declining. They might therefore attempt to form a "gold bloc." However, the U.S. holds a substantial gold hoard, so that it could potentially create major disturbances in the gold price should it have the will to do so.

Whether gold will be phased out as a monetary asset is ultimately a political decision. For example, a future closely knit European bloc, including Germany, could possibly prevent it if, for some reason, it decided on such a course of action.

Aside from such considerations, I might note that the combination of current political problems in South Africa, economic and financial difficulties in Soviet Russia, and the IMF program for selling gold over the next few years, is exerting a depressing influence on the price of gold for the short to intermediate term. Over the longer run, however, there may be new constraints on supply which might then lead toward a resumption of a rising gold price trend.

3. THE SDR

Relative to official holdings of gold and reserve currencies, it is clear that the SDR is not now the principal international reserve asset. After IMF quotas may be increased, as now proposed, total Fund resources will amount to perhaps only 4 percent of world trade; that ratio was four times higher about 30 years ago. So whether the SDR does, in fact, become the principal international reserve asset will depend on future decisions of the IMF member nations. At this juncture it is obvious that the Jamaica Agreements do not ensure that SDRs will, indeed, eventually become the principal reserve asset of the international monetary system.

4. THE NEED FOR A ONE-THIRD INCREASE IN IMF QUOTAS

The proposed one-third increase in IMF quotas represents a small, though helpful, addition to world monetary resources. As compared with existing totals

of world liquidity, the grand total of IMF resources is relatively small. However, if the Fund is to continue to carry out its important function of extending conditional credit to countries, that is, credit which is preconditioned on the adoption of sensible, though sometimes politically difficult, economic policies on the part of borrowing countries, then it needs liquid resources to be a credible and effective institution.

5. WHETHER THE FUND IS BECOMING AN AID-GIVING AGENCY

I do not agree that the IMF is gradually being converted into a foreign aid agency. As a case in point I would note the recent \$5.2 billion short-term credit that was extended by major central banks to the United Kingdom. If the U.K. is unable to fully repay this credit after six months, it is anticipated that it will then be transferred to the IMF where Britain will be subject to economic policy preconditions. Thus, the Fund may prove helpful to all of its members, developed and underdeveloped.

With respect to the so-called Trust Fund being set up out of IMF gold sales, one should consider the size of these resources to gain a proper perspective. In such a light the amount of funds involved are too small to be regarded as a significant potential source of inflation. Other issues concerning the establishment of an orderly world monetary system are too important to allow—the Trust Fund issue to become a serious diversion.

6. "ARE THERE SUFFICIENT CONSTRAINTS ON CREDIT CREATION IN THE EURO-CURRENCY MARKETS TO INSTILL CONFIDENCE IN THE FUTURE STABILITY OF AN INTERNATIONAL MONETARY SYSTEM HEAVILY DEPENDENT ON THE DOLLAR?"

This question is related to one asked by Senator Percy during my testimony before the Senate Foreign Relations Committee. Senator Percy asked if I, "as a banker, believe that the Euro-currency market contributes to international inflation? Do you believe that there is a need for controls of the Euro-currency banks?"

My response to Senator Percy was overly concise. I said at that time:

"If a truly effective global system for imposing minor reserve requirements on Euro-currency deposits could be worked out, I could possibly support it, not because I believe the Euro-currency market is a dangerous engine of inflation, but, rather, because I believe that if central banks hold a small amount of reserves of these Euro-currency banks, then, ipso facto, they are going to be held accountable and more responsible for what goes on in those markets . . . I believe, so far as the contribution of these markets to world inflation is concerned, that it has been grossly exaggerated . . ."

In order for controls or even minimal reserve requirements on Euro-currency deposits to be effective, they would have to be imposed in an airtight global system, or else the Euro-currency markets would tend to move away from where controls are imposed to where controls are not imposed. For example, if the Bank of England were to impose new regulations on the Euro-currency banks located in its jurisdiction, then the affected institutions could easily migrate elsewhere in the world to be free of such interference. Given the longstanding sound traditions of British banking, a shift away from London would be likely to result in a deterioration of the Euro-system, rather than in an improvement of it. Accordingly, this explains my reference to the required existence of "a truly effective global system" for imposing such restraints. However, in my judgment, such a system would be utopian and academic in today's world. I do not believe that an airtight global system for regulating the Euro-currency markets really lies within the realm of practicality.

There appear to be two important problems: First, such a global system would require the joint participation of most, if not all, of the 128 member countries of the International Monetary Fund. In today's world many of these countries would probably not command the trust of the total world community to manage the operation of Euro-markets to the satisfaction of all interested parties.

A further requirement to close possible loopholes in such a hypothetical global network would be that every participating nation would have to legislate prohibitions against its nationals engaging in Euro-currency transactions in any country which is not a participant in the system. But even if this were done, it is doubtful that the authorities of all the countries would, in fact, hold the power to effectively implement such a legislative restriction. Therefore, my response to Senator Percy was somewhat misleading, for although I stand by the logic

underlying my answer, the premise upon which such a system would be based is purely hypothetical and, it would appear, not achievable in today's world.

Turning now to the part of Senator Stevenson's question concerning whether constraints on credit creation in the Euromarkets are sufficient to instill confidence in the international monetary system heavily dependent on the dollar, I would respond as follows:

In my opinion, the expansion of the Euro-currency markets should not be viewed as independent of the monetary and credit policies pursued by the world's major national monetary authorities. The growth of the Euro-currency markets represents the share of world credit expansion which can be captured by the Euro-market institutions on the basis of their superior efficiency, lower costs of operations, and the existence of clients who find it convenient to conduct transactions with such a highly internationalized system.

To oversimplify, the U.S. Federal Reserve and, say, the German Bundesbank together adopt policies which determine the scope by which credit may expand. These policies imply some limit on the growth of credit, and there is then competition between domestic banks and other financial institutions and the Euro-market institutions in the sharing of the available potential for credit expansion. When seen in this perspective, it is clear that the growth of Euro-currency market credit mainly constitutes a share of a given pie, rather than a primary source of world credit expansion. If the Euro-banks try to expand to capture loan demand from "domestic" banks, they must charge lower interest rates. But they may not be able to expand their deposits for that would require paying higher interest rates. Without such additional deposits, the Euro-banks have no extra funds to lend out. So I see no necessity for controlling the expansion of Euro-currency credit. Rather, in the example I have given, the ultimate constraint on credit is determined by the policies of the Fed and the Bundesbank.

I remain confident in the stability of the Euro-currency system. As a case in point, I might note that in 1974 it is estimated that Italian banks which participated in the Euro-currency system lost as much as four fifths of their gross Euro-dollar liabilities. Yet, with very minimal support from the Bank of Italy, none of these banks failed. They were able to wind down their Euro-currency assets roughly in proportion to their loss of liabilities, thus demonstrating the underlying strength of the system to withstand a major shift of funds. I might also note that the September 1974 statement of the central bank governors who attended a meeting of the Bank for International Settlements (BIS) in Basel, Switzerland, provided further reassurances to the Euro-currency markets. The central bankers indicated their readiness to cooperate and stand behind the stability of institutions participating in the Euro-currency markets.

As a matter of fact, it is important to bear in mind that the principal participating Euro-currency banks are those whose home offices are mainly located in but a few major countries, principally the United States, the United Kingdom, Germany, and, to a lesser extent, perhaps one or two other major countries. Accordingly, the logistical problems of cooperation between the central bank authorities of those countries is by no means one of unmanageable proportions.

To conclude, I believe, in competition, and the existence of the Euro-currency markets has had a beneficial effect in improving the efficiency of banking in the entire world. A lot of countries, businesses, and banks have benefited from the Euro-currency markets and are highly confident as to its strength and stability. I personally share in that assessment.

[From the Wall Street Journal, May 19, 1976]

DOUBTS ABOUT FLOATING RATES . . .

(By Eugene A. Birnbaum)

The starting point for most discussions of monetary policy is of course a nation's "money supply." But the very idea of a money supply may be outmoded and inadequate for today's times because it was derived from experience during a much less complicated era of fixed exchange rates.

An important though neglected fact is that the "total money supply" of a country is an abstraction: it has no measurable empirical counterpart. To be conceptually complete the *aggregate* money supply of a country should in theory incorporate the value of *all* forms of moneyness, however and wherever held. Characteristics of money are possessed by many things, financial as well as real.

During World War II and in early postwar years, cigarettes, chocolates, chewing gum, and even silk stockings functioned as money in some places of the globe.

Since the intrinsic value of fiat paper money is zero, its moneyness accounts for the totality of its value. Some value for moneyness also attaches to assets readily convertible into money: time or savings deposits, bonds, stocks, commodities, etc. Their moneyness varies, depending on circumstances, but it correspondingly contributes to the worth of these assets.

A CUMULATIVE SUM

To aggregate the total money supply, domestic currency and checking accounts would, of course, be included, as would the cumulative sum by which all other holdings of financial and real assets are valued above their intrinsic worth by virtue of their moneyness. The same principle applies even to assets held abroad.

In the absence of a measure of a nation's "true" aggregate money supply, an array of largely arbitrary statistical "proxies" has been invented. The Western world's monetary authorities compile these, publish, and make use of them as guides for policy. Policymakers, economists, politicians, and journalists who comment about the "money supply" are, thus, in reality, referring to the performance of statistical proxies.

In the United States, at least seven such proxies, identified as M1, M2, through M7, are regularly compiled. The most closely scrutinized are M1 (the sum of currency and privately held demand deposits in domestic commercial banks), and M2 (M1 plus commercial bank savings and time deposits held by the public, excluding large negotiable certificates of deposit).

The current fixation on "money supply" as the prime target, progress report and scorecard for the nation's economic policy derives from the landmark study by Milton Friedman and Anna J. Schwartz, "A Monetary History of the United States: 1867-1960." National Bureau of Economic Research (Princeton University Press, 1963).

Covering a period of 93 years, that study found a relatively stable relationship between the growth of the M2 proxy and U.S. gross national product statistics (GNP).

The principal theoretical implication for policy of the relationship found by Friedman-Schwartz is that control of M2 by the Federal Reserve will determine the course of GNP, and that if such control is properly executed, little or no attention need be paid to other economic policy instruments, like government deficits or surpluses, interest rates, or exchange rates. It is even argued by monetarists that rates should be left alone to fluctuate according to the interplay of market forces, while steady-state expansion of M2—achieved by appropriate interventions by the open market desk of the New York Fed—operates inexorably to achieve the M2-ordained GNP objective.

There is no need to quarrel with the actual statistical findings by Friedman-Schwartz for the era from which they were drawn. *But during about 80 of the 93 years covered in their study there were fixed exchange rates for the dollar.* Accordingly, it is legitimate to question whether theories based upon that research are applicable to the dramatically different current conditions of worldwide floating exchange rates. Indeed, the Friedman-Schwartz study, which covered several periods of instability of money and income under both fixed and floating rates, included the years 1867-1881—one of the rare extended periods of floating exchange rate in U.S. monetary history—as one of those showing "appreciably greater instability of the year-to-year change in both money and income."

There are now definite grounds for skepticism concerning the assumed stability of the relationship between M2 and GNP under floating exchange rates. For one thing, shifting exchange rates impose upward pressures on short-term interest rates in the depreciating currency, while depressing them (or slowing their rise) in the appreciating currency. Changing interest rates, correspondingly, have variable effects on the whole gamut of alternative measured proxies for the aggregate money supply.

In other words, rising or falling interest rates and exchange rates may move money from one M to another, as they induce national and international shifts between currencies or demand deposits, time deposits, Treasury bills and bonds, stocks, commodities, etc., reflecting changing preferences between competing forms of holding money—even though the total "moneyness" of a national economy may be unchanged.

Further, to the extent that monetary authorities may concentrate attention on controlling the growth of one or another M, their interventions may correspond-

ingly alter exchange and interest rates, causing further instability among the various Ms. If these relationships behave erratically, it's difficult to imagine a stable relationship between M proxies and the GNP.

This is not to denigrate the many valuable contributions of the Friedman-Schwartz National Bureau study. But at the very least it is now appropriate to be aware that major question marks arise as to whether the Friedman-Schwartz findings are relevant under today's floating exchange rates. Indeed, as statistical evidence mounts, increasing attention is being paid to the fact that the measured money proxies currently bear *unstable* relationships with respect to each other and the GNP. Accordingly, official monetary policy intent on adopting steady growth of will o' the wisp money supply proxies could touch off *instability* of the GNP—the very opposite of monetarist beliefs.

ONE IMPLICATION

One implication of this analysis is that the restoration of some semblance of relatively stable exchange rates will be necessary before monetarist findings of a bygone era may again be relevant. It could well be that only under the inherent disciplines of general exchange rate stability are structural conditions created which reveal steady relationships between money supply proxies and corresponding measures of national economic activity—as found by Friedman-Schwartz.

If this is correct, as I strongly suspect, then an important implication for monetary policy follows from it: The possibility of using Federal Reserve monetary policy to achieve GNP objectives is subject to the limiting constraint that major foreign exchange rate relationships of the dollar remain relatively undisturbed. Accordingly, U.S. monetary policies would require a degree of synchronization with those of other major countries—at the very least with those of West Germany—so as to avert disturbing exchange rate fluctuations which otherwise could undermine the stability of U.S. monetary and national income relationships.

The Federal Reserve has generally resisted loud and frequent clamors for more aggressive intervention to steady the growth of proxies for the monetary aggregate. There have been repeated warnings about deviations from preordained money growth targets. In spite of these complaints, the economic recovery, so far at least, has made continuing progress. Under today's floaty exchange rates, there could be much wisdom in the Fed's defiance of its critics.

Senator STEVENSON. Thank you, Mr. Birnbaum. I didn't, in my introduction, do justice to any of you and in particular I didn't mention the lengthy distinguished public services many of our witnesses have contributed.

I think this is one of the most remarkable panels that I have been privileged to listen to since I came to the Senate.

But unhappily my privilege is about to end. I have just been informed by the leadership that the Export Administration Act is about to be brought up on the Senate floor and I have to manage that act.

So we will continue with the panel, and Senator Proxmire is of course the chairman of the full committee, and he has kindly agreed to chair these hearings.

But I apologize to you and I personally regret it very much. It would be helpful to me as well as to the Congress to hear the rest of you, but I am going to have to excuse myself to leave to prepare to manage the legislation on the floor of the Senate.

Our next witness is Mr. Roosa.

STATEMENT OF ROBERT V. ROOSA, PARTNER, BROWN BROS., HARRIMAN & CO.

Mr. Roosa. Thank you Mr. Chairman.

I wish you well in your management and I hope before long you will be helping to manage the successful passage of the legislation we are considering here today.

I am delighted to have a chance to appear with this group, before this committee to endorse the legislation that is proposed and to suggest that there will, after this legislation, as there has been since Bretton Woods, continue to be many problems that will not have been fully solved by a single action contemplated at any one time.

I would like if I may Mr. Chairman, to introduce my own full statement for the record and summarize what I try to say there very briefly.

Senator PROXMIRE. Without objection your statement will be printed in full for the record in the record.

Any other panel member who wishes may do that also.

Mr. ROOSA. Thank you.

The first point I make is that there is continuity in the evolving money situation of the world. At times it runs ahead of events and tries to shape a framework within which events can then move.

This time it is the other way around. Events have run ahead of the system as previously established and it is time now to fabricate a set of legitimizing arrangements which will not only provide for greater assurance of orderliness in the way in which we proceed with new implementations, but also will be flexible enough to leave room for the further kinds of adaptation which the system will surely need.

I wouldn't want to identify myself chapter and verse with everything Eugene Birnbaum has said, but I certainly applaud his insistence on the fundamentals and the recognition that in time the world could very well tear itself apart if all currencies were freely floating without some central convergence and that that central convergence will, I hope, emerge under the contemplated arrangements in time between the Deutsche mark, the yen, the dollar. It is a position that I have urged since long before the events even of August 15, 1971, so I have no trouble in endorsing that aspect of Mr. Birnbaum's suggestion again.

I do believe for the present that in a world of such widely divergent patterns there is no alternative to continuance of a system that is essentially one of floating currencies as among the major countries.

As we all understand, many of the other countries who are not in a position to qualify as members of the leading industrial circle are themselves floating only in the sense that they peg to one or another of these leading currencies and occasionally adjust their peg.

By and large, they determine their own performance by what happens to the leading currencies so that we still have a mixed system, and I would expect as time goes by, it will be possible if there is recognition of the need, the overriding need to give priority to domestic stability within individual leading countries, that there will be an opportunity for the closer harmonization among these principal industrial countries that Mr. Birnbaum describes.

I think another aspect of the new arrangements that I find very encouraging in contrast with testimony of the Congressman from whom we just heard, is the progress toward multilateralizing the consultation and to some limited degree the decisionmaking process.

One of the shortcomings of the International Monetary Fund and its effectiveness over the years has arisen from separation in distance and in responsibility between the executive directors domiciled in Washington and the governments they represent in the 120-odd countries of the world that are now members of the Fund.

In think the Jamaica procedure has been an important step in trying to reconcile that continuing conflict between full hearing of all members and the need for a smaller group to thresh out the final details and specific action.

The process of evolving the Jamaican agreements proceeded along the lines of a pattern, now tested in a preliminary way, that resulted in ultimate dependence on at least the vote delivering capability of only 20 men representing of course in fact, all of the members of the Monetary Fund.

But each of them being principal officers of their own governments, they were capable therefore of acting with a degree of responsibility and immediacy which has not often been possible in the executive board of the Fund itself.

So I regard the development of the interim committee and ultimately of the executive council as an important new development in the evolving international monetary system.

I think it is important also that the SDR has been given a more distinct role in the Fund. In my view it is important that gold has been dethroned but not exiled.

Gold will still have a role for anyone who wants to hold it. Obviously it has had intrinsic attraction to mankind for generations and we are not going to remove it by a simple act of legislation.

But I think it has been shifted into a position where its potential for harmful disruption of the monetary system is now largely gone.

I think it is important too, that the position of the dollar has been redefined. There is never going to be any complete avoidance of dependence on the dollar so long as we remain the dominant industrial power in the world, with many countries dependent on the dollar as a standard of value and many more using it as a medium of exchange.

But I do feel that the mechanical requirement that the dollar be in effect the standard of value for the members of the Monetary Fund was imposing an undue burden and periodic strain on our own performance, a distortion which did not reflect our own basic economic conditions.

In this proposed legislation the dollar is no longer the standard of uniform value for all transactions in the Monetary Fund, instead being replaced by the SDR. The SDR does have the advantage in a world of such great instability of at least providing that closer approach to a relatively stable norm that is just arithmetically implied when you depend on an average among several rather than depending on only one currency or one commodity.

But I think the final aspect of all of this that runs through comments about the sale of gold and use of the trust funds and so on that I would like to stress is that it has been possible, I believe, during the course of all these negotiations to avoid a great risk so far, and that is the risk that the IMF would be converted into an aid or development financial institution.

We have got institutions for that purpose; the separation should be kept. If the Monetary Fund is to have a hope of evolving ultimately into the role of a—albeit with some constraint—a central bank for the world economy, it has to retain the separate identity that distinguishes it from aid-giving institutions.

That is why I am gratified that there has been no further step in the direction of linking the creation of SDR's to aid.

I think that would corrupt the strictly monetary concept of the SDR. I do feel however that the needs for aid as epitomized in some of this IMF action really point toward the need for more aggressive U.S. Government support of the other Bretton Woods institutions: The World Bank, the IDA, and the International Financial Corporation. I think it is regrettable that there has been in this area such a sluggish response on the part of the United States.

I believe this is the area where, if we are going to have a chance of avoiding additional disruptive unexpected but chaotic influences on the world monetary system, we and the rest of the developed world are going to have to take more prompt action, more effective on a larger scale, because the less developed countries are, through the accumulating of more and more debt, building up more and more potential for an unfortunate chaotic situation.

Until they can match their debt exposures with greater productive capacity, the potential for the 100-odd less developed countries is indeed still forbidding.

So I would conclude, Mr. Chairman, by saying that I think the legislation does what we need. It moves on all fronts in what I regard as the right direction. It leaves flexibility for future adaptation which we will also likely need and it points toward comparable emphasis on the support by our Government of the other Bretton Woods institutions whose responsibilities are growing and which are not subject to as much change in their nature as we are now proposing for the monetary fund.

[Complete statement follows:]

For Release on Delivery

THE JAMAICA AGREEMENTS

Testimony prepared for submission to the
International Finance Subcommittee of the
Senate Banking Committee on S. 3454

on August 27, 1976

by Robert V. Roosa, Partner
Brown Brothers Harriman & Co.

Mr. Chairman,

It is a pleasure to appear before this Committee again in the continuing sequence of deliberations on the evolution of the international monetary system. I stress the word "continuing" because the process of adapting monetary arrangements to the needs of a dynamic world economy is never-ending. At times there may be opportunities to introduce new arrangements or procedures which can help to lead and shape the patterns of economic change within and among nations. That is what happened at Bretton Woods in 1944. At other times patterns of actual economic change may themselves push beyond older monetary arrangements, requiring ad hoc improvisation within the international monetary system. And unless such impromptu improvisations are soon to degenerate into chaos or conflict, new legislative arrangements must rather promptly catch up with and legitimize them. The legislation before you today is mainly of this second form.

While new problems will always be emerging in both the structure and functioning of the international monetary system, and new adaptations will be required to cope with these new problems, a periodic codification of the essence of what has evolved in the design of international monetary relationships is essential. For monetary adaptations to economic change should, to the fullest practicable extent, occur within a framework of guidelines designed in advance not only to assure that flexibility can in fact occur, but also that whatever uses are made of that flexibility will not create new and greater problems. The stakes are too great in today's interdependent world to invite disorder by inaction.

The various provisions of this legislation, and the understandings surrounding it, constitute a critically important advance in the search for a suitable balance between money's role as master and as servant for the world economy. The so-called Jamaica Agreements should be viewed in longer

perspective as a combination of individually modest but collectively crucial forward steps in the progressive evolution of the world's monetary arrangements. The legislation itself preserves what is essential in existing institutions; it affirms significant additions to those institutions, and it provides further flexibility for future adaptation to change. Indeed, coming amidst an unusual convergence of potentially disruptive forces in the economic relations among nations, the legislation before you represents a remarkable achievement in finding a common denominator among the problems and needs of those nations.

In considering this legislation, important as it is, however, it is necessary to guard against exaggeration. For even after its enactment, the basics of international economic relations will remain very much as they were before the recent round of improvisations began. That is, individual nations will still pursue their own national objectives in economic policy. Differences among nations in resources, in performance, and in objectives will still create potentials for conflict or disorder in the flows of trade and capital among them. The monetary system will still serve as a partial check or discipline upon particular countries whose course is sharply divergent from the central tendencies prevailing among the others. Yet the system will also be capable of supporting continuing economic expansion within and among all countries.

Neither floating exchange rates nor a par value system can of themselves assure harmony among national economies as widely different as Germany and Zaire, or the United States and India. But the forward steps included in the Jamaica Agreements, and the casting aside of those vestigial remnants from Bretton Woods that have become outmoded, will certainly raise the prospects for stability with growth throughout the countries that adhere to the International Monetary Fund. But no country can expect to have stability provided for it by this or any other monetary system, nor can it expect to be insulated from outside strains by any monetary mechanism. Sustainable growth for any country within a framework of viable relations to other countries will still have to depend, first, on reasonable stability in the domestic performance of that country, and second, on the readiness of each country to make suitable adjustments in its domestic performance when its own prices, production, or trade have shot far out of line with those of other closely related countries. An altered exchange rate (whether it floats or is deliberately moved) can only rarely make up all the difference. There is no escape from the hard realities of what the professionals call "the adjustment process." That is as true for Germany as it is for Zaire; as inescapable for the United States as it is for India.

The various provisions of this legislation have been reviewed often

The various provisions of this legislation have been reviewed often and will no doubt be repeated by others on the panel here this morning. I propose to sidestep those details, and the various criticisms that can still be made of them (for they are, of course, only compromises among many differing national views and interests). Nor will I digress here into a dialectical discourse on the pros and cons of "managed floating." Perhaps my role can best be to try to set the proposals as a whole in perspective -- a perspective that grows out of some twenty-two years on the Governmental side of these evolving relationships and now more than eleven years of viewing them from the private sector. It seems to me that there are at least five significant aspects and implications embodied in the arrangements contemplated by this proposed legislation. Positive progress in the long continuum of monetary development is made possible with respect to (1) consultation for multinational surveillance; (2) the uses of Special Drawing Rights; (3) the position of gold; (4) dependence on the dollar; and (5) the payments pressures on less developed countries.

1. Consultation. The ultimate source of genuine effectiveness and orderliness within the international monetary system must come from a willing understanding among nations, and from ready consultation when misunderstanding develops, rather than from any set of mechanical devices, or from a mystical invocation of the power of free markets -- though I do not mean that mechanics are unimportant, nor that encouragement of free market influences is undesirable. One persisting obstacle to understanding and consultation arises from the inherent conflict between the need for representation by large numbers of participating countries, on the one hand, and on the other, the difficulty of reaching a usable and timely consensus unless the number of participants can be manageably small when critical issues arise. Peremptory action by a single nation is no satisfactory solution, as I believe the United States discovered on August 15, 1971.

The negotiations culminating at Jamaica have, in this respect, broken new and promising ground. Several separate roles for various groupings and regroupings of countries have been implicitly acknowledged. There is a place for consultation among a few of the leading industrial countries. There is a place for parallel consultations among the less developed countries -- all together, and in several sub-groupings. And all of these different groups have in turn been, in effect, joined together through a group of delegated representatives, functioning within the structure of the International Monetary Fund as the "Interim Committee." That Committee presently includes twenty Finance Ministers or central bank Governors, about evenly divided between those of the less developed and the more developed countries. It is expected (and I would hope) that the Interim Committee will be transformed, in furtherance of the Jamaica Agreements, into a permanent Council. When that is done, following ratification of the amended IMF Articles in accordance with

the legislation you are considering, there may be greater assurance that all voices will be heard, and that a working consensus will evolve, as major issues affecting international monetary stability arise in the future.

It is through the Council, and its membership of officials from the highest levels of Government, that the most meaningful results can be expected from the IMF "surveillance" that is central to the case-by-case approach to emerging future problems. To be sure, IMF staff surveillance can and should include an ascertaining of facts, as well as the rendering of opinions. But the articulation of practical recommendations, and the development of common plans of support and of action, can only be the work of responsible Ministers, speaking for their own Governments (and for those whom they represent as spokesmen). That is why the Council can be more than just another consultative body. It can bring to bear the inherent power of many Governments to reinforce the IMF itself in focussing attention on the repercussions which the actions of particular Governments, acting individually or collectively, may have upon the functioning of the international monetary system.

2. Special Drawing Rights. Under the new Agreements the SDR is recognized as the principal standard of value -- though not yet the principal medium of exchange -- in monetary relations among nations. This standard is determined as a composite of the currencies of the sixteen countries which each account for at least 1 per cent of total world trade. By replacing the old dollar-gold price standard, the new arrangement hinges the entire monetary system upon a standard which represents an averaging of the differences among many currencies, and has the greater relative stability, as a norm, which an averaging process inherently assures.

Although neither the amount of SDR's in existence, nor the degree of freedom in their use, yet permit their becoming a principal medium of exchange among nations, the path toward that further objective will be opened by several small steps within the Agreements. Obligations to the IMF can be settled in SDR's. Transfers among nations can be made on the books of the IMF in SDR's. And the IMF at its own initiative can exchange SDR's for the currencies of any member country. These are important first steps in a long process that can be broadened as experience grows.

3. Gold. Under the Agreements, gold is dethroned as a standard of value but is not exiled as either a reserve asset or as a limited means for international monetary settlements. The time-honored attractiveness of gold as an easily handled commodity of high intrinsic value is still recognized, for all who wish to hold or use it. But the potentialities of a gold standard for creating or aggravating a monetary crisis -- potentialities that became so frighteningly actual as the world economy grew in scale and com-

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plexity -- have been set aside.

To be sure, the arrangements are still flexible enough to allow a powerful combination of countries, if one were to be formed, to attempt to peg the price of gold and restore it to more active use as a standard of value, at least for a segment of the international monetary system. That is a risk, but I trust not a likelihood, in the present arrangements. In any event, the arrangements specifically provide that gold is no longer to be used in meeting obligations to the International Monetary Fund, and useability at the IMF is a necessary condition for acceptance of any asset as a standard of value in today's environment.

4. The U. S. Dollar. International dependence on the dollar as a medium of exchange continues, but the additional burdens formerly placed upon it as a standard of value for all members of the IMF have now been removed. To be sure, a large number of countries continue, in effect, to peg their currencies to the dollar, and to make necessary adjustments in their own exchange rates by altering the pegs. To that extent, continuation of a nominal "dollar bloc" is no doubt an inevitable concomitant of the enormous relative size of the United States within the constellation of nations and of the chaos that would result if all currencies (large or small) were floating without any anchor.

Indeed the bulk of transactions among countries whose exchange rates are floating (as well as a high proportion of transactions among the countries whose currencies are kept within the "European snake") is still carried out in dollars -- at times with the effect of unduly depressing the exchange rate of the dollar against other strong currencies. That is a dis-equilibrating tendency which will recur until more of the transactions of other leading countries are invoiced in their own currencies -- a change which has already started with respect to the yen and the D-mark -- and until the SDR can be used more actively as an intervention currency in the foreign exchange markets (at least for transactions among central banks).

There is at any rate now a growing recognition that the United States is not itself promoting an undervalued dollar as a means of taking undue trading advantage of other countries. Any sizeable reduction in the dollar's role, as world trade and payments continue expanding, will probably come only slowly, however, because such a shift will have to depend on changes in trading practices and trading mentality which are not readily responsive to mere legislative action.

5. The Less Developed Countries. The needs of less developed (or developing) countries have been accorded a range of useful new facilities,

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under the Agreements, without yet compromising the appropriate monetary role of the IMF. That is, so far as international agencies are concerned, the extending of direct loans for continuing domestic requirements should, in my view, remain the responsibility of the World Bank, its affiliated institutions, and comparable regional and national development banks. The International Monetary Fund should continue as the imperfect counterpart of a central bank, furnishing the world's primary reserve asset and providing only short-term financing to bridge temporary balance of payments shortfalls.

Under the Agreements, and in part in advance of them, the IMF's capabilities for extending additional credits to assist countries through periods of reserve losses attributable to crop failures, or natural disasters, or unusual circumstances, have been substantially enlarged. For two years, a special oil facility also served to help both developed and developing countries through a difficult initial phase of adjustment to the mutation in oil prices. Modest additional provision has also been made on a continuing basis for an interest subsidy account and for a trust fund to be created from the proceeds of the IMF's sale of part of its gold. All of these are limited advances toward coping with the serious payments problems confronting the non-oil producing LDC's, but all do go in the right direction.

One very great danger has been avoided. That was the risk -- a risk to which most less developed countries in their understandable eagerness for balance of payments assistance in the aftermath of 1973 have seemed rather indifferent -- that the SDR's would be used directly to grant additional development aid (as outright grants or as long term loans). Such a "link" would, in my opinion, soon establish overwhelming pressure to create additional SDR's as a means of extending aid. In effect, aid would come through the legerdemain of money creation, bypassing explicit provision in the budgets of the countries from whom the actual goods embodying that aid would in fact flow. Once the SDR became subverted to this purpose, the hope of its establishing a unique and wholly unprecedented position as a man-made reserve asset, universally acceptable because its supply was solely related to the world's fundamental needs for monetary reserves, would be destroyed.

This last area of concern, that of the LDC's and their growing balance of payments pressures and problems, seems to me the most critical area among those still calling for further action. The need is not necessarily for effort through the IMF; indeed the greater need is for efforts outside the IMF in order to avert a serious distortion of the IMF's own essential purpose and image. This is not the place today to explore the LDC issues in detail, but it is certainly also not the place to ignore or deprecate them.

We must be careful to avoid slipping into euphoria over the balance

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of payments and developmental needs of these countries following the "oil shock" of 1973. There are many, and I have been among them, who probably cried wolf too soon -- at least so far as the potential for an actual breakdown in the payments system was concerned. But we were not wrong in what we foresaw as to the direction of pressures and the scale of the changes. For it was apparent then, and is verifiable now, that grave structural consequences for many of the LDC's -- an inability to pay for needed imports and a shrinkage of already inadequate growth rates -- would result from the wholesale readjustment of the patterns of world trade and payments that followed the abrupt increase of oil prices.

Where some of us went wrong was in fearing that an outright stalemate might occur as early as 1975 or 1976 for some of the LDC's. Actual stalemate has been averted by a combination of unexpectedly heavy spending on the part of the OPEC countries and unexpectedly bountiful lending of funds both by those countries and by the banking institutions of many of the developed countries. But the vast extension of credit, much of it for rather short maturities, has only delayed, if not compounded, the impact of the very real structural realignments that must ultimately be faced by many of the LDC's.

This is not, I submit, a complex of problems to be met through resort to additional monetary reform, and certainly not through a creation of SDR's that would debase their value. It is not, indeed, primarily an IMF type of need. But it is a complex of problems which can threaten to impair the continued smooth functioning of an international monetary system that services the payments requirements of an incredibly virile, versatile, and demanding world economy. It calls at the least for prompt and ample support of the World Bank, the International Development Association, the International Finance Corporation, and related lending or financing institutions. I hope that such support will have the urgent attention of this Committee and the Congress, as a counterpart of the very necessary legislation that is before you today.

Senator PROXMIRE. Thank you very much, Mr. Roosa. The next witness is Mr. Bennett.

I have the same reaction Senator Stevenson had. This is a most distinguished panel.

But we do have a shortage of time so if you could condense your statement we would appreciate it.

STATEMENT OF JACK F. BENNETT, SENIOR VICE PRESIDENT AND DIRECTOR, EXXON CORP.

Mr. BENNETT. Mr. Chairman, I have worked for 17 out of the past 21 years with EXXON. Perhaps I should acknowledge to the committee that my testimony this morning probably is also influenced by my earlier academic and Government work on international financial matters and by the fact that I did work in the Treasury from 1971 to 1975, first as Deputy Under Secretary and then as Under Secretary of Monetary Affairs.

I would like to begin my testimony by recording my admiration for the accomplishments of the Treasury officials in the time since I left the Treasury in June 1975.

My earlier assignments have given me an intense personal experience of the difficulties of international monetary negotiations.

Yet despite those difficulties, agreement has been reached on basic reform in the sense of agreement on fundamental changes in the rules in the right directions.

For me, those negotiated changes are neither interim, partial, nor minireform.

They are the changes roughly appropriate for today. I don't know of any other major changes appropriate for today. What changes we may find appropriate in the future. I don't know.

But I should perhaps mention that I doubt very much the prediction of Eugene and Bob, that we will find it wise to return closer to a legal fixed exchange rate relationship among major currencies.

I expect the reverse, and as a result, I expect in fact we shall have more stability.

Of course, the results of these recent negotiations may not be ideal from any individual point of view. But the question before your committee is not whether they are ideal but whether the Congress should refuse to ratify these agreements and send the administration back to try to negotiate something different.

I am convinced that that would be a serious mistake. The willingness of other governments to enter into negotiations with us on international economic matters would be seriously undermined, and no better agreement would be negotiated.

In the coming decade the United States and the world are unlikely to have as much employment, growth, and freedom from economic disturbance as I think would be possible with wiser domestic policies.

But we will have more of those desirable results than would have been the case if these recent negotiations had failed or if, alternatively, they had tried to put us on the road to reestablishing a par exchange system, or, worse yet, one tied to gold.

The Jamaica agreements, if ratified, will, in my judgment, provide advantages in three areas. They will facilitate international trade and

investment, aid in the fight against inflation, and assist in the development of the economically less advanced areas of the world.

For those of us in business I think one of the most important ways in which agreements are likely to facilitate trade is by removing the tendency illustrated so often in the past for governmental commitments to fixed exchange rates to lead to efforts to preserve those rates by putting contraproductive controls on private international transactions.

Also, now that the world's monetary officials can turn their attention from fine disputes about the architecture of ornate castles in the air, I think they can concentrate on the real world before us. As a result, through consultations, through publicity, and through decisions which nations may receive from the IMF and which must extend assistance through the IMF, these officials may now actively deter individual governments from burdening international commerce with protectionist and autarchic controls and with exchange market interventions which prevent gradual economic adjustments and lead to disruptive lurches in exchange rates. The excuse, "We are just trying to maintain a fixed rate," is no longer available to countries taking such actions.

Senator PROXMIRE. I am sorry to interrupt. That is a roll call. I will run right over and come right back and be back in less than 10 minutes.

I am sorry.

[Recess.]

Senator PROXMIRE. I am sorry. I apologize, Mr. Bennett. You were right in the middle of your statement.

Mr. BENNETT. I will try to shorten it a bit.

I was talking about advantages of this new agreement in terms of facilitating trade.

I would like to skip over now to a second advantage that I expect from the new agreements, assistance in fighting inflation.

I say this recognizing that there are some who feel our only hope in stopping inflation is to impose on ourselves the discipline of an international exchange rate fixed in terms of either a basket of currencies or possibly in terms of gold.

I sympathize with the advocates of this course in their appreciation of the damage which inflation has done on our economies. But I conclude there is no gimmick which will save us.

The only hope is better policies achieved through better public understanding of the effects of inflation, and that wider understanding is more likely to develop with floating exchange rates.

Par values are no longer credible deterrents to inflation.

Those who would urge governmental actions which would be inflationary would not be deterred by any contention that their proposals would undermine the Government's commitment to a fixed exchange rate.

They would know such commitments are not inviolable. And they would be prepared in any event to argue that their proposals were of such priority as to justify additional governmental borrowing abroad or controls on other activities affecting the exchange rates.

In fact, as a result of the appearance of stability sometimes achieved by such controls, they sometimes encourage basically more profligate policies.

For those reasons public consciousness of a government's inflationary actions is likely to be retarded in a par value system as compared to a situation in which inflationary actions are promptly reflected in the exchange rate.

Given the distaste of the electorate for a decline in the international value of a nation's currency, ready visibility of the effects of inflationary measures on currency values is likely to be a much more effective deterrent than the more circuitous consequences under a par value system.

This conclusion seems inconsistent with recent experience in the United Kingdom, for example.

The third area of advantage I see in the new agreements is the benefit which they are likely to bring to the development of the economically less advanced areas.

In making this remark, I am not thinking primarily, as some might expect, of the large amounts of loans which are being made to the less developed countries out of the regular resources of the IMF and those which will be made out of the new trust fund.

I am thinking, rather, of two other effects. First, the new agreements for a more flexible monetary system will reduce the pressures in the developed countries for protectionist measures which constrict the export markets of the less developed countries.

Second, the demonstration that the developed countries in large part have come to realize the economic damage which can be done by efforts to maintain fixed exchange rates should assist those in the developing countries who realize that such rates are likely to inflict even greater economic and social damage on the less developed countries, where the foreign exchange control apparatuses accompanying such fixed rate have often proved rife grounds for corruption.

In summary, I see the advantages of the new agreements in the fact that they are not focused on a symptom, that is, a stable exchange rate, but rather are concerned with the underlying substance, that is, the necessity of pursuing stable basic economic policies and avoiding disruptive, restrictive, and interventionist policies.

All of which is not to say that there are not some dangers present, for there are.

Under the new agreements there could still be attempts at excessive management of exchange rates.

After all, the proposed new IMF Articles still contain anachronistic language about promoting exchange stability, about a preferential position for current transactions. And the report of the executive directors of the IMF on the new articles contain some disconcerting words speaking of changes designed to assist the SDR to become the principal reserve asset of the International Reserve System.

It seems to me that there are always likely to be some central bankers urging firmer management of exchange rates with the consequent danger that inevitable change will take the disruptive form of discontinuous lurches.

Already this year we have seen how the efforts of the Italian authorities to stabilize the international value of the lira led to the subsequent drop in its value being so precipitous as to unsettle other markets.

More recently we have seen how the efforts to hold the mark and some lesser European currencies into a narrow band have generated uncertainty and uneasiness in the world currency markets.

There is also a danger that the world's monetary authorities will not fulfill with due diligence their responsibilities under the new system for surveillance of national policies.

One source of concern, which Bob also mentioned, is the fact that the new articles which do not literally establish administrative level oversight committee, but merely provide that such a committee could be established by an 85 percent vote.

I hope the committee will be set up promptly, for I think that high-level surveillance will be crucial to the proper functioning and evolution of the system.

I do not believe it is possible to draft hard and fast rules to fit all the situations which are likely to arise, but a committee meeting at a political level should have the flexibility and prestige to make judgments which would influence national policy.

In recent months it probably would have been useful for such a committee to address itself to the question which has been raised whether this year the Japanese Government has been attempting improperly to hold down the value of the yen by adding substantially to Japanese holdings of liquid foreign securities.

Undoubtedly during this period the IMF staff and executive board have held their regular reviews of Japan, but I suspect that questions of this type can sometimes best be handled only at a higher political level in a multilateral context.

Incidentally, I should say, Senator, that I have serious doubts about the practical effects of the suggestion put forward by Senator Percy this morning.

As he noted, his proposal would not guarantee the Congress access to any particular piece of information held by the IMF. On the other hand, I fear that it might reduce substantially the access of the IMF to information which other governments, for economic and political reasons, would not as readily make available if they feared such wide circulation as Senator Percy suggests might result.

I might also note that the ministerial committee we were talking about could probably assert itself if a few countries tried to establish some new de facto relationship between gold and the international monetary system, though my judgment is that the risk is minimal.

In the year and a half since the removal of U.S. restrictions on private ownership of gold bullion, the instability of the price of gold has been plain for all to see. That instability was evident well before the IMF gold sales started a few months ago.

I realize, of course, that some in this country and on this committee have expressed concern that the existing agreement among the major nations does not provide that the ban against trying to peg the price of gold will extend beyond early 1978.

On the other hand, I notice that even the French are not buying what they would be entitled to buy under their interpretation of that agreement.

I would be prepared to see that special agreement ended right now and I certainly wouldn't seek to prolong it.

In my view, the sooner the special legal status for gold is ended, the better, so that it will have a legal status no different from that of other commodities.

That is the surest way to remove temptation from those who would try to subject us again to the fragility of a gold-based system.

Finally I should mention that there is also a danger that the IMF will be allowed to degenerate to an automatic checkwriting machine through failure in practice to exercise its legal prerogative to determine which members are entitled to assistance and on what terms.

It has been recognized that it is important to distinguish between the IMF short- and medium-term general financial support and the long-term project assistance of the type provided by the World Bank and other agencies.

It is also generally recognized that loans from the IMF are no longer for the purpose of preserving particular exchange rates.

But there has been reliance to a disturbing degree on narrow formulas rather than the overall judgment in providing IMF loans.

Over the last few years quite a few billions were provided under a semiautomatic basis under the semiautomatic oil import facility, and new agreements provide for expansion of the compensatory financing ability based on a very limited view of a nation's external trade.

I think the dangers I have listed do exist. But they are recognized and thus can be avoided.

Any institutional framework could be subverted. Institutional arrangements are nonetheless important in determining results, and I am convinced that the new arrangements which have been negotiated represent a tremendous improvement over those of the past.

No longer does a structure center on an effort to prevent change in exchange rates.

As a result, the effort to deter disruptive governmental restrictions and interventions can now continue without the serious handicap under which it has labored in the past.

I think international cooperation in financial affairs now has a promising future.

For that reason, Mr. Chairman, I urge your committee to give prompt support of the proposed legislation before you.

Thank you.

Senator PROXMIRE. Thank you, Mr. Bennett.

Mr. Salant?

STATEMENT OF WALTER S. SALANT, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. SALANT. Mr. Chairman, I appreciate the privilege of being invited here as a witness.

The opinions that I will express and that are in my written statement, which I have submitted to the reporter, are personal opinions and not necessarily those of my colleagues or the trustees or officers of the Brookings Institution.

I might also note, in view of Congressman Rees' statement that the Brookings Institution had estimated the loss of employment due to some of the monetary practices followed, that those estimates should not be attributed to the Brookings Institution any more than any state-

ment should be. They are those of the particular staff member who made them.

The interim committee of Governors of the Monetary Fund, meeting in Jamaica, not only reached agreements about the substance of a comprehensive amendment to the articles of agreement of the Fund but reached other agreements that do not require changes in the articles.

Let me say that, although the agreements do not come close to solving all the problems of the international monetary system, I think Congress should authorize their acceptance.

My reason for this recommendation is that the agreements are on the whole, if not in all respects, a constructive step, and that they evidently represent the best that could be obtained through agreement among nations with diverse views on a number of issues.

Although the proposed amendments do not resolve some serious problems, they do provide a basis for doing so in the future. Further experience with the system, as it operates, may be needed before these first steps toward the improvement of international monetary arrangements can be followed by agreement about the matters remaining unresolved.

The subjects covered have conventionally been discussed under the various specific headings concerning which agreement was reached, such as exchange rate arrangements, agreements about gold, about special drawing rights, increases in the quotas of members of the Fund, liberalization of financing facilities, and so forth.

I think this organization of the subject is not very helpful in appraising the agreements, so I shall organize my remarks along more functional lines, considering the main aspects of the agreement in relation to the characteristics of the system that appeared to need improvement.

In the dozen or more years during which the working of the international monetary system has been intensively analyzed by professional economists and policymakers, there evolved a general agreement that the international monetary system had three major defects, which were related to each other, but separable.

The first was called the adjustment problem and refers to the lack of a satisfactory mechanism for maintaining equilibrium in balances of payments and for restoring it when it has been destroyed.

The second problem, called the liquidity problem, centered on the absence of any rational method for controlling the amount of international monetary reserves, so that they should grow fast enough to accommodate the growth in the need for reserves, but not so fast as to generate, or at least facilitate, inflation in the world as a whole.

Actually, international liquidity, even in the hands of international monetary authorities, consists not only of reserves but of facilities for borrowing, but the main defect in the system was regarded as centering on the reserves aspect of liquidity.

The third problem, dubbed the confidence problem, arose largely because the system permitted the use of several different kinds of reserve assets: Gold, national currencies, and reserve positions in the Fund, with the addition in 1969 of special drawing rights, which were created in part to remedy the liquidity problem. The confidence problem, insofar as it related to official reserves, referred to the dan-

ger that if a country became fearful that the value of one component of its reserve assets would depreciate in relation to other components, it would try to alter the composition of its reserves, and that efforts to do so would cause severe monetary disturbances.

For example, fear that a reserve currency was likely to depreciate in terms of gold would induce central banks to try to convert those currency reserves into gold, and this would cause a loss of reserves to the country in whose currency the reserves were being held, forcing the depreciation of that currency which was only feared before, causing losses to other holders of that reserve currency, and perhaps changing the total amount of reserves.

As long as countries were free to exchange one form of reserve for another, this was a danger. There was a corresponding problem of the confidence of private holders in the value of a currency, for a loss of confidence on their part could give rise to large reserve movements and also bring about the very developments which were feared.

The balance-of-payments adjustment problem arose largely because, for deficit countries under a system of fixed exchange rates, it implied the pursuit of relatively deflationary policies (that is, deflationary relative to those of other countries) and relatively expansive and possibly inflationary policies on the part of surplus countries.

But deflationary policies adversely affect employment and output, and deficit countries resist them.

Moreover, with U.S. dollars and a few other national currencies being held as reserves, the United States and other reserve-currency countries could finance deficits in their balances of payments without paying out reserve assets. The United States, for example, could do so by increasing its liabilities to foreign monetary authorities, so long as those monetary authorities were willing to hold the proceeds of their surpluses in dollar assets. In effect, the reserve-currency country in deficit could manufacture the international money with which to finance its own deficit, so that it was under no pressure to correct a disequilibrium in its balance of payments and the burden of adjustment was placed on their countries.

It will be seen that these difficulties arose from the effort to maintain fixed exchange rates, aggravated by the use of national currencies and international reserves.

The proposed amendment of the articles says almost nothing explicitly about the adjustment process, but it eliminates the legal obligation of member countries to maintain their currencies within a very limited range around their par values. This obligation has been generally ignored since March 1973, but the amendment, by releasing countries from the obligation, legitimizes the floating of exchange rates.

Under the proposed amendment, orderly exchange arrangements and a "stable system of exchange rates" are to be promoted by "fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions." That provision would replace the old provision for obligatory official intervention in the foreign exchange market.

The only reference to "adjustment" is in an undertaking by member countries "to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance-of-pay-

ments adjustment or to gain an unfair competitive advantage over other members."

That means that member countries undertake both to avoid depreciation of their currencies to gain an unfair competitive advantage and to allow depreciation and appreciation of their currencies when they are necessary for effective adjustment.

The provisions appear to do the minimum that needed to be done about balance-of-payments adjustment.

It is true, however, that they only express an objective. While countries undertake to avoid both the abuse of encouraging movements of rates not necessary for adjustment and the abuse of necessary movements, reliance evidently has been put on surveillance by the IMF of the practices of countries and on the adoption of "specific principles for the guidance of members." (Article IV, section 3b.) There are no new rules or sanctions to prevent abuses or violations. Their absence is the problem I see concerning adjustment. It may be that enough sanctions are already available, if the Fund is willing to use them. If not, this may be a problem.

The more immediate problem, however, and the major next effort of U.S. policy with regard to adjustment matters is to develop and promote adoption of a good set of principles for surveillance by the Fund.

With regard to international liquidity, it was generally agreed in the course of the discussions of reform that better control of the amount of official reserves was needed. And, in view of the problem of confidence in reserve assets, better control over their composition was also needed.

The influences determining both the amount and the composition of reserves under the old system, were generally regarded as irrational, being affected by gold production, by developments in the private demand for gold, by the state of the balance of payments of the United States and the other countries whose currencies were held as reserves, and other factors affecting the relative demands for reserve currencies.

This was the main reason why it was thought desirable to reduce or at least control the roles of gold and of reserve currencies in the system and to make the SDR the principal reserve asset.

As to the amount of reserves, in the early stages of discussion concerning reform of the system, many people feared that reserves would not grow fast enough to accommodate what they regarded as needed increases in them. More recently, many economists have come to fear that international reserves are excessive in amount and would encourage a continuation or acceleration of world inflation.

Under the old system an increase in national currency reserves without a concomitant increase in gold reserves would cause a loss of confidence in currency reserves and a run on reserve currencies that would break down the structure of exchange rates.

To remedy this problem it was thought necessary to find a way of consolidating reserves into one form, or at least to place some limits on the proportions in which the different forms of reserves were held. A number of suggestions were made about consolidation through so-called substitution accounts under which members would exchange the forms of reserves that it was desired to phase out for SDR's and other forms of reserves that it was thought desirable to retain.

The amendment makes no provision to meet this problem. It's only provision bearing on the composition of reserve assets is that members undertake to collaborate with the Fund and with each other, in order to insure that the policies of the member with respect to reserve assets are "consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system."

The only other agreement on this subject was that the executive directors "should continue their consideration of the subject of a substitution account," but that this work should not delay amendment of the articles.

Professor Fritz Machlup has called this lip service to the idea.

The amendments also include a number of provisions for making the holding of SDR's more attractive. It appears clear, however, that SDR's cannot be made of any great importance at the moment, whatever their future potentialities, since they are only about 4 percent of total reserves—\$10 billion out of a total of \$235 billion of national monetary reserves—and if gold is written up to its present market value, they would be little more than 3 percent.

With regard to control of the total volume of international reserves, the main relevant actions taken at Jamaica were those having to do with gold and surveillance by the Fund of the exchange rate and reserve policies of members and of the monetary system as a whole.

So far as gold is concerned, the amendments abolish its official price. This change frees national monetary authorities to write the book value of their gold reserves up to the market value.

If all monetary authorities write the book value of their gold up to \$105 per ounce, the recent approximate market value, this would raise the value of gold reserves, as of the end of May 1976, the most recent figure I have for all countries, from about \$41 billion to about \$101 billion, or by \$60 billion.

The agreement also eliminates all requirements to use gold in transactions with the Fund and prohibits the Fund from accepting gold, unless a specific decision requiring an 85-percent majority vote is made.

In addition, one-sixth of the Fund's holding of gold is to be sold in the market. If national monetary authorities buy this gold directly or indirectly after the articles are amended, there would be a further increase in official gold holdings, although it is a question whether monetary authorities would then regard gold holdings as reserves.

Another one-sixth or 25 million ounces of the Fund's gold holdings is to be returned to the member countries in proportion to their quotas in the Fund.

If the members write up the value of these 25 million ounces to \$105 an ounce, this would add another \$2.6 million to their gold reserves and almost \$1.6 billion to their total reserves (\$2.6 billion addition to their gold reserves, less approximately \$1.0 billion because they pay for it at the old official price).

If these possibilities occur, the changes in official gold holdings will be substantial and in the direction opposite to the one widely recommended.

In the first place, the distribution of the Fund's gold, disperses gold holdings instead of consolidating them.

Second, the changes increase, instead of reducing, the role of gold in the monetary system, at least so far as the amount of it is concerned.

Third, they increase the total amount of monetary reserves.

Fourth, when gold could be sold on at the official price, it was, in effect, frozen. By enabling monetary authorities to engage in gold transactions at the market price, the gold agreement makes it more liquid, which may make effective monetary reserves, even at the same stated values, larger than before.

The Group of Ten countries, which hold 73 percent of the world's gold reserves, agreed among themselves not to peg the price, at least in the next 2 years, and they also agreed that the total stock of gold in their hands and the hands of the Fund will not be increased, at least for 2 years.

The latter provision places a limit on purchases, but it does not rule out purchases of gold to support the price when it is weak.

The means of enforcing these restrictions, moreover, do not appear to be very strong. These monetary authorities agreed to report their official sales and purchases to the Fund, but only every 6 months, which seems very infrequent.

In short, the agreements appear to increase the role of gold in the system in some ways as much as they decrease it in other ways, and the ways in which they increase that role may be more important.

In particular, the arrangements permit substantial increases in monetary reserves at a time when there is still a general threat of world inflation.

Reviewing the agreements about the amendments and the other agreements concerning gold reserves as a whole, I have to agree with the critics of the agreement that the problems of control of liquidity and the composition of reserve assets were not resolved, and remain at least as great as they were before.

Hope for their solution may perhaps have been placed in the principles that the Fund is instructed to develop for surveillance of exchange rate arrangements, reserve assets, and the monetary system as a whole, and the possibility that experience in the next few years will permit agreement that cannot now be reached.

The question arises whether the failure to provide an effective means of controlling the size and composition of reserves is so serious that Congress should refuse to authorize U.S. acceptance of the agreements, despite the change from a rigid par value system to a system of flexible rates or free choice.

Several experts have expressed the opinion that this aspect of monetary reform remains essential and at least one regards it as urgent. The main reason for this belief is that an unduly large volume of reserves or an unduly rapid rate of their growth is bound to generate further world inflation.

My own opinion is that even if excessive creation of reserves is a serious problem, it is not especially urgent. The dangers seem to me to be of a longer run character.

One reason for that opinion is that even if the volume of world reserves or, more generally, of international liquidity influences the world price level, the relationship appears to be very loose and to operate slowly. An excessive level of world reserves exerts whatever inflationary impact it has by loosening the restraints of national monetary and fiscal authorities on their own policies, removing their

inhibitions against running larger deficits or smaller surpluses in their balances of payments than they otherwise would, and transmitting the resulting impulses to other countries.

If the economic authorities of the major countries are seriously determined to restrain inflation, they can do so; the growth of their holdings of international reserves can undermine that determination only by an insidious and slow process.

Increases of a country's international monetary reserves increase its money supply only when they are acquired by being purchased in the market with central bank money, and the big increase in reserves that will result from the Jamaica agreement is not of that character. It will be mainly a writing up of book values. The fact is that the reserves being acquired by intervention now are not very large.

While the reserves problem is one that requires solution, it is not so urgent that we should reject the agreements that have been reached, especially since there is no realistic reason for supposing that any better agreements could be reached in the near future.

The problem should continue to receive high-level attention, and we must hope that the accumulation of further experience under the existing arrangements and the passage of time will permit it to be solved.

I therefore think that the committee should recommend to the Congress that it authorize acceptance of the agreements.

I would add, however, that it should also recommend that Congress use whatever means are appropriate to press the executive branch to give highest priority in the field of international monetary matters to developing principles for Fund surveillance of exchange-rate and related policies and, second only to that, to control of the volume and composition of reserve assets.

Senator PROXMIRE. Thank you very much.

[The complete statement follows:]

THE JAMAICA AGREEMENT

Statement by Walter S. Salant *
Senior Fellow, Brookings Institution *
before the
International Finance Subcommittee
of the
Senate Committee on Banking, Housing, and Urban Affairs
August 27, 1976

The agreement reached by the Interim Committee of Governors of the International Monetary Fund at their meeting in Jamaica on January 7-8, 1976 consists of agreements about the substance of a comprehensive amendment to the Articles of Agreement of the Fund and other agreements that do not require changes in the Articles. The United States cannot accept the proposed changes in the Articles and some of the other agreements without Congressional authorization, although that is not true of all the matters agreed upon at Jamaica. I understand that the primary issue before the Committee is whether the Congress should authorize acceptance of the Agreements for which authorization is required, but that, beyond that, the Subcommittee is interested in the broader issues with which the Jamaica meeting was concerned. Let me say at the outset that although the Jamaica Agreement does not come close to solving all the problems of the international monetary system or even all those on which experts had evolved substantial agreement in the discussions of recent years, I think the Congress should authorize their acceptance.

My reasons for recommending that Congress authorize acceptance of the agreements are that they are, on the whole, if not in all respects,

* The opinions expressed in this statement are my personal opinions and not necessarily those of the trustees, officers, or other staff members of the Brookings Institution.

a constructive step, and that they evidently represent the best that could be obtained through agreement among nations with diverse views on a number of issues. Although the proposed amendments do not resolve some serious problems, they do provide a basis for doing so in the future. Further experience with the system as it operates may be needed before these first steps toward the improvement of international monetary arrangements can be followed by agreement about the matters remaining unresolved.

The subjects covered have conventionally been discussed under the various specific headings concerning which agreement was reached, such as exchange rate arrangements, agreements about gold, about special drawing rights (SDRs), increases in the quotas of members of the Fund, liberalization of financing facilities, and so forth. I think this organization of the subject will not be very helpful in appraising the agreements, so I shall organize my remarks along more functional lines, considering each aspect of the agreement in relation to the characteristics of the system that appeared to need improvement.

In the dozen or more years that the working of the international monetary system has been intensively analyzed by professional economists and policymakers, there evolved a general agreement that the international monetary system had three major defects, which were related to each other but separable. The first was called the adjustment problem, by which is meant the lack of a satisfactory mechanism for maintaining equilibrium in balances of payments and for restoring it when it has been destroyed. The second problem, called the

liquidity problem, centered on the absence of any rational method for controlling the amount of international monetary reserves so that they should grow at a rate that is not too slow to accommodate the growth in the need for reserves, but also so that they do not grow so rapidly as to generate, or at least facilitate, inflation in the world as a whole. Actually, international liquidity, even in the hands of international monetary authorities, consists not only of reserves but of facilities for borrowing, but the main defect in the system was regarded as centering on the reserves aspect of liquidity.

The third problem, dubbed the confidence problem, arose largely because the system permitted the use of several different kinds of reserve assets: gold, national currencies, and reserve positions in the Fund, with the addition in 1969 of special drawing rights, which were created in part to remedy the liquidity problem. The confidence problem, insofar as it related to official reserves, referred to the fact that if a country holding its reserves in one form became fearful that the value of that component of its reserves would depreciate in relation to other components, it would try to alter the composition of its reserves and that efforts to do so would give rise to monetary disturbances. For example, fear that a reserve currency was likely to depreciate in terms of gold would induce central banks to try to convert those currency reserves into gold, and this would cause a loss of reserves to the country in whose currency the reserves were being held, forcing the depreciation that was only feared before and causing losses to the other holders of the reserve currency. As long as countries were free to exchange one

form of reserve for another this was a danger. There was a corresponding problem of the confidence of private holders in the value of the currency, for a loss of confidence on their part could give rise to large reserve movements and bring about the very developments which were feared.

Balance-of-Payments Adjustment

The adjustment problem arose largely because, for deficit countries under a system of fixed exchange rates, it implied the pursuit of relatively deflationary policies (i.e., deflationary relative to those of other countries) and relatively expansive and possibly inflationary policies on the part of surplus countries. But deflationary policies adversely affect employment and output, and deficit countries resist them. Moreover, with U.S. dollars and a few other national currencies being held as reserves, the United States (and other reserve-currency countries) could finance deficits in their balances of payments without paying out reserve assets; the United States, for example, could do so by increasing its liabilities to foreign monetary authorities, so long as these monetary authorities were willing to hold the proceeds of their surpluses in dollar assets. In effect, the reserve-currency country in deficit could manufacture the international money with which to finance its own deficit, so that it was under no pressure to correct a disequilibrium in its balance of payments and the burden of adjustment was placed on other countries.

It will be seen that these difficulties arose from the effort to maintain fixed exchange rates, aggravated by the use of national currencies and international reserves.

The proposed amendment of the Articles says nothing explicitly about the adjustment process, but it deletes the provisions of the Articles that obligate member countries to maintain their currencies within a very limited range around their par values. This obligation has been generally ignored since March 1973, but the amendment, by releasing countries from the obligation, legitimizes the floating of exchange rates. Under the proposed amendment, orderly exchange arrangements and a "stable system of exchange rates" are to be promoted by "fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions," rather than by obligatory official intervention in the foreign exchange market. The only reference to "adjustment" is in an undertaking by member countries "to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." That means that member countries undertake both to avoid depreciation of their currencies to gain an unfair competitive advantage and to allow depreciation and appreciation of their currencies when they are necessary for effective adjustment.

The amendment is very permissive with regard to the choice of exchange arrangements. Members may peg their currencies to another currency, float alone, or float jointly with others, as they please. They may declare par values in terms of anything except gold. The Articles also would permit the introduction of a widespread system of "stable but adjustable" par values, but only by an 85 percent majority of the total voting power.

Since the United States will have more than 15 percent of the voting power, it will be in a position to veto the introduction of such a system. Moreover, the decision to introduce such a system shall be made, according to the amended Articles, in the light of (among other things) "arrangements under which both members in surplus and members in deficit in their balances of payments take prompt, effective, and symmetrical action to achieve adjustment." (Article IV, Section 5.) Even then, any country can refuse to establish a par value, so long as it consults with the Fund and ensures that its exchange arrangements "are consistent with the purposes of the Fund and are adequate to fulfill its obligations" under Article IV, Section 1. The par values that would be established may be defined in terms of SDRs or any other common denominator prescribed by the Fund, except that it may not be established in terms of gold or a currency. (See Schedule C, Paragraph 1.) Even when countries establish par values, they may allow the spot rates for their currencies to vary within 4½ percent on either side of the par value, unless some other margin is adopted by an 85 percent majority. (Schedule C, Paragraph 5.) This provision permits a range of fluctuation between any two such currencies of 18 percent, a much wider range than was permitted under the original Articles of Agreement.

These arrangements appear to do as much as needs --in the literal sense-- to be done about balance of payments adjustment. It is true, however, that they only express an objective. While there are declarations in the amendment about avoiding abuses, both by encouraging and by refusing to allow rates to move up or down, the emphasis is on surveillance by the IMF

of the practices of countries and on the adoption of "specific principles for the guidance of members." (Article IV, Section 3b.) There are no new rules or sanctions to prevent abuses or violations. Their absence is the problem I see concerning adjustment. It may be that enough sanctions are already available, if the Fund is willing to use them. If not, this may be a problem. The more immediate problem, however, and the major next effort of U.S. policy with regard to adjustment matters is to develop and promote adoption of a good set of principles for surveillance by the Fund.

International Reserves

With regard to international liquidity, it was generally agreed in the course of the discussions of reform that better control of the amount of official reserves was needed. And, in view of the problem of confidence in reserve assets, better control over their composition was also needed. The influences determining both the amount and the composition of reserves under the old system were generally regarded as irrational, being affected by gold production, by developments in the private demand for gold, and by the state of the balance of payments of the United States and the other countries whose currencies were held as reserves. This was the main reason why it was thought desirable to reduce or at least control the roles of gold and of reserve currencies in the system and to make the SDR the principal reserve asset.

As to the amount of reserves, in the early stages of discussion concerning reform of the system many people feared that reserves would not grow fast enough to accommodate what they regarded as needed increases

in them. More recently, many economists have come to fear that international reserves are excessive in amount and would encourage a continuation or acceleration of world inflation.

Under the old system it was also feared that an increase in national currency reserves without a concomitant increase in gold reserves would cause a loss of confidence in currency reserves and a run on reserve currencies that would break down the structure of exchange rates. To remedy this problem it was thought necessary to find a way of consolidating reserves into one form or at least to place some limits on the proportions in which the different forms of reserves were held. A number of suggestions were made about consolidation through so-called "substitution accounts" under which members would exchange the forms of reserves that it was desired to phase out for SDRs and other forms of reserves that it was thought desirable to retain. The amendment makes no provision for such a substitution account. The only provision that I have found in the amendment bearing on the composition of reserve assets is that, under Article VIII, Section 7, each member "undertakes to collaborate with the Fund and with other members in order to ensure that the policies of the member with respect to reserve assets be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing rights of the principle reserve asset in the international monetary system." Apart from this, the only thing agreed to at Jamaica is that the Executive Directors "should continue their consideration of the subject of a substitution account," but that this work should not delay amendment of the Articles.

Professor Fritz Machlup has called this "lip service" to the idea, and his characterization seems to me justified. There may not be a problem of shifts between gold, SDRs, and the dollar, but there will still be danger of shifts between currencies and a threat to the stability of exchange rates that is not justified by needed adjustments in balances of payments.

The amendments also include provision for making the holding of SDRs more attractive. They delete the existing limitation on the rate of interest payable on holdings of SDRs, making the rate subject to determination by a 70 percent majority of the Fund's voting power. They also widen the role of SDRs by making it easier for central banks to use them to enter into SDR transactions with each other without special authorization by the Fund and by dropping the present requirement of Article XXV, Section 3(a) that a country demonstrate a need to exchange reserve assets in order to meet specific financing requirements. Other changes widen the categories of possible holders of SDRs to include official entities other than countries participating in the SDR arrangements and permit transactions among holders who are not participants. These and other provisions for making SDRs a more attractive reserve asset (which are explained on pages 68-72 of the report by the Executive Directors of the IMF to the Board of Governors, dated March 1976) are highly technical and need not be considered here. It appears clear, however, that they cannot be of any great importance at the moment, whatever their future potentialities, since SDRs were only about 4 percent of total reserves at the end of May 1976 (\$10 billion out of a total of \$235 billion of national monetary reserves)

and if gold is written up to its present market value they would be little more than 3 percent.

With regard to control of the total volume of international reserves, the main relevant actions taken at Jamaica are those having to do with gold and surveillance by the Fund of the exchange rate and reserve policies of members and of the monetary system as a whole. (Surveillance of exchange rates and policies and reserve practices are referred to in Article IV, Section 3 and in Article VIII, Section 7).

So far as gold is concerned, the amendments abolish its official price. This change frees national monetary authorities to write the book value of their gold reserves up to the market value. If all monetary authorities write the book value of their gold up to \$115 per ounce, the recent approximate market value, this would raise the value of gold reserves (as of the end of May 1976, the most recent figure I have for all countries) from about \$41 billion to about \$111 billion, or by \$70 billion. The agreement also eliminates all requirements to use gold in transactions with the Fund and prohibits the Fund from accepting gold unless a specific decision requiring an 85 percent majority vote is made. In addition, one-sixth of the Fund's 150-million-ounce holding of gold are to be sold in the market. If national monetary authorities buy this gold directly or indirectly after the Articles are amended, there would be further increase in official gold holdings, although it is a matter of opinion whether these would then be regarded as "reserves." If they buy gold from the Fund such purchases reduce their other reserves.

Another one-sixth or 25 million ounces of the Fund's gold holdings is to be returned to the member countries in proportion to their quotas in the Fund. If the members write up the value of these 25 million ounces from \$42.22 an ounce to \$115 an ounce, this would add another \$2.9 billion to their gold reserves and \$1.8 billion to their total reserves (\$2.9 billion addition to their gold reserves less \$1.1 billion which they pay for at the official price).

If both of these last two possibilities occur, that is, national monetary authorities buy the gold that the Fund sells and also mark up the amounts that are restituted, the changes in gold reserves are in the direction opposite to the one widely recommended. In the first place, these changes disperse gold holdings instead of consolidating them. Second, they increase instead of reducing the role of gold in the monetary system. Third, they increase the total amount of monetary reserves. Fourth, when gold could be sold only at the official price it was in effect frozen. By enabling monetary authorities to engage in gold transactions at the market price, the gold agreement makes it liquid, thereby making effective monetary reserves, even at the same stated values, larger than before.

The Group of Ten countries, which hold 73 percent of the world's gold reserves, agreed among themselves not to peg the price of gold, at least in the next two years, and they also agreed that they would not use their freedom to buy it in such a way as to increase the total stock of gold in their hands and the hands of the Fund. The latter provision places a limit on purchases, but it does not rule out purchases of gold to support the price when it is weak, since it leaves the monetary authorities free

to engage in gold transactions at market-related prices subject to these restrictions. The means of enforcing these restrictions, moreover, do not appear to be very strong. The monetary authorities are not even required to report official sales and purchases more frequently than every six months.

In short, the agreements in Jamaica appear to increase the role of gold in the system in some ways as much as they decrease it in other ways, and the ways in which they increase that role may be more important. In particular, the arrangements permit substantial increases in monetary reserves at a time when there is still a general threat of world inflation. Reviewing the agreements about the amendments and the other agreements concerning gold reserves in general, I have to agree with the critics of the agreement that the problems of control of liquidity and the composition of reserve assets were not resolved, and remain at least as great as they were before. Hope for their solution may perhaps have been placed in the principles that the Fund is instructed to develop for surveillance of exchange rate arrangements, reserve assets, and the monetary system as a whole and the possibility that experience in the next few years will permit agreement that cannot now be reached.

The question arises whether the failure to provide an effective system for controlling reserves is so serious that Congress should refuse to authorize U.S. acceptance of the agreements, despite the desirable change from a relatively rigid par value system to a system of flexible rates or free choice or, if you prefer, to a non-system. It is

generally agreed that in a system in which exchange rates float freely --that is in which there is no official intervention-- reserves are of little concern; all disequilibria between the demand for a currency and the supply of it are reflected in the price, so that reserves are not needed. Since it is clear, however, that we do not and shall not have that kind of system but rather one in which exchange rates are managed, the question is how important reform of the reserve system is under such an arrangement.

Several experts have expressed the opinion that this aspect of monetary reform remains essential and at least one regards it as urgent. The main reason for this belief is that an unduly large volume of reserves or an unduly rapid rate of their growth is bound to generate further world inflation. Governor Henry Wallich of the Federal Reserve System, while recognizing that the relations between international liquidity and payments positions is very loose, believes that reserves matter. He notes that acquisition of reserves through intervention in the foreign exchange markets expands bank reserves and the domestic money supply. He also argues that acquisition of liquidity, whether in the form of reserves or credit facilities, increases the proportion of national income that is imported, although he recognizes that this is not true of all countries, and that reserves also influence the policies of some countries with respect to exchange rates, so that effective control of international liquidity and of gross reserves, which are an important part of such reserves, does influence economic policy and behavior. He regards this conclusion as no less valid under floating than under fixed exchange rates and concludes

that international liquidity in general and reserves in particular do matter. Mr. Tom de Vries, an Alternate Executive Director of the Fund, in an article in the April 1976 issue of Foreign Affairs entitled "Jamaica or the Non-Reform of the International Monetary System", says that the system permits a country to obtain the amount of reserves it prefers by borrowing and manipulating its exchange rate and that this system, in which total reserve creation is determined by demand, is bound to reinforce inflationary tendencies in the world. For this reason he regards the problem of controlling international liquidity as an urgent unsolved question. Professor Robert Triffin of Yale University, who diagnosed some of the problems inherent in the Bretton Woods system as long ago as 1960, also criticizes the agreements on this score, as well as on others.

My own opinion is that even if excessive creation of reserves is a serious problem, I doubt that it is especially urgent. The dangers seem to me to be of a longer run character. One reason for that opinion is that even if the volume of world reserves or, more generally, of international liquidity influences the world price level, the relationship appears to be very loose and to operate slowly, as Governor Wallich recognized in the course of his own argument. An excessive level of world reserves exerts whatever inflationary impact it has by loosening the restraints of national monetary and fiscal authorities on their own policies, encouraging them to run larger deficits or smaller surpluses in their balances of payments than they otherwise would and transmitting the resulting impulses to other countries. If the economic authorities of the major countries are seriously determined to restrain inflation, the growth of

their holdings of international reserves can undermine that determination only by an insidious and slow process. Increases of a country's international monetary reserves increase its money supply only when they are acquired by being purchased in the market with central bank money, and the big increase in reserves that will result from the Jamaica agreement --the capital gain from the increase in the book value of gold reserves-- is not of that character. The fact is that the reserves being acquired by intervention now are not very large. I therefore regard the problem as one that requires solution, but as one not so urgent that we should reject the agreements that have been reached, especially since there is no realistic reason for supposing that any better agreements could be reached in the near future. The problem should continue to receive high-level attention, and we must hope that the accumulation of further experience under the existing arrangements and the passage of time will permit it to be solved. That view may be regarded as defeatist but the acceptance of the agreements that it implies is more realistic and less defeatist than would be a rejection of the proposed amendments to the Articles of Agreement. I therefore think that the Committee should recommend to the Congress that it authorize acceptance of the amendments. I would add, however, that it should use whatever means are appropriate to press the Executive Branch to give highest priority in the field of international monetary matters to developing principles for Fund surveillance of exchange rate and related policies and second only to that, to control of the volume and composition of reserve assets.

Senator PROXMIRE. Professor Aliber, again I apologize for the late hour. You gentlemen are very, very patient.

Professor ALIBER. Thank you, Mr. Chairman.

It is a privilege to be here, especially among such distinguished colleagues.

I would ask that my statement be inserted in the record.

Senator PROXMIRE. Yes. It will be.

**STATEMENT OF ROBERT Z. ALIBER, GRADUATE SCHOOL OF
BUSINESS ADMINISTRATION, UNIVERSITY OF CHICAGO**

Professor ALIBER. I will speak briefly to three or four of the major highlights in my statement.

There is, I think, a great deal that I would agree with that my colleagues on the panel have said today and a great deal that I disagree with. I support the legislation. I think I should indicate that I think the legislation is unimportant in terms of its economics. We are largely at the stage of monetary reform where the end is the means. This is part of an ongoing process. We are at a stage in which the future shape of the system is not yet definable and the rules for that system are still premature.

If we look at monetary agreements they are essentially two types. One type is prospective and really affects the future behavior of countries. The Bretton Woods Agreement was of that model.

Most other agreements are retrospective. What one essentially does is legitimize the ongoing behavior of countries and the agreements have minimal impacts on their behavior. This agreement clearly is in the second set. The world is not going to be significantly different if this legislation is passed, if we have the Jamaica agreements. What we are essentially dealing with is the trade-off between rules and of market forces.

In the 1960's we saw great pressures on that fight, the rules became increasingly inconsistent with the market forces. The market forces were observable in the gold market and the gold parity which was deemed such a large central part of the system finally was changed. The system pegged exchange rates, which were part of the rules, gave way under the pressure of market forces.

As we look to the future, one of the problems we have to see is what is going to be the nature of market forces and what is going to be happening in the exchange market.

Two points, I think, are important here. Both point to the responsibilities that fall on the United States. If the United States succeeds in adopting stable monetary policies, then we have laid the necessary conditions for monetary stability around the world and we will observe almost automatically that the fluctuations in exchange rates become smaller and smaller and that we will have laid the basis for a system of stable parities.

Whether there are then advantages in legitimizing a par value system can be determined at that time, but the advantages clearly are going to be small, rather than large. If we do not succeed in getting price stability, then the efforts to use rules to get to stable exchange rates are going to prove unsuccessful and efforts at monetary reform will accomplish very little. So, we have the necessary condition in successful domestic policies, the sufficient condition is that the United

States then take leadership in getting rules to legitimize the exchange rate, practices, and behavior that we would then observe. So, at this time, it is, I think, essentially premature to try to do anything about monetary reform.

We should take those measures which are necessary to stabilize the system. In the interim future to achieve and lend some stability to the gold market. Gold is an extremely important monetary asset. We have, in the United States, "kidded" ourselves about the role of gold in the system. Gold was dethroned from the system in 1913. It's really been a peripheral asset ever since. We gave it undue importance in the 1960's because we became fascinated with the fixed price relationship and because we became obsessed with the political costs of changing the gold price. Gold is either the most important reserve asset in the system or is the second most important reserve asset in the system.

Cost is extremely important to many countries. Many of these countries are friends and allies. No U.S. interest is served by the large instability that we have had in the gold market. No great costs would be imposed on the United States and participating arrangements in limiting gold price movements.

Most of the instability in the gold price movements that we have seen in the last 3 or 4 years have come about because of the actions of governments. The large gold price increases that began in 1972, continued through 1973, were a reflection of the distrust in money, the feeling that rates of inflation were going to continue to accelerate.

The downturn in gold prices since 1974 has relatively little to do with U.S. legislation or the U.S. gold sales. The downturn came about because expectations of inflation were changing very sharply. The sharp downturns we have seen in the gold price in recent months must be due to the IMF gold sales.

I thank you, Mr. Chairman.

[Complete statement follows:]

STATEMENT OF

ROBERT Z. ALIBER

PROFESSOR OF INTERNATIONAL ECONOMICS AND FINANCE,

GRADUATE SCHOOL OF BUSINESS,

UNIVERSITY OF CHICAGO

AUGUST 27, 1976

Before the International Finance Subcommittee of the Committee on Banking, Housing, and Urban Affairs on S. 3454, a bill to amend the Bretton Woods Agreements Act, August 27, 1976

It is an honor to be invited to testify on the Jamaica Agreement,

This agreement should be ratified by the Congress. The importance of the agreement is that it legitimatizes the existing exchange market arrangements, especially the widespread move to floating exchange rates by the industrial countries. The cessation of central bank intervention in the foreign exchange market at established parities contravened the legal rules of the Bretton Woods system; the United States and other countries have ignored their treaty commitments.

The evidence of the last three years suggests that floating rates will work even without a treaty; the Jamaica Agreement adds little if anything to the economics of the system. The agreement enhances the importance of rules in international monetary arrangements--of a cooperative approach to common problems, and an agreed procedure for reconciling conflicts.

It would be misleading to suggest that the meaningful steps have been taken toward what is usually meant by monetary reform. What has happened is largely procedural. The rules will have minimal impact on exchange market practices. But to expect significant progress on monetary reform while inflation rates range between 5 and 10 percent in the major industrial countries involves a misunderstanding of what monetary reform is all about.

The amendment to the Bretton Woods Agreement provides an opportunity to review the U.S. positions on international monetary policy over the last fifteen years, and to contemplate the most appropriate posture for future changes in monetary arrangements--where the United States wishes to go, and how it might best get there.

International monetary reform has been on the agenda for more than fifteen years since Professor Triffin of Yale published the Gold and the Dollar Crises. Monetary reform involves changes in commitments that countries make to each other, either bilaterally, or more recently, on a multi-lateral basis. They may commit themselves to lend to others, to intervene (or not to intervene) in the exchange market at particular rates, to buy (or sell) gold at fixed prices, to raise (or lower) interest rates, to maintain the growth of their monetary variables within certain limits, and to avoid the use of exchange controls. There have been numerous changes in institutional arrangements, such as the General Arrangements to Borrow, the reciprocal credit arrangements among central banks, the Special Drawing Rights arrangements, increases in IMF quotas, the gold pool, the two-tier gold system, and the Smithsonian Agreement. Those agreements involving transfers of credit generally have been treaty-based (in part because the domestic funds involved in the extension of credit are treated as a public expenditure in the national financial accounts); those concerned with gold and exchange rates involve executive agreements, at least initially.

Reform agreements fall into two groups--some are prospective, and attempt to influence the future international monetary behavior of participating countries. One model is that of the Bretton Woods Agreement, which promulgated a set of rules for the exchange market practices of individual countries which differed sharply from their then-current practices. The Keynes Plan for an international clearing union, and numerous plans for world central banks in the 1960's are in this group. Some agreements are retrospective in that they tend to codify the current mode of monetary behavior. Thus the Jamaica Agreement codifies the current

pattern of exchange market arrangements; countries can permit their currencies to float or they can peg their currencies. Accordingly accepting the commitments which are contained in the reform package requires no significant change in the exchange market behavior or practices of any Fund member.

The prospective approach to monetary reform implies that market forces or policies should be constrained to conform to the rules, while the retrospective view implies that the rules would not be inconsistent with the practices or behavior of the participants.

Countries can peg their currencies or permit them to float without a monetary agreement. Similarly, they can lend to each other on an ad hoc basis without any agreement. So it is appropriate to consider the advantages that result from an agreement.

Treaties like other contracts offer the advantage that each participant can have greater confidence in the actions that other participants might take in particular circumstances. The rules then tend to constrain what might be called--rather loosely--the pressures of market forces. For example, under the pegged rate system, disturbances might cause a currency to weaken or strengthen; the rules limited the movements in the rate.

This conflict between rules and market forces is evident in the U.S. policy in recent years toward gold and the system of pegged exchange rates. Much of the U.S. energy in international monetary relations in the 1960's was an attempt to adhere to a gold parity and a set of exchange rates that were becoming increasingly inconsistent with market forces. In the 1960's, the thrust of U.S. policy was to avoid a change in the dollar price of gold. There was a gold shortage in that the private demand and foreign official demand exceeded new production; gold was becoming increasingly under-priced, and only U.S. gold sales maintained the price at \$35. Eventually, as U.S.

gold holdings declined, and measures to devise substitutes for gold proved less than completely successful, it became necessary to acquiesce to market forces, and cease pegging the price of gold.

In the late 1960's and early 1970's, as the U.S. inflation rate increased relative to rates in other industrial countries, the dollar became progressively overvalued. Market pressures indicated that exchange parities would have to be changed. The U.S. authorities, after belatedly recognizing that a realignment of parities was necessary, sought to avoid any U.S. initiative. Foreign authorities generally were no more eager.

Eventually a new set of rates was negotiated in the Smithsonian Agreement. But the market pressures, in the form of divergent rates of price inflation in the major industrial countries, meant that the pattern of rates negotiated in Smithsonian was obsolete almost as soon as it was negotiated.

Throughout 1972, U.S. policy remained committed to stable but adjustable rates. A year later, U.S. policy was strongly committed to floating rates. Floating rates came about not because of plan or design, but because pegged rates were not feasible, since they were no longer credible. Investors had lost confidence in the statements of national authorities that the parities would be maintained--all too frequently such statements had, because of the exigences of market forces, proved inoperative.

In 1973 and 1974, the swings in exchange rates--especially between the dollar and the mark--were very large, much larger than would have been predicted from changes in relative price level. Observers were concerned that such large swings would deter international trade and investment, and perhaps impart an inflationary bias by raising the price of imports. The U.S. authorities were extremely reluctant to intervene in the exchange market

to dampen the range of rate movements.

Within two or three years, U.S. policy had gone from the extreme of attempting to forestall variations in the exchange rate to the extreme of considering it undesirable to dampen rate movements. In the first case, the adjustments in exchange parities were too long delayed; in the second, the movements in exchange rates were too large and too sudden. In part the sharp shift in the U.S. position from a strong support of pegged rates to a sharp support of floating rates reflects a retrenchment in U.S. international commitments--or in the U.S. view of its commitments.

U.S. international financial policy has not been a success, in that costs have been incurred to avoid changes that were probably inevitable. These costs varied. Some wasted the taxpayer's money, like shipping Milwaukee beer to Munich. Some reduced credibility of U.S. commitments for statements were made that would soon be proven incorrect. The U.S. alliance relationships were weakened, since undue pressures were placed on other countries to do something about the balance of payments that must have reduced their willingness to make other accommodations to U.S. requests. And the policy impasse about changing parities in the 1969-71 period was a major cause of the Great Inflation two years later.

A major error in U.S. policy has been its stand-patism--its failure to appreciate the strength of market forces, and the exaggeration of the strength of rules in resisting market forces. Almost inevitable, the largest country in the system is likely to have a stronger interest in the status quo than other countries, and for several reasons. One is that credibility is much more important to a large country than to smaller countries; the large country is likely to place greater value in commitments. Moreover the largest country has a large interest in the stability of the system.

The second U.S. policy error has been the failure to recognize the external consequences of U.S. domestic behavior and especially the U.S. role as a source of monetary disturbances; the U.S. inflation and the long delay in changing parities was a major cause of the breakdown in the Bretton Woods system of pegged exchange rates. It is generally accepted that the payments balance or the exchange rate ought not to prove a barrier in selecting the appropriate domestic policies. But that proposition does not mean that the United States should ignore the consequences on other countries of inappropriate domestic U.S. policies.

That the United States is the largest single country in the system has several important implications for the negotiations on monetary arrangements in the future. One is that U.S. economic policy is much the most important in determining the economic stability of the system--in the changes in the world price level. The second is that the rules are inevitable designed to constrain U.S. behavior, and so the concern is whether the United States will agree to a set of rules that might be more constraining on the United States than on others. (The negotiations leading to the Bretton Woods system were atypical, for given the tremendous dependence of other countries on the United States, they were not in a position of bargaining equality.) The third factor is that the United States is the most important country when the rules of the system are to be negotiated; if the United States can no longer hope that its recommendations will be readily accepted, by other countries, it retains a formal and informal veto over their initiatives. And so the United States must be concerned with which constraints it might accept on its choice of measures because a wider interest is served.

It is frequently suggested that pegged exchange rates may impose a constraint on the choice of domestic policy, and hence impose a cost. Similarly, the \$35 gold parity was said to be a constraint. Both commitments provided

other industrial countries with somewhat greater confidence about the movements in exchange rates.

As we look beyond the Jamaica Agreement, two responsibilities fall on the United States. One involves following the domestic economic policies that are appropriate for international economic stability. The second is that of participating in institutional arrangements that will enhance the stability of international financial arrangements. These two propositions are closely tied. Unless U.S. domestic economic policies result in stability, efforts to stabilize the system by new institutional arrangements will not be successful. If domestic policies are successful, then the costs that fall on the United States of measures to enhance the stability of the system will be small. The responsibility for stabilizing economic policy lays no additional burden on the United States--what is good for U.S. domestic economic policy in terms of measures for appropriate price and employment targets is good for the rest of the world.

If the United States is not successful in stabilizing its own economy, so that the inflation rate drops and the cyclical variations in income decline, the international monetary arrangements will not prove stable, and efforts to devise new institutional arrangements are likely to be wasted.

If the United States stabilizes its own economy, there are additional payoffs to participating in institutional arrangements which stabilize international markets. The U.S. national interest is served by orderly and stable arrangements. Such arrangements facilitate trade and high level employment. Otherwise U.S. trading partners will be subject to alternate rounds of inflation and recession. Foreign governments will find it difficult to cope with these shocks, threatening their ability to govern.

From time to time, the United States may find its interest served by the

extension of credit to another government, either directly or through an international financial intermediary. Such credit will facilitate the adjustment to shocks, both shocks like world recession or the oil price increase, or domestic shocks like crop failure.

As major industrial countries stabilize their price levels, exchange rates will follow a more stable pattern. Countries that want to peg their currencies will be able to do so.

Even before exchange rates stabilize, however, the United States should take the initiative in stabilizing the gold market. Gold has a long and monetary history. Central banks hold about \$150 billion of gold in their reserves (valued at \$100 an ounce). Efforts to demonetize gold can only be disruptive; even the IMF gold sales for the Trust Fund are unsettling. Gold is important in the reserves of other countries. No important U.S. interest by sharp changes in gold price. Gold can remain a monetary asset and at the periphery of the system.

Senator PROXMIRE. Thank you very much.
Our final witness is Mr. Sidney Brown.
Mr. Brown.

**STATEMENT OF SIDNEY BROWN, VICE PRESIDENT AND ECONOMIST,
EDITOR OF THE DEAK-PERERA REPORT, DEAK & CO., INC.**

Mr. BROWN. My remarks will be very short.

I would like to stress that I am speaking for myself and not for Deak & Co.

As you know, it is always to the advantage of foreign exchange traders to have a highly volatile foreign exchange market and not a stable one.

The latter is what I happen to endorse.

I was cognizant of the excellent questions Senator Stevenson had in the Congressional Record with regard to the hearings.

I thought they were superb and something I would like to see students and professors address themselves to.

Because of the shortness of time and all other consideration, I thought I would go to the heart of those questions that were raised.

There are two reasons as to why the proposed amendments to the International Monetary Fund should be postponed. The delay should last until the ambiguous, vacuous, and contradictory revisions are cleared up.

Then, and only then, would Congress be able to know what it is voting for, clearly and not blindly.

As presently advanced, the amendments would legalize the present foreign exchange rate confusion and unnecessary turmoil. They are hardly an improvement over what the present Bretton Woods system provides, if implemented.

Currency devaluations and central banking interventions, since floating commenced, have been on a scale that far surpasses the worst that occurred under pegging.

Moreover, a firmer hand on the IMF tiller and deficit member countries' willingness to submit to the Fund's lending conditions would, in my opinion, have provided a viable, practical, and efficient international monetary system.

Reason No. 1 is found in amended article IV, section 1. It deals with members' obligations. Each member is obligated to "assure orderly exchange arrangements," and at the same time "promote a stable system of exchange rates."

The phrase "orderly exchange arrangements" is a euphemism for complete freedom, as is done illegally now, to select any kind of an exchange rate system any member desires, legally.

For example, some members, as they now do, can peg their currencies to the U.S. dollar, or to a basket of currencies using a formula of their own making.

Or they can latch on to the SDR. Some members have allowed their currencies to float independently, and others have agreed their currencies should float jointly.

As confusing as this may be, and it is, even though we are concerned here with major countries, the degree to which there may be clean or dirty central bank intervention in the foreign exchange markets,

and nonmonetary restrictions, complicates the chaos even more, if that is possible.

Business internationally can live with this confusion, but no one denies that it has added unnecessarily to costs, wasted resources, and complicated financing.

Even in times of catastrophe, business can manage to perform and even prosper, but that is not, from an economic viewpoint, the system under which business should be forced to operate.

Even if the above confused situation could be ignored, there still remains the other permissible obligation, to promote a stable system of exchange rates.

How the two can be reconciled is difficult to imagine.

One, you permit a member to select any kind of an international exchange rate system, and, two, you ask that the member pursue a stable rate system.

To resolve this incompatibility, the drafters presented the following theory as to how it can be done. The amendment calls upon members to conduct internal economic and financial policies in such an orderly and sound manner that no matter what exchange rate system they elect, a stable exchange rate system would automatically evolve.

Even under a pegged rate system, however, countries would have to also foster stable, noninflationary growth policies to maintain their currencies' strength.

However, without the mandatory requirements of remaining in the pegged band permitted, they would not have the compulsion that is missing in the permissible system of choice granted in the amendment.

The administration places a great deal of confidence in that obligation which calls upon members to refrain from avoiding exchange rate manipulation to prevent balance-of-payment adjustment or to gain an unfair competitive advantage.

This is strange confidence indeed, one without teeth, because the drafters left out the June 1974 international monetary reform proposals calling for floating exchange rate guidance involving graduated pressures and various indicators to prevent or stop just that, that is, manipulation.

Actually, section 1 is a paean to naivete and permissiveness.

The greatest amount of faith the administration places on the workability of the proposed amendments is to be found in section 3 of the same article. It calls upon the Fund to also do the impossible.

The Fund, it says, "shall exercise firm surveillance over the exchange rate policies of members (sic)."

Moreover, the Fund "shall adopt specific principles for the guidance of all members with respect to those policies."

Congress would be buying a pig-in-the-poke if it voted for statutory change without knowing in advance exactly what specific principles the drafters have in mind.

In addition, just what constitutes firm surveillance inasmuch as the June 1974 stab at international monetary reform with teeth has been quietly and conveniently buried as a lost cause.

The saddest feature of the revision is the most incongruous. After all the homilies have been paid to relying on the good, unselfish nature of the major competitive nations, to bring about a so-called superior

international monetary system, the policeman's hands are tied to make sure that under no circumstance could it crack down on an errant member.

The Fund is directly and distinctly informed that its vague firm surveillance and specific principles powers cannot stand in the way of a country's domestic social and political policies.

Under those terms when, if ever, could the Fund apply any conditionalities to any credit tranche drawings?

The authors of the revision, in promising everything and anything to any member, claim that the central theme throughout the proposals governing exchange arrangements is freedom of choice for members, but not freedom of behavior.

It makes a good political slogan until carefully examined. Upon examination, it turns out that you cannot have your cake and eat it, too.

The one is 180° the opposite of the other, and there is only a powerless Fund, hardly able to give priority of one over the other.

And even if it could, the other permissive provisions effectively tie its hands.

The second reason calling for postponement is to settle the question as to whether the SDR will serve as an international standard of value when it is not "the" or "a" key currency.

In an attempt to represent fairly the major 16 currencies in the weighted basket, of which the SDR is the total sum, the dollar's weight dominates, making the SDR an impractical measure, or standard of value.

In a recent publication it was pointed out that the three SDR-denominated bond issues are selling at anywhere from 75 to 125 basis points higher yield than comparable maturities specified or denominated in dollars and deutsche marks.

This is, I think, fitting testimony to the fact that SDR-denominated issues are not acceptable in the private markets.

To get back to my statement.

In addition, the SDR measures the currencies which, in turn, measure the SDR. It is a vicious circle as though feverish patients would cite their symptoms and the sum total of the symptoms would measure their fever. The SDR hardly qualifies as an objective standard like a thermometer, or a yardstick, or gold at a fixed price under a redeemable gold standard.

In demonetizing and displacing gold, the drafters removed the gold content of the SDR. And once the United States was unwilling, or anyone else, singly or jointly, to buy and sell gold to keep its price fixed, there no longer was a North Star for the settlement of transactions.

Detaching gold from the SDR, then, has worsened, not helped, matters.

Until a better standard of reference can be created, then it would be, in my opinion, wise to postpone this crucial legislation on which all the other amendments rest.

The wiser course at this point, I would submit, is the resurrection of the Bretton Woods system—with teeth.

Thank you.

[Complete statement follows:]

PREPARED STATEMENT BY SIDNEY BROWN, VICE PRESIDENT AND ECONOMIST, DEAK & Co., INC., NEW YORK, N.Y., AND EDITOR, DEAK-PERERA REPORT

I should like to call attention to two reasons as to why the proposed amendments to the International Monetary Fund charter should be postponed.

The delay should last until the ambiguous, vacuous and contradictory revisions are cleared up. Then, and only then, Congress would be able to know what it is voting for, clearly and not blindly.

As presently advanced, the amendments would legalize the present foreign exchange rate confusion and unnecessary turmoil. They are hardly an improvement over what the present Bretton Woods System provides, if implemented.

Currency devaluations, and central banking interventions, since floating commenced, have been on a scale that far surpasses the worst that occurred under pegging. Moreover, a firmer hand on the IMF tiller and member countries' willingness to submit to the Fund's lending conditions would, in my opinion, have provided a viable, practical and efficient international monetary system.

Reason number one is found in amended article IV, section 1. It deals with member's obligations. Each member is obligated to "assure orderly exchange arrangements", and at the same time, "promote a stable system of exchange rates."

The phrase orderly exchange arrangements is a euphemism for complete freedom, as is done illegally now, to select any kind of an exchange rate system any member desires, legally. For example, some members, as they now do, can peg their currencies to the U.S. dollar, or to a basket of currencies using a formula of their own making. Or, they can latch on to the SDR. Some members have allowed their currencies to float independently, and others have agreed their currencies should float jointly.

As confusing as this may be, and it is, even though we are concerned here with major countries, the degree to which there may be clean or dirty central bank intervention in the foreign exchange markets, and non-monetary restrictions, complicates the chaos even more, if that is possible. Business internationally can live with this confusion, but no one denies that it has added unnecessarily to costs, wasted resources, and complicated financing. Even in times of catastrophe, business can manage to perform and even prosper, but that is not, from an economic viewpoint, the system under which business should be forced to operate.

Even if the above confused situation could be ignored, there still remains the other permissible obligation, to promote a stable system of exchange rates. How the two can be reconciled is difficult to imagine. One, you permit a member to select any kind of an international exchange rate system and, two, you ask that the member pursue one kind of a system.

To resolve this incompatibility, the drafters presented the following theory as to how it can be done. The amendment calls upon members to conduct internal economic and financial policies in such an orderly and sound manner that no matter what exchange rate system they elect, a stable exchange rate system would automatically evolve.

Even under a pegged rate system, countries would have to, also, foster stable, non-inflationary growth policies to maintain their currencies' strength. However, without the mandatory requirements of remaining in the pegged band permitted, they would not have had the compulsion that is missing in the permissible system of choice granted in the amendment.

The Administration places a great deal of confidence in that obligation which calls upon members to refrain from avoiding exchange rate manipulation to prevent balance of payment adjustment or to gain an unfair competitive advantage. This is strange confidence indeed, one without teeth, because the drafters left out the June, 1974, international monetary reform proposals calling for floating exchange rate guidance involving graduated pressures and various indicators to prevent, or stop, just that, i.e., manipulation.

Actually, Section 1 is a plea to naivete and permissiveness.

The greatest amount of faith the Administration places on the workability of the proposed amendments is to be found in Section 3 of the same article. It calls upon the Fund to also do the impossible. The Fund, it says, "shall exercise firm surveillance over the exchange rate policies of members (sic)." Moreover, the Fund "shall adopt specific principles for the guidance of all members with respect to those policies."

Congress would be buying a "pig-in-the-poke" if it voted for statutory change without knowing in advance exactly what specific principles the drafters have in mind. In addition, just what constitutes "firm surveillance" inasmuch as the June, 1974, stab at international monetary reform with teeth has been quietly and conveniently buried as a lost cause.

The saddest feature of the revision is the most incongruous. After all the homilies have been paid to relying on the good, unselfish nature of the major competitive nations, to bring about a so called superior international monetary system, the policeman's hands are tied to make sure that under no circumstance could it crack down on an errant member.

The Fund is directly and distinctly informed that its vague "firm surveillance" and "specific principles" powers can not stand in the way of a country's domestic social and political policies. Under those terms, when, if ever, could the Fund apply any "conditionalities" to any credit tranche drawings?

The authors of the revision, in promising everything and anything to any member, claim that the central theme throughout the proposals governing exchange arrangements is freedom of choice for members, but not freedom of behavior. It makes a good political slogan until carefully examined. Upon examination, it turns out that you can't have your cake and eat it, too. The one is 180 degrees the opposite of the other, and there is only a powerless Fund, hardly able to give priority of one over the other. And even if it could, the other permissive provisions effectively tie it hands.

The second reason calling for postponement is to settle the question as to whether the SDR will serve as an international standard of value when it is not "the", or "a", key currency. In an attempt to fairly represent the major 16 currencies in the weighted basket, of which the SDR is the total sum, the dollar's weight dominates, making the SDR an impractical measure, or standard, of value.

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Until a better standard of reference can be created, then it would be in my opinion wise to postpone this crucial legislation, on which all the other amendments rest.

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Senator PROXMIRE. Thank you very much, all of you gentlemen.

I have a whole series of questions. It is just a shame that we have had these interruptions and that we have had to take so long.

I know Senator Helms is also having problems today, so I am going to yield to him first and then I will ask questions.

Senator HELMS. Mr. Chairman, I thank you.

I sit in some awe of such a distinguished panel. You are a vast source of information which will be most helpful.

First of all, I would like to know your perception of the possible or probable inflationary impact of the increase in IMF quotas inasmuch as more money will be going out to recipient nations.

It doesn't matter who responds first.

Mr. BROWN. I would say that it would be a step toward additional international monetary inflation.

Senator HELMS. Does any other member of the panel disagree?

Mr. ALIBER. I would predict that the impact on the rate of inflation would be zero.

Mr. ROOSA. I would agree with Aliber.

Mr. BENNETT. Senator, I don't think it is appropriate to look just at the increase in quotas separate from the other provisions. It is a package deal.

I am sure the total package assists in fighting inflation and would reduce it.

Mr. BIRNBAUM. The one-third increase in IMF quotas is really a small, though helpful, addition to world monetary resources in my opinion, as compared with the existing totals of world liquidity; the grand totals of IMF resources beyond just this increase is still relatively small.

If the Fund is to continue to carry out its important function of extending conditional credit to countries, that is, credit that is pre-conditioned on the adoption of sensible though sometimes politically difficult economic policies on the part of borrowing countries, then it needs liquid resources to be credible and effective.

Mr. BROWN. If I may just say that if Mr. Birnbaum is qualifying his answer with the word "small," I would, too. I suppose it is a small step.

But in terms of even the expert testimony of Mr. H. Johannes Witteveen, Managing Director of the IMF, the world is surfeit with international liquidity.

In fact, he's called for IMF international control of international liquidity, something which the United States and all other member countries have apparently turned down.

This quota increase is again another piece of evidence that we are creating money ahead of production. And this, I think, is the saddest part about monetary inflation. Why money inflation leads to price inflation requires, of course, a thorough explanation and we don't have the time for that this morning.

Senator HELMS. I share the chairman's view. I wish we could have had a substantial period of time to go into this with these gentlemen. This is a blue-ribbon panel if I ever saw one.

With your indulgence, Mr. Chairman, I have two or three other questions.

Perhaps this has been touched on, but just for my edification, would you tell me what you think will happen if the IMF bill is not approved by the Congress this session and is carried over until next year?

Mr. Brown?

Mr. BROWN. Obviously this current floating travesty of international law, which certainly ranks in monetary history as one of the United States black marks, will continue while awaiting legalization.

I would also say, if I were asked this question, that we should do as Switzerland has refused to do; that is, we should resign from the International Monetary Fund.

Senator HELMS. I believe I am correct in saying previous to 1967, the increases in the IMF subscription required regular appropriations. Now they don't. We put the Export-Import Bank into budget, we put the IDA and a host of other aid organizations in the budget.

Should not this go in the budget? Don't its loans have the same economic effect as international expenditures?

Mr. BROWN. Senator Helms, I think others on the panel would also like an opportunity to reply to your second question.

Senator HELMS. I am sorry; please proceed.

Senator PROXMIER. I think Mr. Roosa wanted to reply.

Senator HELMS. Good. Let us go back to the previous question, then. Mr. ROOSA. I feel that the risks of not approving the legislation now are of two kinds.

First, that the longer we continue without legitimizing procedures which are in their nature inevitably imposed by changed world conditions, the longer we lose an opportunity to provide some agreed form of surveillance over the way in which these new freedoms and these new risks of abuse are conducted.

So that I feel every day that passes without moving toward strengthening the multinational surveillance of the way these new freedoms are carried out adds to danger.

In that sense, that is where I think the real risk of additional inflation or, on the other hand, perhaps breakdown in the functioning of international payments, are real possibilities.

But I think the second is that we do need the increase in IMF quotas for the reason Mr. Birnbaum has indicated.

This would get into the technicalities of the way in which quotas are calculated and the way in which individual countries have the opportunity to draw, but the crucial part is that the Fund as now constituted with its present quotas would not be able to do as much in a situation of great strain for many of the less developed countries to provide the kind of conditional credit that helps to impose the discipline that many of the people in charge of these countries would like to impose, but under domestic political pressures they need the additional help of being assured that they can get some credit, so that their own nation can proceed under more effective domestic performance to then take part in the world economy.

They need much that can only be accomplished if they are able to prove to their own people, or point out to their own people, the fact that this hinges on outside conditional assistance of the kind the Fund provides. That is, the assistance comes on terms that provides, if you want to put it crudely, responsible domestic leaders with the excuse they need to take the domestic action which they would like to take, but for which they need the additional support indicated by the IMF representing the whole world community.

So I think that for both of these reasons it is important to get the legislation out.

Jack?

Mr. BENNETT. I would like to add, Senator, that failure of the Congress to act this time on an agreement which was negotiated over so long a period after so much consultation in the Congress, would seriously undermine the willingness of other countries to enter into cooperative international endeavors with us.

This, taken together with other past failures to carry through on what has been negotiated; would be a serious blow to international cooperation.

Mr. ALIBER. I would like to make just three brief remarks.

First, I would like to see the legislation passed this year.

Second, if you asked if the legislation were not passed, would the underlying economics of the world be significantly different or would the economic situation in many LDC's or most be significantly different?

I would have to say no. But I think the third reason for passing the legislation is linked to the suggestion that Mr. Brown gave, that the United States might resign from the IMF.

It is like suggesting we resign from the world. I think it is premature to make that suggestion.

We have been involved in this negotiation. Big bets have been placed and little cost appears to be attached to passing the legislation at this time.

Mr. BROWN. Switzerland is not a member, we are.

Mr. ALIBER. Switzerland is barely a member of the world.

Mr. ROOSA. Switzerland has specifically and repeatedly insisted through its central bank and its government that it does not want to undertake any of the kind of responsibility or participation in the international monetary system that the United States cannot escape and most of the rest of the world requires.

This is a matter of record.

Mr. BROWN. I suspect if the United States were to pursue the policies that are idealistically called for in the proposed amendments that we should, on our own, reestablish the dollar as the Swiss have established the Swiss franc, and I think this would be one of the finest things we could do for the rest of the world.

Mr. BIRNBAUM. In the interest of time, Senator Helms, I won't comment further on your question.

Senator PROXMIRE. Your third question, Senator Helms, was not answered.

Senator HELMS. That's right. Do you have any opinion about that?

Senator PROXMIRE. Putting this into the budget.

Mr. BROWN. I am disturbed by several recent developments. But my short answer is, yes, it should be in the budget. I would like to just digress a moment and comment on the recent Export-Import Bank financing arrangement with the National Power Corp. in the Philippines where they put the ukase of the U.S. Government into a private, publicly offered bond carrying the full faith and credit pledge of the U.S. Government. I think it is \$367 million maturing from 1987 to 1991.

Incidentally, unlike any registered SEC prospectus, there is nothing any investor could ascertain about that particular company except the U.S. Government has promised to pay principal and interest when due in the event of any default. The U.S. Government is a co-signer.

Certainly things like this which are off-budget items should be put into the budget.

I understand that as of March 31, 1976, approximately \$177 billion of such guaranteed issues were outstanding. That, I understand, excludes even off-budget Federal agencies.

Mr. BIRNBAUM. Senator Helms, in regard to this question, I think it might be important to make clear the fact that when we subscribe to an increased U.S. quota in the IMF, that it is not the intent, as it is for items included in the budget, to spend these moneys for goods and services or Government spending programs, or for programs involving the loan of funds that are going to be repaid, let's say, only over a long period of years.

Rather, the U.S. quota in the Fund represents a potential form of foreign exchange reserve of the United States. When other member countries in the IMF draw on the quota that we have subscribed to in

the IMF, then to the extent that they draw dollars, the United States correspondingly receives an increased automatic right to draw an equal amount of foreign exchange reserves from the IMF.

So the U.S. quota in the Fund is a different animal than budgeted expenditures.

It is more in the nature of, let us say, acquiring gold which is added to our official reserves.

One might exchange dollars for gold or exchange gold for dollars. In this instance, we are exchanging the right of other IMF members to draw dollars from the IMF for a corresponding right for the United States to draw an equal value of currencies of other members from the IMF. This right is known as the so-called super tranche. It is automatic, and therefore enables us to obtain from the IMF the reserves we may need, to the extent that other countries may have drawn upon the dollars we made available to the IMF through our quota subscription.

Senator HELMS. So we have some differences of opinion.

Mr. Chairman, could we have a show of hands? I would just like to see a referendum on this question just for my own information.

Who feels the subscription should be in the budget?

[One hand raised.]

Senator HELMS. I take it the other five do not.

Mr. ALIBER. I abstain.

Senator HELMS. Mr. Chairman, I promise I will be through in a minute.

I notice that the loan authority requested in the bill, \$2 billion at the Secretary's discretion, is authority to lend funds that have been appropriated.

Do you not feel that the other funds to the IMF be appropriated, too?

Anybody want to tackle that one?

Mr. SALANT. I am not sure I understand the question. What other funds are you referring to?

Senator HELMS. The \$2 billion under the 1962 agreement.

Now this is—at the Secretary's discretion.

Mr. BIRNBAUM. That is the so-called general arrangements to borrow, the GAB, Senator?

Senator HELMS. Yes.

Mr. BENNETT. I think, Mr. Chairman, this question is really the same as your previous one.

Senator PROXMIER. Speak a little more loudly, Mr. Bennett. We can't hear you.

Mr. BENNETT. I don't see any distinction between this question and the one you just put, whether the increase in the quota should be appropriated.

Senator HELMS. I see.

Now, Mr. Chairman, I would like to hear the comments of the panel on a proposal relating to gold.

As you know, Congress legalized the ownership of gold on the International Development Association bill in 1974, but it did not legalize gold clause contracts.

This is a contract in which payment can be required in gold or dollars measured in gold.

I would like to hear your views on whether we should consider putting such a rider on to a bill such as the IMF.

Senator PROXMIRE. We will start with Mr. Bennett and go right down the line.

Mr. BENNETT. I would recommend against putting such a rider on this bill.

I am sure the proposal would be extremely controversial and would cause delay.

On the other hand, I would not oppose separate consideration.

I am concerned by some of the company the proposal keeps in the sense that sometimes it is put forward as part of an effort to restore the gold standard, which, as my testimony says, I think would be a mistake.

On the other hand, I don't think that after careful consideration and separate legislation, legislating that proposal would have any great practical effect.

People have seen the instability of the price of gold and are not going to rush into signing gold contracts.

So at an appropriate time I would see no harm at all.

I don't think it should be attached to this bill.

Mr. ROOSA. I would agree with Mr. Bennett.

Mr. BROWN. I would like to see such a rider attached to this bill, but not for the reasons that Mr. Bennett fears, that it might unduly prolong the discussion in Congress, and so on.

I think it would remove an "Alice in Wonderland" condition where money supposedly can be anything except—well, you just can't use gold as money.

You can arrange gold or money liquidation of a gold futures contract, but you cannot write up a contract allowing an optional choice of payment when one of the options is gold this is splitting hairs.

If you want to exchange gold for an automobile, you can't. You have to turn around and sell the gold, get the money and then buy the automobile. You can't even barter.

It is even illegal under existing legislation, to barter gold coins, say, for gold bullion. According to some experts—and there is great controversy over this—you can't.

I think a legal gold clause contract would resolve these "Alice in Wonderland" bewildering situations that we do have, right now.

Incidentally, I would like to point out that even Federal Reserve Chairman Arthur Burns has reversed his view expressed over a year ago and said that he himself would not oppose the restoration of that particular privilege.

Mr. Bennett and others. I would like to say that you can talk all you want about the instability of gold, but the instability of gold is for one reason and one reason only. It is an accurate thermometer reflecting the follies of government.

So don't blame gold when it is unstable.

I think what you are doing is backing away from the symptoms of gold. You are not attacking the cause for its instability.

I think gold really exemplifies something that people through history have found to be not perfect, not idealistically, but certainly the best hedge they can have against governmental stupidities.

Mr. SALANT. I would not see any point in such a clause. I must disagree with Mr. Brown's last statement that the fluctuation in the price of gold reflects the stupidity of governments.

I don't see how the stupidity of governments at whatever absolute value you place on it, could have changed so much as to account for gold having risen to almost \$200 and now being almost \$100.

Does that stupidity double and then halve in 2 years?

I think it is unlikely.

Mr. BROWN. Coming up is an article of mine in *Commodities Magazine* which does point out that gold was touted in 1973 and 1974 like over-the-counter market stocks were touted in the 1960's.

Gold was certainly oversold then, but double-digit inflation gave it impetus.

As for gold clause contracts, I would still say, yes, to the rider.

Mr. ALIBER. I see no reason why Walter Salant should be prohibited from denominating a debt to me with a gold clause attached to it.

I see no reason for attaching a rider amendment to this bill which might make it possible for Salant and others to put gold clauses in private debts.

It may very well be true that Government stupidity did not double and then half in the last year. That is really quite misleading.

The evidence is that fluctuations in the gold price are related to expectations about the rate of inflation.

When investors expect the rate of inflation is going to accelerate we get very sharp increases in commodity prices.

When they expect inflation to decelerate, we get declines in commodity prices.

So it is not so much related to stupidity in government policy, but it predicted what government policy was going to be like in terms of monetary growth.

Mr. SALANT. I didn't mean to suggest that expectations of future inflation don't have anything to do with it, but the instability of the price certainly suggests that gold is no firm anchor.

The expectations of future inflation affect the prices of a great many commodities. But in general you don't have such fluctuations in the average prices of commodities, though you do for some specific ones.

To tie anything to this one commodity, which is and has been seen to be quite unstable, would seem to me a mistake.

Mr. BIRNBAUM. Being the last on the list, Senator Helms, there is less for me to say.

Senator HELMS. We will start on the other side for the next question.

Mr. BIRNBAUM. I would say as a matter of principle I would not object to the use of gold clauses in private contracts. However, I do feel that perhaps it would be improper to attach a gold clause provision on this bill.

Senator HELMS. One final question.

I am concerned about the interest rate on these loans. If inflation continues 6 to 10 percent per year, let's say, and loans are made from the trust fund at one-half of 1 percent per year, don't you think the capital of the fund is going to be eroded rather rapidly and dangerously?

Mr. BIRNBAUM. Senator, the amounts involved in the trust fund to which you refer are small when seen in perspective. Of course the exact amount will depend on the proceeds from sales of 25 million ounces of gold, and the price of gold has varied considerably. The trust fund will not receive the full sales proceeds, but only the net amount that derives from the excess of the sales price over the so-called official price of gold. In addition, not all of this excess will be used for loans through the trust fund; part of the proceeds will be directly distributed to nonoil producing developing countries in proportion to their IMF quotas.

So I don't see that the trust fund constitutes a major impairment of IMF capital.

Senator HELMS. You don't see wisdom in charging an interest rate roughly equivalent, if we can use that expression, to the inflation rate then?

Mr. BIRNBAUM. I would agree with you that as a general principle it would be better to relate the interest rate to market rates. But in this instance we are dealing with only the poorest nations of the world—those IMF member countries with per capita incomes of no more than 350 SDR's per annum. So obviously there is a special humanitarian consideration in attaching such a very low rate of interest, and extended terms of repayment, to trust fund loans. The arrangement also represents a negotiated compromise, since all IMF member countries will also receive an additional 25 million ounces of gold which is being distributed directly in proportion to the size of their quotas in the Fund. This means that the rich countries will tend to receive much more gold than the poor countries.

It is a very special arrangement.

I simply don't see it as sufficiently important to divert us from the more important issues concerning the international monetary system and the amendment of the IMF articles which are now before the Congress.

Mr. ALIBER. Senator, I think you made an ingenious suggestion. I think in a world of price stability trust fund loans ought to be 1.5 percent. They are charity loans.

I think trust fund loans ought to be 6.5 percent if the rate of inflation is 5 percent. It is the same act of charity.

It is, if you want, doing the borrowers a good deed by forcing them to think through and rationalize and choose more effectively on their investment projects.

I am envious of you for having thought of it first.

Mr. SALANT. I am going to pass on this one.

I suspect that a lot more has gone into the determination of this interest rate than I am aware of, and I am not going to express an opinion about it.

Mr. BROWN. If the United States is going to continue its role as a great world humanitarian, then I think the United States should, if it is its disposition, lend money even at 1.5 percent.

If, on the other hand, loans are to be tied to productive purposes and are supposed to be noncharitable—then, as Senator Proxmire mentioned, I believe interest rates, if so specified for those kinds of loans, should perform at the least its pricing function. However, the trust fund was set up to make concessionary loans at charitable interest rates—hardly an IMF function.

Mr. ROOSA. I would take the view that I would not, if I had been negotiating, been in favor of this provision.

But it is a minor part of the total, and I, recognizing that compromises are essential, feel this is one I can swallow without any great difficulty.

I, in general, feel interest rates should be placed at whatever the market indicates and if it is not going to be a market-determined rate, the degree of subsidy has to be clearly understood and the reasons for the subsidy made clear.

I think an interest subsidy account perhaps makes sense in two ways, both the way in which it causes those extending the credit and subsidy to be careful of what they are doing, and also in reminding the recipients that this is a subsidy out of line with the normal patterns of world payments.

But it just seems to me that this is not a sticking point for passing the legislation.

Mr. BENNETT. Mr. Chairman, I suspect the interest rates on the regular loans of the IMF are more significant than those just from the trust fund.

Most of the earlier comments here have referred to the trust fund.

On the regular drawings I think the present interest rates vary from 4 to 6 percent.

On the drawings under the oil facility, they go up to the 7- to 8-percent range.

Recently the U.S. administration, despite opposition, has led a successful move to increase somewhat the interest rates in the World Bank.

I would see no harm if this committee urged the Treasury to lean in the same direction in the IMF.

Senator HELMS. Gentlemen, I thank you.

Mr. Chairman, I thank you.

Senator PROXMIRE. I didn't realize they were 4 to 6 percent. That is the most shocking revelation I have heard today.

I had a talk with Mr. Yeo the other day on this and I am interested to get his answer when he comes before us.

After all, that is at a lower interest rate than the Government is paying for the money.

It is obviously a direct subsidy. If we make that kind of a loan, I think we ought to go through the budgetary process.

Dr. Salant, you said that you analyzed this agreement from the standpoint of three elements: the adjustment problem, the liquidity problem, and the confidence problem.

You indicated this wouldn't solve any of your three problems yet you came out for the legislation.

You did say it might help a little as far as adjustment is concerned, as far as liquidity and confidence, it might help a little, but that it might not matter much, which would put you pretty much in the position of Mr. Aliber.

Mr. SALANT. I think it is important and that the contribution relating to the adjustment problem is significant, although much remains to be done in the form of developing principles for Fund surveillance.

The reason I attach importance to the parts of the amendment that relate to the adjustment problem is that in a world of interdependent

countries it is important not only to establish agreed codes of acceptable behavior but, beyond that, to develop the practice of observing such codes. Violation of outdated rules during transition periods is sometimes unavoidable, but it would be very damaging in the long run to allow the flouting of agreed rules to become accepted practice. When one cannot avoid this by changing the realities, it is better to avoid it by changing the rules to accord with those realities. In this case the realities have changed, and failure to change the outdated rules to accord with them would entrench the practice of ignoring agreed codes of behavior and contribute to making them meaningless. That is why I think it important to legitimize an existing practice, even if doing so has no other observable or short-run economic effect.

About the two other problems, I think you have correctly summarized my view. But I think the liquidity problem is always a problem of the internal policies of the member countries. And so that failure to solve the problem further at this time doesn't seem to me very serious.

Senator PROXMIRE. At any rate, your analysis is that this is pretty limited progress, a short step?

Mr. SALANT. I think it is limited progress but I think our experience with the system of flexible rates is very limited; we have a good deal more to learn about how to operate it. I hope we will be able to acquire that experience and that after we have had the additional experience there will not be too much divergence of views as to what conclusions should be drawn from the experience.

But the fact is that views are very diverse now and there is a limit to what could be obtained by agreement.

Senator PROXMIRE. Mr. Brown, you called for a firmer hand on the IMF tiller. You talk about how the hands are tied. Do you want to untie those hands and put a firmer hand on the tiller? Wouldn't this result in some degree of surrender of our own sovereignty? Wouldn't it mean an international policeman that would contradict much of what I understand to be your philosophy?

Mr. BROWN. You put your finger right into the middle of the nuclear core. Yes, the U.S. policy has been that we don't want to surrender any control over our monetary—fiscal processes to an international monetary authority. That is why we have opposed Mr. Whiteveen's desperate cry for IMF international control.

Go back to Canada in the 1950's, the floating exchange departure. The IMF said nary a word. We can skip the fact that many countries are full-fledged members of article 8, yet, they perpetuate exchange controls.

There are certain loopholes that permit such things as years and years of foreign exchange controls, and there are different ways to accomplish the same thing.

You wonder what the IMF is doing, where is its strength. Take the fact we stung the world and the IMF with what we did on August 15, 1971. We flaunted the IMF. We signed a solemn international agreement and went back on our word.

Senator PROXMIRE. What I am trying to say is that you seem to propose here a tougher, stronger position. From a realistic standpoint, you wouldn't expect other countries and certainly you wouldn't expect the Senate or Congress to go along with that kind of decision or for that matter, it would probably contradict the attitude of most people

in this country. We have a struggle to try to get cooperation with international organizations, and to try to get a tough policeman determining our monetary policies. I just think——

Mr. BROWN. Let's look at the alternatives. My views now reflect the knowledge I gained by reading Joseph Gold's analysis of the proposed amendments. He is the general counsel of the International Monetary Fund. In what must have been a slip of the tongue, he said that the proposed amendments are not a blueprint but are a collage.

Of course, he was absolutely 100 percent in favor of the amendments. Don't misunderstand his point of view from what I just said. But I think it was a slip of the tongue on his part. He did go on to point out in his most recent pamphlet that we are trying to give to the IMF the kind of powers or pressures that theoretically they are supposed to have had. This is a step toward international monetary control, very subtly so as not to offend any legislature in any major country opposed to giving the IMF any kind of disciplinary role.

The discipline given to the Fund is unspecified, unclear and I don't know what the floating rate guidance principles will be. I don't know the specifics. I don't know what firm surveillance means. I think we have to meet that test, or settle for international monetary anarchy in the absence of a universally accepted world currency, or IMF control over international liquidity.

I think the world has reached the point where we have to have control over excessive international liquidity generated by deficit countries.

Senator PROXMIRE. Could I ask you, Mr. Bennett, you seem to be a rather firm champion of this proposal.

The National Advisory Council on International Monetary and Financial Policy says on the first page of its special report on the bill and I quote:

The agreement fulfills policy and objectives that the United States has pursued over several years of negotiations on international monetary reform.

Is that really true? Don't the Jamaica agreements represent a glossing over of some of the major unsettled questions including the future role of SDR's, the future role of gold, the dollar, specific principles to guard against competitive exchange rate practices? Isn't this really an interim reform leaving fundamental disagreements for later resolution?

Will these limited achievements remove incentives for further reform in the future?

Mr. BENNETT. As I said in my statement, I do not regard this as an interim reform. I do not think you can write rules in advance to apply, for example, to the current Japanese situation. It takes judgment in the light of the current situation.

But the new agreement does provide an opportunity to apply surveillance to the Japanese situation without giving the Japanese the excuse to say we are merely acquiring reserves to maintain our exchange rate.

It gives us a framework in which surveillance can be conducted. As far as the SDR, I agree the new agreement does nothing new about the SDR as an asset. It uses the SDR as a cocktail in terms of which obligations to and from the IMF are stated.

Senator PROXMIRE. Can I ask, Mr. Aliber, you indicated this would not have much economic effect but you approved it. Are you concerned that this might remove incentive for further reforms?

Mr. ALIBER. A few years ago we had an alderman in Chicago who said "Chicago ain't ready for reform yet." The analogy I think applies. It's too early, too premature to see what the system is going to be like.

We don't really know what the role of gold and the dollar will be if the system stabilizes and it is silly to make rules for the future.

On the other hand, and I go back to my opening remarks, that the means is the end. It is almost as if reform and participation in the dialog, continuations of discussions is really the end process.

The rules, if you want, are a vehicle, something to talk about so we can continue communication with other governments.

Senator PROXMIRE. One final question I would like to ask Mr. Roosa. How can you determine whether the one-third or more increase in IMF resources is the appropriate increase? It's been denied this is very much or that this is inflationary, but I have the impression that the international monetary system is pretty liquid right now.

And we have certainly suffered recently from world inflation. Why do we want to increase liquidity now?

Mr. ROOSA. I think it is a problem of distribution rather than amounts. If the desired result in terms of distribution of quotas, particularly in the sense of targeting them for the less developed countries, if that objective is going to be achieved, it is just sort of an arithmetic byproduct of the Fund's arrangements that you can't accomplish that unless you do one of two things.

Either you increase all quotas in a proportionate manner which is what is proposed, or you rearrange quotas.

Now, the one rearrangement achieved here is in raising the quota of the OPEC countries. That provides access to more resources. But to increase the quotas of the LDC's individually at this stage I think would have been extremely difficult. Yet the principal reason for having an increase is that on the one side there will be the potential for attracting the resources, particularly now of the wealthy OPEC countries, and on the other side, more resources can be made available to those countries who need additional credit (within this overall adequate total framework) and who need it on the conditional terms we have been talking about here.

Senator PROXMIRE. That is an interesting argument because what you are saying as I understand it is that this may help at least somewhat meet the problem of the countries that have been hit so hard by the increase in energy prices.

Mr. ROOSA. Yes.

Senator PROXMIRE. If that is the case in view of the fact that there seems to be somewhat fading interest and support for the \$25 billion safety net Secretary Kissinger proposed, could it be we no longer have to worry about that possible obligation?

Mr. ROOSA. It may be. I think the safety net as you know is intended really to take care of the great distortions that might occur—

Senator PROXMIRE. We have gotten along pretty well without it.

Mr. ROOSA. Yes; we did partly of course because the IMF for 2 years had an oil facility on which the British could draw and bailed them out in part during the strains of the late 1974, early 1975.

But the purpose as I would describe it in what I have just said, is really in effect to assure use of the fund as one means through which additional OPEC resources flow to less developed countries that are still trying to adjust to the great mutation in payments patterns that followed the oil price change.

That I think is an important conduit product of raising the quotas. Whether we will continue to need something similar just for the developed countries, which is what the safety net does, I think is an open question.

There are other ways of handling that including through the IMF, and I would suspect that the great advantage of the safety net lies in the fact that it provides the stimulus for bringing all of those developed countries together in the International Energy Agency under the aegis of the OECD.

I think we have to learn more from their own studies as to whether there is a continuing need. I am just not in a position to judge.

Senator PROXMIRE. Thank you very much. I want to thank all of you gentlemen. I do want to tell Mr. Birnbaum that I can't resist saying that I was interested in your suggestion that we reduce taxes on producers. Trouble is we don't know who is a producer. Farmers are producers; I suppose some factory workers are, although I am not sure if they produce cigarettes and liquor that you should consider them producers that should have lower taxes.

Whether bankers are producers and U.S. Senators are producers, I am simply not sure. You will certainly get debate on that.

Mr. BIRNBAUM. Not to mention Government civil servants. But I have expressed a guiding principle applicable to workers and businesses, and the example I mentioned concerning the United Kingdom illustrates what can happen if the principle is neglected.

Senator PROXMIRE. Thank you. Thank you, gentlemen. Mr. Yeo Heavens, it is a quarter to 2. Will you come up? I apologize. It is a tough afternoon for us. That is why I have kept you so long.

STATEMENT OF EDWIN H. YEO III, UNDER SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY SAM Y. CROSS, EXECUTIVE DIRECTOR, INTERNATIONAL MONETARY FUND, AND NANCY JACKLIN, COUNSEL

Mr. YEO. Good afternoon, Mr. Chairman.

I have with me Sam Cross, Executive Director, International Monetary Fund, and our lawyer, Ms. Jacklin.

I have reduced my statement in stages. Next to zero, I am at the minimum.

I would like to submit my written statement for the record.

Senator PROXMIRE. Fine.

Mr. YEO. We urge prompt and affirmative action on the legislation to approve the amendment of the IMF articles of agreement and to consent to an increase in our IMF quota. We feel this is the most important legislation in the international finance field in many years. It represents international agreement on a new monetary system, formulated at Rambouillet and Jamaica, following lengthy international negotiations in which the United States played a leading role; and it strengthens the IMF's ability to deal with the world's problems

of balance-of-payments financing and adjustment by a general increase in quotas.

The new monetary system is a more flexible, pragmatic, market-oriented system, replacing the exchange rate rigidity and gold emphasis of the Bretton Woods system.

The new system discards the outmoded and unworkable elements of Bretton Woods, but keeps and builds on the good features of that system. Most importantly, it retains the emphasis of the present IMF articles on a liberal, open monetary and trading order; the commitment to cooperation and responsible international behavior in monetary affairs; and the central role of a proven institution—the IMF—as the heart and monitor of the system.

The new system, like the Bretton Woods par value system before it, seeks to promote monetary stability. That is its objective, but by a different approach. While Bretton Woods sought to impose monetary stability on the world by a structure of par values, the new system recognizes that monetary stability is the result not of par values or negotiations but of orderly underlying economic and financial conditions in member countries.

Reflecting that change in approach, the new system changes the obligations of member countries. Under Bretton Woods, a fundamental obligation of each IMF member was to maintain a par value for its currency. No other exchange practice—such as floating—was recognized or tolerated. Under the Jamaica system, there is wide latitude for a member country to allow its currency to float or follow other arrangements of its choice. The fundamental obligations are that countries must direct their policies toward fostering orderly underlying economic and financial conditions, and that they must avoid manipulating exchange rates to prevent balance-of-payments adjustment or to gain unfair competitive advantage. The new system thus concentrates on the real determinants of monetary stability—stable economic and financial conditions—rather than on the exchange rate consequences that were the main focus of Bretton Woods.

The new system is organically complete and workable. It has the flexibility to evolve as the world evolves, and it can be expected to function well in the years ahead without major revision. Its adoption has been widely accepted as a positive and beneficial move, a major structural improvement for the world economy.

It is acceptable to 128 different nations of widely differing interests, needs, and attitudes, in a period of deferment and change in monetary doctrine.

If it does not satisfy every enthusiastic reformer—and any theorist tends to measure a new system against his own subjective judgment of the ideal monetary system—it does certainly constitute a workable and pragmatic system that is a major improvement on the Bretton Woods system as it operated from 1950 to 1970. This new system is much better suited to dealing with today's problems than any conceivable variation of the stable but adjustable par value system.

I think this summarizes the two major changes and I think in view of the time that I would like simply to add, Mr. Chairman, that what you have before you we regard as vital. It is the result of some lengthy negotiations, but it is not perfect.

Senator PROXMIRE. Did you hear Senator Percy this morning?

Mr. YEO. No, sir; but I am familiar with the amendment.

Senator PROXMIRE. I understand the Treasury opposes that.

Mr. YEO. We feel it is unnecessary, Mr. Chairman.

Senator PROXMIRE. Supposing you had your choice of that amendment or putting this into the Budget. Which would you take? [Laughter.]

Senator PROXMIRE. That is a serious problem for us because this was taken out of the budget a few years ago, 8 years ago, as you know.

And you are asking for our proceeding with something that results in subsidized loans. At least with no information except at the discretion of the Treasury Department. So, it is very hard, it seems to me, for us to have any oversight.

One way of getting oversight is to put it in the budget. It has to come before us every year and we look at it.

Another way, a looser way, is to request information, be able to get the appropriation information and the Treasury would be the judge of what is appropriate.

Mr. YEO. Well, Mr. Chairman, the balance in the question is in the direction of the operation of the Fund. We have no misgivings, no reluctance whatsoever to provide Congress information, as it desires.

Our recommendation would be against Senator Percy's amendment.

I cannot say to you that we would be necessarily in an unworkable situation if the Congress adopted Senator Percy's amendment. I think that we would certainly understand and wish to cooperate with the Senator's desire.

The thing we wish to avoid is the disclosure of information, or in the minds of other countries, the threat of disclosure of their affairs. The threat of disclosure of their affairs would reduce their willingness, perhaps their ability to cooperate within the IMF framework.

If I might say so, I think that Congress, as evidenced by this committee and this chairman, has complete oversight of conduct of international—

Senator PROXMIRE. Really effective oversight, as you know, does depend on getting the facts and information. Senator Percy, I thought, made a very powerful case this morning in arguing that we should be able to get information. He cited instances where they weren't able to get it and where that information was germane and we needed it. You might want to review his testimony.

Mr. YEO. I would be happy to.

Senator PROXMIRE. He is, as you know, an extraordinarily competent Senator and very concerned about this.

The bill we have here contains a provision to amend the authority of the Secretary of the Treasury to use the Exchange Stabilization Fund as provided in the Gold Reserve Act of 1934.

Instead of using the Exchange Stabilization Fund for the purpose of stabilizing the exchange value of the dollar, the Secretary would be empowered to use the bill as he may deem necessary, consistent with U.S. obligations in the Monetary Fund. That change, which acknowledges we now live in a world of floating exchange rates, raises an important question. For what purposes is the Exchange Stabilization Fund being used now that the exchange rate for the dollar is floating?

The IMF may adopt specific guidelines in the future for the exchange rate policies of members.

At present there are no formal IMF guidelines and Congress has not adopted guidelines for those exchange market policies carried out for the Exchange Stabilization Fund.

So, at a minimum, it would seem appropriate for Congress to increase oversight with respect to use of the Exchange Stabilization Fund by requiring an annual GAO audit of Fund operation, setting an annual budget limitation even if it is not in the budget in the usual form, on expenditures from the Fund. Would you agree with that?

Mr. YEO. No, sir. I think that the Exchange Stabilization Fund in a floating system is more relevant than in the par value system that obtained in the 1960's. The par value system in the 1960's was characterized by massive intervention.

Senator PROXMIRE. It is more relevant, but we know less how it is going to be used.

Mr. YEO. I think that, in terms of testimony that we have given before Congress on our intervention policy, we have indicated that it is our policy to intervene in exchange markets to counter disorderly market conditions. That probably is the most precise statement of intervention policy that we have had in the post-World War II period.

So, that I think the Congress is aware of what our intervention policy is.

I think also that use of the Exchange Stabilization Fund under the language adopted by the House, use of the Exchange Stabilization Fund would have to be congruent with article IV. Article IV reinforces the concept of limited intervention to counter disorderly market conditions.

It might be an elliptical way to approach it; constraints on the use are there.

Senator PROXMIRE. Let me follow up on article 4 effect. That also imposes an obligation to members of the IMF, quote,

* * * to avoid manipulating exchange rates on the international monetary system in order to prevent effective balance of payment adjustments or to gain an unfair competitive advantage over other members.

What is meant by manipulation? Who will decide whether a country is manipulating its exchange rates?

What I am concerned about is, for instance, Japan has been accused of manipulating the value of the yen in order to promote Japanese exports. How will the Fund go about determining if a country violated this, and if it did so find, what would the Fund do about it?

Mr. YEO. The item you mentioned under section 1 has to be coupled with the granting to the Fund authority to maintain firm surveillance which is in section 3 of article IV. A combination of the two puts the Fund in a position where it will, I believe, on a case-by-case basis, examine the practices, as well as the motivations. As you read the "thou shalt not manipulate" item in section 1, you can see motivation, as well as results, and what the Fund—

Senator PROXMIRE. It can examine and monitor but what can it do?

Mr. YEO. The Fund can take three steps. One, it can admonish in public—really, four steps. First, private consultations with a member country that the Fund feels is violating section 1 of article IV.

Senator PROXMIRE. It can do that now.

Mr. YEO. It can do that now. This gives it explicit authority in article IV.

The second thing the Fund can do under that explicit authority is to admonish a country that it has become convinced is violating the section that you mentioned.

The third thing it can do is that it can refuse to grant the use of Fund facilities to a violating country.

The fourth thing that it can do is recommend to the membership the expulsion of a country that has violated the item in section 1 you referred to.

I would like to add—

Senator PROXMIRE. Which of these are new powers that they do not have now?

Mr. YEO. The thing that is new, Mr. Chairman, is the explicit agreement on nonmanipulation of exchange rates contained in section 1.

Second, the explicit coupling of that agreement in the same article with granting the Fund authority to maintain surveillance.

I would like to go on and point out that if you want, as you have very acceptably pointed out, if you want supranational government, if you want an organization that is running the U.S. economy, running the Belgium economy, then you can argue that if that is the kind of organization you desire, then you can argue for more teeth.

The second reduction is that you can argue the Fund would have in its possession some sort of physical force. I think that that is really rather farfetched.

The third reduction is that you believe there is a value in cooperative behavior and participation in cooperative institutions and that the authority of these institutions reflected in terms of the—of their comments, in terms of their judgments, and ultimately in terms of this institution's ability to eliminate access to its credit, you have to believe in that type of organization.

I personally would not like to see our sovereignties substantially limited and I believe in the efficacy of that type of an approach.

As a practical matter I would submit that there is no other approach. The Fund has the tools that, as a practical matter, we can reasonably expect it to have.

Senator PROXMIRE. I am going to ask you one more question, then I will submit questions for the record. I have to go to the floor.

Milton Friedman once said that the function of the international monetary system is the pseudo-generation of pseudo-crisis that can only be resolved by upper level bureaucrats meeting in exotic location around the world. Why don't you ever have an international monetary meeting in Sandusky, Ohio. Why does it always have to be in some beautiful place in Europe?

Mr. YEO. Mr. Chairman, we are in the process of writing the Secretary's speech for the meeting coming up in Manila in early October.

I promise to recommend to him that he recommend that we have it in a nonexotic place. Seriously, the places that I have been are a blur of sleepless nights. And sometimes when I am in private life, I am going to go back and see what they really look like. I know that the hotels look like but that is the extent of it, sir.

Senator PROXMIRE. Thank you very much. This has been—I know it's been very difficult for you. We will submit questions for the record. (see p. 150).

[The complete statement of Mr. Yeo, succeeded by additional material received for the record, follows:]

PREPARED STATEMENT OF EDWIN H. YEO III, UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS

Mr. Chairman and Members of the Subcommittee: I urge prompt and affirmative action on the legislation to approve amendment of the IMF Articles of Agreement and to consent to an increase in our IMF quota.

This is the most important legislation in the international finance field in many years. It represents international agreement on a new monetary system, formulated at Rambouillet and Jamaica, following lengthy international negotiations in which the United States played a leading role; and it strengthens the IMF's ability to deal with the world's problems of balance of payments financing and adjustment by a general increase in quotas.

The new monetary system is a more flexible, pragmatic, market-oriented system, replacing the exchange rate rigidity and gold emphasis of the Bretton Woods system which broke down five years ago.

The new system discards the outmoded and unworkable elements of Bretton Woods, but keeps and builds on the good features of that system. Most importantly, it retains the emphasis of the present IMF Articles on a liberal, open monetary and trading order; the commitment to cooperation and responsible international behavior in monetary affairs; and the central role of a proven institution—the IMF—as the heart and monitor of the system.

The new system, like the Bretton Woods par value system before it, seeks to promote monetary stability, but by a different approach. While Bretton Woods sought to impose monetary stability on the world by a structure of par values, the new system recognizes that monetary stability is the result not of par values but of orderly underlying economic and financial conditions in member countries.

Reflecting that change in approach, the new system changes the obligations of member countries. Under Bretton Woods, a fundamental obligation of each IMF member was to maintain a par value for its currency. No other exchange practice—such as floating—was recognized or tolerated. Under the Jamaica system, there is wide latitude for a member country to allow its currency to float or follow other exchange arrangements of its choice. The fundamental obligations are that countries must direct their policies toward fostering orderly underlying economic and financial conditions, and that they must avoid manipulating exchange rates to prevent balance of payments adjustment or to gain unfair competitive advantage. The new system thus concentrates on the real determinants of monetary stability—stable economic and financial conditions—rather than on the exchange rate consequences that were the main focus of Bretton Woods.

The new system is organically complete and workable. It has the flexibility to evolve as the world evolves, and it can be expected to function well in the years ahead without major revision. Its adoption has been widely accepted as a positive and beneficial move, a major structural improvement for the world economy. It is acceptable to 128 different nations of widely differing interests, needs, and attitudes, in a period of ferment and change in monetary doctrine. If it does not satisfy every enthusiastic reformer—and any theorist tends to measure a new system against his own subjective judgment of the ideal monetary system—it does certainly constitute a workable and pragmatic system that is a major improvement on the Bretton Woods system as it operated from 1950 to 1970. This new system is much better suited to dealing with today's problems than any conceivable variation of the stable but adjustable par value system.

The stable but adjustable par value system of Bretton Woods was in retrospect a "fair weather system." It worked fairly well in the late 1950's and early 1960's when we experienced low rates of inflation, had no massive dependence on expensive OPEC oil, faced only moderate capital flows, and enjoyed a long period of world prosperity.

The new system is a "system for all seasons." It recognizes that we can't always expect the pleasant economic environment of that earlier period. It recognizes that nations will not always be willing to follow the monetary and other macro-economic policies needed to keep prices and incomes in close harmony with their neighbors. It recognizes there will be differing propensities to inflate—in Europe alone, price increases in the past year varied from 5 percent in Germany to 17 percent in Italy and 33 percent in Iceland. It recognizes that there has been a revolutionary change in exchange markets; that nations cannot afford to risk free speculation that results when a par value becomes unrealistic; that a nation cannot maintain in the face of market pressures an exchange rate that does not reflect its competitive position. And it recognizes that different exchange policies may be preferred by and appropriate for different countries.

No single prescription necessarily meets the needs of all nations large or small, diversified or one-crop, manufacturing or primary producers. The Jamaica amendment makes it legal for countries to follow exchange practices over a wide spectrum from individual free floating, through managed floating, group floating and trotting pegs, all the way to pegged rates that are adjusted by infrequent changes.

While the new system will be a tolerant system, as IMF Managing Director Witteveen has put it "freedom of choice is not freedom of behavior." The Fund is empowered to exercise broad surveillance on all types of exchange practices of members, to promote international cooperation and avoid unfair competition or exchange policies that prevent international adjustment.

The IMF is in a very real sense the focal point, the core of the system. Members are obliged to provide the Fund with the information necessary for intelligent surveillance of their exchange rate policies. In addition, the Fund is called upon to adopt "specific principles" for the guidance of members with respect to those exchange rate policies to assure that manipulative practices are avoided. In the Bretton Woods system the Fund's attention was more likely to be directed toward a member in times of crisis, and more narrowly focused toward exchange markets. By contrast, under the new system, Fund consultations with members are likely to be more continuous, more broadly based, more concerned with the real international impact of a country's actions, and directed to all countries, not just those in deficit.

Fund surveillance and oversight of members' exchange rate policies does not mean that the Fund can determine the policies of sovereign countries. This would be totally impractical, and unacceptable to the United States and all Fund members. But one member's behavior should not be at the expense of other members' well being. Within that context, the Fund can develop general principles interacting with a type of common law based on application of these principles to individual cases, aimed at assuring that members' exchange policies promote stability and adjustment and are not designed to gain an unfair competitive advantage.

In developing specific principles, the Fund will need to proceed cautiously. Such principles must have very broad acceptance by Fund members. Their development cannot be forced, but they can be expected to emerge over time in the light of general and specific consultations with members. In this way, the general principles of acceptable behavior will evolve, grounded on the agreed objectives and obligations of the new system.

Detailed codes of behavior are not set forth in the amended Articles. Nor should they be. The original Articles drafted in 1944 contained specific rules and regulations—far too many of which became obsolete and unworkable as time passed and conditions changed. The Articles is a constitution, not a contract. It should not prescribe detailed rules as these must take account of each individual case and circumstance—particularly in an institution of such diverse country membership that the largest member is 60,000 times as big as the smallest in terms of GNP. Moreover, the amended IMF constitution is a flexible one, permitting a modification to a different kind of monetary system if conditions change and a large consensus favors such a move, and if detailed rules were to be included there would have to be rules for more than one system.

The Fund does have sanctions which can be applied when critical provisions of its Articles are violated—most importantly it can deny an offending member access to its resources or it can exclude it from membership. But the IMF relies more on its moral force, as voice of the international community, and that carries considerable weight.

Some reformers have expressed concern that the new system does not establish formal IMF control over the level and growth of international reserves. This matter was discussed at great length in the reform negotiations. But no group, neither the developing countries, the oil exporters, nor the industrial nations showed any willingness to accept the restrictions on their ability to borrow, lend, or acquire currencies that would be necessary to establish quantitative limits on reserves. There is in addition considerable doubt in many quarters that placing such power of decision in an international body would be either effective or desirable. At the very least, the time for such a move would appear to be well in the future, not now.

A second and related major change in approach in the new system is the shift away from gold. Under the Bretton Woods system, gold, with its supply limitations, speculative pressures, and competing industrial demands, proved a capricious and volatile asset, unsuitable as a basis for the international monetary

system—just as it had earlier proved unsuitable as a basis for the U.S. and other domestic monetary systems. In recognition of these inadequacies, the new system promotes a further reduction in gold's monetary role, by eliminating gold's legal position as the central asset and numeraire of the monetary system, by eliminating the required use of gold in IMF transactions, and by empowering the IMF to dispose of its remaining gold holdings.

With dismantling of many IMF rules and restraints on official gold transactions, important side arrangements have been agreed among the Group of Ten—the major gold holding nations—to assure that gold does not re-emerge as a major international monetary asset. This understanding, which is not part of the amended Articles, but is consistent with and supportive of the policies of the amended Articles, provides that participating nations: will not act to peg the price of gold; will agree not to increase the total stock of monetary gold; will respect any further conditions governing gold trading to which their central banks may agree; and will report regularly on gold sales and purchases.

The arrangement took effect February 1, 1976, and will be reviewed after two years, and then continued, modified, or terminated. It is in our view an important and necessary safeguard during this transitional period, although I am firmly convinced that in any case gold's role in the monetary system will continue progressively to decline.

In parallel with phasing down gold's monetary role, the new system provides an expanded role for the Special Drawing Right, and modifies certain of the rules governing that new asset.

Under the amended Articles, the link between the SDR and gold is severed. The SDR replaces gold as the common denominator of the system, and is the unit for measuring IMF rights and obligations. The SDR is expected to take on an increasingly important role, not only as a unit of account used in measurements, but also as an asset used in transactions. With respect to its asset use, there is an obligation on members to collaborate with the Fund toward the objective of making the SDR the principal reserve asset of the international monetary system. Also the SDR takes over from gold the preferred status as asset to be received by the Fund in payment of charges, in meeting repurchase obligations, and to be accepted by members in exchange for currencies replenished by the Fund.

A number of technical steps have been taken to improve the SDR's quality and usability so that it may better fulfill its purposes. Thus countries will have greater freedom to enter into SDR transactions with each other on a voluntary basis; the possible uses have been expanded; and the Fund may broaden the categories of holders—though not beyond official entities—and the operations in which they engage. Also, the decisions for altering certain policies governing SDRs are made easier—such as the terms and conditions governing approved transactions, and the rules that require countries to “reconstitute” or buy back after a certain period some of the SDRs they have spent.

At the same time these rules governing use of the SDRs are being eased, important safeguards have been retained which help assure that the SDR will remain a widely accepted and valued asset. Thus, the limit on members' obligation to accept SDR is retained, and IMF quotas remain the basis for new SDR allocations.

Both of the two main improvements in the monetary system—the move to more flexible exchange rate arrangements and the move to reduce gold's monetary role—are of critical importance to the United States. Under Bretton Woods, it was the dollar that was pinned down at the center of the system, and our exchange rate that could not adjust adequately in response to market forces—with the result, in the late 1960's and early 1970's, not only of increased debts, but also of loss of jobs, productive capacity and transfer of our industry abroad. The new monetary system embodied in this legislation provides important safeguards against such an adverse position. This is a matter of critical importance to the strength of our economy and the prosperity of our citizens.

The amended Articles will terminate for IMF purposes existing par values for all IMF members. The legislation before you would repeal the par value of the dollar. Prior Congressional approval would be required to authorize any future establishment of a par value for the dollar in the Fund, or to authorize any change in the par value if one were established. The standard for the dollar of \$42.22 per fine ounce of gold in present legislation would be retained solely with respect to gold certificates held by the Federal Reserve System—the only domestic purpose for which a par value in terms of gold is needed. These gold certificates are being retired by the Treasury as its gold holding are sold.

I have confined my remarks to the major points. Numerous other changes being made to improve the operation of the IMF and the monetary system are explained in detail in material we have submitted to the Congress.

This legislation has been approved in the House by a large majority, and favorably reported by unanimous vote of the Senate Foreign Relations Committee. It is urgent that the Congress move promptly and affirmatively to complete legislative action. Since the breakdown of Bretton Woods five years ago, international exchange arrangements have of necessity been operating outside the law. We must restore the structure of an equitable, workable, lawful system. The United States has played a prominent role in bringing about acceptance of the new arrangements, and our acceptance of them will encourage others to follow so that we can implement these proposals with a minimum of delay.

THE REFORMED INTERNATIONAL MONETARY SYSTEM

(By Edward M. Bernstein, President of EMB (Ltd.) Research Economists)

PROCESS OF REFORM

By the mid-1960s it had become apparent from the large and persistent balance of payments deficits of the United States that the international monetary system established at Bretton Woods was no longer functioning properly. One defect was that the charter of the International Monetary Fund made no provision for an adequate growth of reserves to meet the needs of an expanding world economy, although it did provide for recurrent increases in the resources available for reserve credit through general increases in quotas. Because of this defect, it was said, the growth of reserves had to be met by accumulating dollars acquired from the U.S. payments deficit. The problem this created was aggravated by a growing preference for gold in the reserves of countries that had already accumulated substantial amounts of dollars. And as the monetary gold stock increased at an average annual rate of only one-half of one percent from 1950 to 1965, this preference could be satisfied only by depleting the gold reserves of the United States. To meet this problem the Fund Agreement was amended in 1969 to give the Fund authority to create a new reserve asset, Special Drawing Rights. Three issues of the new reserve asset were made at the beginning of each year from 1970 to 1972, aggregating about SDR 9.3 billion.

The continuation of the U.S. payments deficit, and its increase to \$10 billion in 1970 and \$30 billion in 1971 on an official reserve basis, showed that the defects in the monetary system were much more fundamental than the inadequate growth of reserves. In the view of the United States, the basic difficulty was the failure of countries to make prompt changes in par values to reflect changes in their relative international economic position. Beyond that, the asymmetrical nature of the adjustment process placed the responsibility for restoring the balance of payments primarily, if not entirely, on deficit countries. After the United States terminated the gold convertibility of the dollar in August 1971 and allowed the dollar to float, it became clear that fundamental changes had to be made in the Bretton Woods system, and that these would have to include greater flexibility of exchange rates, symmetrical responsibility of surplus and deficit countries for balance of payments adjustment, and consequential changes in the obligation to maintain convertibility and in related matters, such as intervention in exchange markets.

In June 1972, the Board of Governors of the Fund appointed a Committee of 20 to advise and report on a comprehensive reform of the international monetary system. The Committee of 20 had the assistance of a very able group of deputies to direct its studies. Two years later, the Committee of 20 presented its final report with an Outline of Reform and accompanying Annexes on a number of technical questions prepared by the chairman and vice-chairman of the deputies. The Committee of 20 recognized that because of inflation, the energy situation and generally unsettled conditions, "it will be some time before a reformed system can be finally agreed and fully implemented." It therefore proposed that a number of steps be taken to begin an evolutionary process of reform. These included immediate action to establish a facility in the Fund to assist members in meeting the impact of the increase in oil costs, to prepare guidelines for the management of floating exchange rates, and to devise a method of valuing the SDR based on a basket of currencies. The action program also proposed the

appointment of an Interim Committee of the Board of Governors with an advisory role pending amendment of the Fund Agreement to create a Council of Governors with decision-making powers.

The Interim Committee was established by the Board of Governors in September 1974. This Committee held five meetings between October 1974 and January 1976 at which it considered the problems that would have to be dealt with in a reform of the monetary system and other matters of high policy of the Fund. Because the Interim Committee consisted of ministers of finance, it could reach agreement on the unsettled questions and make recommendations for resolving them that had the support of their Governments. At its fifth meeting in Kingston, Jamaica, January 7-8, the Interim Committee completed agreement on virtually all of the outstanding issues. Its recommendations on reform and on matters of high policy were transmitted to the Executive Directors who put into effect those that could be implemented under the existing powers of the Fund and prepared a comprehensive amendment for those requiring basic changes in the Fund Agreement. A number of questions on reform remain unsettled and they will continue to be studied by the Interim Committee and the Executive Directors, but without delaying the presentation of the comprehensive amendment for approval by member Governments, a process that may take about 18 months before it comes into effect.

At the press conference following the Jamaica meeting, Mr. H. Johannes Witteven, the managing director of the Fund, said: "[We] can say that we have now come to the end or almost to the end of a long process in which we have run through all of the Articles [of Agreement of the Fund] very thoroughly, and I think we have achieved a complete updating of the Articles of Agreement in the present situation." The comprehensive amendment is the result of four years of cooperative effort of the Committee of 20, the Interim Committee, the Executive Directors and staff of the Fund, and of the officials and technicians of many member countries. The delay in reaching an agreement on monetary reform has not been without benefit. It has enabled the reform to take into account how the world economy and the monetary system have actually worked in a period of great uncertainty. It has given Governments time to reach agreement on such complex issues as the exchange regime, the monetary role of gold, and the special payments problems of developing countries.

THE EXCHANGE RATE REGIME

One of the major questions on which it was very difficult to secure agreement was the exchange rate regime. The Outline of Reform stated categorically: "The exchange rate mechanism will remain based on stable but adjustable par-values... [and] countries should, whether in surplus or deficit, make appropriate par value changes promptly." Greater flexibility in exchange rates would be provided through wider margins and simplified procedures for making small changes in par value. Countries could adopt floating rates in particular situations, subject to Fund authorization, surveillance and review. This preference for a norm of par values with greater flexibility was gradually modified in the discussions of the Interim Committee. While France held that the monetary system should be based on par values, the United States held that this depended on prior attainment of stable monetary conditions and that countries should be allowed to have floating rates.

The failure of the second devaluation of the dollar in February 1973 showed that it was not possible to restore a system of fixed par values under prevailing conditions. That is why the present mixed system evolved. It combines a high degree of exchange stability for the currencies of the European common float (the snake) in terms of each other, a floating dollar to which other currencies were attached, and independent floating of other major currencies. From the point of view of the exchange market, the present system has worked well. It has avoided exchange crises involving the dollar of the type that occurred in 1971 and 1973. It has balanced the supply of and demand for dollars in the exchange market, although not without large fluctuations in the dollar exchange rates for the snake. It has had no obviously adverse effect on world trade, apart from some problems affecting exports and imports of manufactured goods. These are positive achievements in a very unbalanced world.

As long as the world is confronted by persistent inflation and large imbalances in international payments, there is no alternative to a system of fluctuating exchange rates combined with broader areas of exchange stability. The objectionable aspect of the present system is not that exchange rates fluctuate, but

that the dollar rates for the snake fluctuate too much. In the past three years, the dollar rates for these currencies have risen and fallen alternately by 10 to 20 per cent over periods of three or four months. Such large fluctuations over such short periods cannot reflect changes in underlying economic conditions—differences in relative inflation or in interest rates. They are primarily due to speculative capital flows in anticipation of changes in exchange rates. The excessive fluctuations of the dollar rates for the snake distort the pattern of trade in manufactured goods. When the dollar is at a peak, the exchange rate imposes an implicit tax on exports and a bounty on imports. When the dollar is at its nadir, the tax and bounty effects are reversed. Moreover, these fluctuations affect the competitive position of trade in manufactured goods in other countries—not only for the United States and Europe, but also for Japan and Canada as well as the developing countries. With such large and erratic fluctuations, the exchange rate cannot perform its fundamental function of bringing about a pattern of trade based on comparative costs and a flow of capital based on comparative profit and interest rates.

The difference in views on the exchange rate regime was finally resolved at a meeting of the heads of States and Governments of the six largest industrial countries at Rambouillet in November 1975 at which they agreed on the need to work for greater monetary stability. In deference to the United States, the communique stated that "this involves efforts to restore greater stability in underlying economic and financial conditions in the world economy." In deference to France, it stated that "at the same time, our monetary authorities will act to counter disorderly market conditions, or erratic fluctuations, in exchange rates." At a meeting of the Group of Ten in December 1975, the ministers of finance and central bank governors discussed these proposals to intensify consultation on exchange rate movements and underlying factors affecting monetary stability and they noted that their central banks were in the process of deepening and broadening consultations for the purpose of countering erratic fluctuations in exchange rates. This understanding cleared the way for agreement at the meeting of the Interim Committee in Jamaica to amend Article IV of the Fund statutes on the exchange rate regime.

Under the amended Article, members will still have a general obligation to collaborate with the Fund and other members to assure orderly exchange conditions and to promote a stable system of exchange rates. The emphasis, however, is shifted to doing this through economic and financial policies that foster orderly economic growth with reasonable price stability. The specific exchange arrangements a member may follow are any of those that prevail today. At present, 12 members of the Fund maintain the exchange rates for their currencies in terms of the value of a unit of SDRs. Eight members in the snake maintain exchange rates for their currencies in terms of each other within $\frac{3}{4}$ of the ratios of their central rates. The United States and a number of other members have freely fluctuating exchange rates for their currencies. Most members of the Fund, however, link their exchange rates to another major currency, with more than 50 linked to the dollar and about 20 linked to sterling or the French franc.

The new exchange regime gives equal status to all present exchange arrangements, although it would be possible to reduce the diversity in the future. The amended Article states: "To accord with the development of the international monetary system, the Fund by an 85 percent majority of the total voting power, may make provision for general exchange arrangements without limiting the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund." More specifically, the Fund may determine that international economic conditions permit the introduction of a widespread system of exchange arrangements based on stable but adjustable par values. To do this, however, the Fund must first determine that underlying conditions are favorable, taking into account price movements (inflation) and rates of expansion in the economies of members (cyclical conditions and rates of growth). As further conditions for establishing such a qualified par value system, the Fund would have to be satisfied that there are adequate sources of liquidity and that arrangements are made for prompt and symmetrical action by surplus and deficit countries in adjusting their balance of payments, as well as arrangements for intervention and the treatment of imbalances, which may mean modes of settlement and convertibility.

The procedure for establishing par values is set out in a separate schedule. The Fund must notify members that par values may be established in terms of the SDR or another common denominator it prescribes, but not gold or a cur-

rency. A member may then propose a par value which will come into effect if the Fund concurs or does not object within a reasonable time. A member that has a par value will be obligated to maintain exchange rates for other currencies with par values within 4½ percent of the cross-rate parities. A change in an established par value may be made only on the proposal of a member and only to correct or prevent the emergence of a fundamental disequilibrium. A member may terminate the par value of its currency by notifying the Fund. A member that does not intend to establish a par value will have to consult with the Fund to ensure that its exchange arrangements are adequate to fulfill its obligations on maintaining orderly exchange conditions and promoting exchange stability. If the Fund does not concur in a proposal for a par value or a change in a par value, or if the par value is terminated, a member will be subject to the obligation to consult with the Fund and fulfill the same obligations as a member that does not establish a par value.

It may seem that the amended Article on the exchange regime has no practical significance because it does no more than legalize the existing exchange system and recognize the need for greater exchange rate flexibility. Even that is of considerable importance, because it corrects a serious omission in the Bretton Woods Agreement. As it has become clear in the past few years that the world economy cannot be adapted to the system of fixed parities, it is necessary instead to adapt the exchange system to the realities of the world economy. In practice, the amended Article may give the Fund considerable influence on the exchange rate policies of its members. After all, there must be more to the general obligation to collaborate with the Fund and other members in assuring orderly exchange conditions and promoting stable exchange rates than to foster orderly financial and economic conditions.

The amended Article is directed as much to countries with fluctuating exchange rates as to those with par values. The Fund is required to oversee the international monetary system in order to ensure its effective operation and the compliance of each member with its obligations on exchange rates. To fulfill this function, the amendment states that "the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." Under this provision, the Fund could adopt guidelines on fluctuating rates that would place responsibility on members to avoid erratic and excessive fluctuations and to moderate such fluctuations when they are not caused by changes in underlying economic conditions. Such a responsibility cannot be one-sided, and intervention to prevent erratic and excessive fluctuations would have to be made only after consultation with the Fund and in cooperation with other members whose currencies are involved.

GOLD AND SDRS

The Outline of Reform stated that "the SDR will become the principal reserve asset and the role of gold and reserve currencies will be reduced" The difficulty in securing agreement on gold was the difference in the views of the United States and France, mainly on the right of monetary authorities to engage in gold transactions at market-related prices. In the course of its discussions, particularly at the fourth meeting on August 31, 1975, the Interim Committee agreed on abolition of an official price of gold and elimination of the obligation to use gold in transactions with the Fund and of the Fund's authority to accept gold. It also agreed on the sale of one-sixth (25 million ounces) of the gold holdings of the Fund for the benefit of the developing countries and the sale of an equal amount to members at the official price of 35 SDRs an ounce (restitution). The interim Committee had previously agreed that national monetary authorities should be free to enter into gold transactions under specific arrangements that would ensure that the monetary role of gold would be gradually reduced. At its August meeting it noted that the Group of Ten had entered into such arrangements.

The comprehensive amendment will eliminate entirely the numerous provisions on gold in the Fund Agreement. The official price of gold will be abolished. Payments in gold to the Fund by its members are now required for subscriptions, repurchases, and charges. These will be replaced by payment in SDRs or in currencies. The general increase in quotas that has just been agreed will not come into effect until the provision for part payment of subscriptions in gold has been amended. Article IV has dropped any reference to countries that buy and sell gold freely for international settlements, and the alternative form of convertibility in gold in Article VIII will be changed. The sale of gold for the benefit of developing countries and the restitution of gold to members at the official price will be

made under the existing powers of the Fund. The amended Agreement, however, will contain enabling provisions under which the Fund could use the remaining 100 million ounces of its gold in restitution to members at the present official price or in sales to the market at prevailing prices, with the profits used to augment its general resources or to provide balance of payments assistance on special terms to developing countries in difficult circumstances. Decisions on the use of profits in the regular transactions of the Fund will require a 70 per cent majority of the total voting power and on the use of profits in other operations and transactions, presumably for the benefit of developing countries, will require an 85 per cent majority.

The abolition of an official price of gold and the termination of gold transactions between the Fund and its members are major steps in reducing the monetary role of gold. The disposal of 50 million ounces in restitution of gold to members and in the sale of gold for the benefit of developing countries will remove one-third of the Fund's holdings and replace them with usable currencies and SDRs. That is a further step in eliminating gold from the Fund. On the other hand, it has been said that the restitution of gold to members will increase its importance in their reserves and that the arrangements of the Group of Ten, with the acquiescence of the Fund, will facilitate a resumption of its use in international settlements. Under these arrangements, to which other countries may adhere, the monetary authorities of the Group of Ten will be allowed to buy and sell gold at market-related prices, provided this does not involve pegging the price of gold or increasing the total stock of monetary gold now held by the Fund and the Group of Ten. The holding of gold reserves and their use in international settlements are the essential features of the monetary role of gold.

In spite of the arrangements of the Group of Ten, it is very doubtful whether gold will be much used in international settlements. Some central banks may be willing to sell gold when confronted with serious payments problems if they have already run down their reserves of foreign exchange and SDRs and have difficulty in securing further reserve credit. The critical question about the use of gold in international settlements is whether central banks will be ready buyers of gold at market-related prices. Central banks are understandably reluctant to acquire assets whose value in their own currencies is subject to sharp fluctuation and that applies even more to gold than to foreign exchange. Moreover, unless the United States and other countries are willing to buy gold at market-related prices, central banks may find that they acquired a reserve asset when they had a surplus which they would be unable to use to settle a deficit. Some gold sales by central banks might be arranged under repurchase agreements, but that would in fact be a loan on gold collateral rather than a true sale of gold. If countries do sell gold to meet balance of payments deficits, it would probably be in moderate amount in the free market and unless matched by purchases by other monetary authorities, say, to restore gold previously sold, it would result in a gradual reduction of the monetary stock of gold.

If termination of the monetary role of gold is conceived as requiring its elimination from the reserves of members of the Fund, then there is no prospect of achieving this at any time in the foreseeable future. Apart from the fact that gold retains its ancient mystique, so that some central banks like to show gold holdings in their balance sheets, there is the problem of what to do with the present stock of about 1 billion ounces held by countries outside the Communist group. Such an amount cannot be sold in the free market, even gradually, without causing a drastic fall in price, which central banks would find very disturbing. Besides, there is no asset that central banks want to acquire in place of gold. When silver was demonetized, central banks hastened to sell most of their holdings in order to buy gold. They are certainly not going to dispose of a sizable part of their gold holdings under present conditions. They may sell minor amounts in the free market from time to time to acquire needed foreign exchange or to meet domestic industrial demand. As for the great bulk of their gold, it will remain at the bottom of the reserve pile, part of the national patrimony but not used except in times of great stress approaching a national emergency.

It has been suggested that the simplest way to eliminate gold from reserves would be by establishing a substitution account in the Fund through which members would be able to exchange a part or all of their gold holdings for SDRs issued by the Fund for this purpose. Obviously, no country would exchange its gold for SDRs at the official price. Nor would any country be willing to make such an exchange at a market-related price unless it became absolutely necessary to sell gold to meet a payments deficit and it found an exchange for SDRs at the current

free market price of gold a convenient method of doing this. That would require an open-end substitution account rather than a once-for-all exchange. The fact is that SDRs have not yet acquired the degree of international acceptance that would induce countries to hold them instead of gold or even instead of currencies. At its Jamaica meeting, the Interim Committee asked the Executive Directors of the Fund to continue their consideration of a substitution account for gold, but without delaying completion of their comprehensive amendment. As this indicates, there is no possibility of creating a substitution account for gold.

The future monetary role of gold will not be determined by rules designed to insulate the monetary system from gold. That will certainly make gold a less usable reserve asset, but even in this regard the gold policy of the United States and other large trading countries is of greater practical importance. The monetary role of gold will be determined by developments in the international monetary system. Gold is very unlikely to resume its previous role as the primary reserve asset into which other reserves, such as dollars, are convertible. But if the international monetary system evolves toward a widespread use of par values, and that does depend on achieving a high degree of price stability, a practical method of using gold in international settlements in conjunction with other reserve assets may be found, as through a Reserve Settlement Account. Although that may seem contrary to all recent developments, the policies of Governments are not immutable. On July 3, 1933, President Roosevelt sent a message to the World Economic Conference in London in which he said:

"I would regard it as a catastrophe amounting to a world tragedy if the great conference of nations, called to bring about a more real and permanent financial stability and a greater prosperity to the masses of all nations, should, in advance of any serious effort to consider these broader problems, allow itself to be diverted by the proposal of a purely artificial and temporary experiment affecting the monetary exchange of a few nations only . . . Let me be frank in saying that the United States seeks the kind of dollar which a generation hence will have the same purchasing power and debt-paying power as the dollar value we hope to attain in the near future. That objective means more to the good of other nations than a fixed ratio for a month or two in terms of the pound or the franc."

Eight months later, the United States adopted the Gold Reserve Act of 1934 which fixed the monetary price of gold at \$35 an ounce.

The Outline of Reform stated that the SDR would become the numeraire in which par values will be expressed. The first step in this direction was taken on July 1, 1974 when the definition of the value of a unit of SDRs was changed from 1/35 of an ounce of gold to specified amounts of a basket of 16 currencies. Such a change had become essential for the operations of the Fund after the sharp rise in the free market price of gold. In fact, Annex 9 of the Outline of Reform discussed various methods of valuing the SDR, including the one that was adopted. The new valuation method has provided a convenient currency base for countries that want to avoid the wide fluctuations in the exchange rates for the dollar relative to the snake. As the dollar was one-third of the initial value of the SDR and as a few other currencies in the SDR basket have changed relatively little in terms of the dollar, the value of the SDR in dollars has fluctuated within a moderate range of 3.5 per cent below and 4.5 per cent above its initial value. The D-mark value of the SDR has fluctuated in a slightly wider range between 2.7 per cent below and 6.3 per cent above its initial value. The amendment to Article IV will make the SDR the common denominator of par values unless some other numeraire is adopted. There would be some technical problem in using the SDR as now valued for the common denominator in a widespread system of par values, particularly for the currencies in the basket, but that could be easily adjusted.

The statement that the SDR will become the principal reserve asset is only a hope for the distant future. The importance of SDRs in the aggregate of reserves will grow gradually as further issues are made, particularly if the stock of monetary gold is decreased and foreign exchange reserves increase relatively little. The use of SDRs in international settlements, however, will certainly become much greater if the SDR acquires more of the characteristics of a freely usable reserve asset. The amended Articles will authorize the Fund to review the rules for reconstitution at any time and to change these rules by a 70 per cent majority of the total voting power. Countries will be free to deal in SDRs without designation by the Fund and without showing a need to use them in settlement of deficits. The Fund will also have broader authority to designate international and regional institutions eligible to hold SDRs and deal in them. In short, with the amendment, countries will be able to use SDRs with complete

freedom as a true reserve asset, in much the same way as they used gold reserves in the past and use foreign exchange reserves now. The improvement in the reserve character of the SDR will have to be followed by a resumption of their issues if they are to be much more widely used in international settlements.

RESOURCES FOR DEVELOPING COUNTRIES

The Outline of Reform stated that in the light of the agreed objective to promote economic development, the reformed monetary system will contain arrangements to help increase the flow of real resources to developing countries. One suggested method was to link the issue of SDRs with development finance, either through direct distribution to developing countries of a larger proportion of SDRs or through allocation of a share of SDR issues to international and regional institutions that provide development finance. It was generally understood, of course, that even with the link the issue of SDRs would be determined exclusively by the need for a trend growth of aggregate reserves. The Interim Committee discussed this question at a number of meetings and reported a diversity of views on the link, but agreed that it should be kept under active study by the Executive Directors. This may be regarded as a polite parliamentary way of shelving the proposal. If the Fund is to provide more resources for developing countries, it will have to be done in other ways.

At the meeting in Jamaica the Interim Committee endorsed the long-standing recommendation of the Executive Directors for a 32.5 per cent increase in quotas rounded up to SDR 39 billion. By groups, the quotas of the oil-exporting countries will be doubled, those of other developing countries increased proportionately with the total, and those of the industrial countries increased less than proportionately. There are, however, considerable differences among individual members in the percentage increase in their quotas. As the general increase in quotas will not come into effect until the amendments to the Fund Agreement have been adopted, the increase in their use of Fund resources before then has been provided in another way. The Interim Committee has agreed that until the amendments come into effect, the size of each credit tranche should be increased by 45 per cent so that total access under the credit tranches would be 145 per cent (now 100 per cent) of the quota, with further assistance possible in exceptional circumstances. The usual 25 per cent drawing limitation on the quotas in a 12-month period and a total of 100 per cent under all credit tranches, with further drawings requiring a waiver, will be resumed after the quota increases have been approved and accepted.

The Bretton Woods Conference adopted a number of resolutions in addition to the agreements on the Fund and the World Bank. One resolution was particularly related to the purposes of these institutions. It stated:

"The United Nations Monetary and Financial Conference recommends to the participating Governments that, in addition to implementing the specific monetary and financial measures which were the subject of the Conference, they seek . . . to reach agreement as soon as possible on ways and means whereby they may best . . . bring about the orderly marketing of staple commodities at prices fair to the producer and consumer alike."

The Fund has long recognized that because of their very heavy dependence on exports of basic commodities the developing countries are exposed to sharp fluctuations in their payments position. That was the reason why the Fund established a compensatory financing facility over ten years ago on which countries could draw for the particular purpose of meeting a shortfall in their normal export receipts. Since this facility was established some 30 developing countries have drawn reserve credit of \$1 billion in compensatory financing. The Interim Committee showed great interest in increasing the availability of resources through this facility. At the end of 1975, the Executive Directors decided that the Fund would be prepared to authorize drawings up to 7 per cent of a member's quota (previously 50 per cent), provided outstanding drawings are not increased by more than 50 per cent of the quota (previously 25 per cent) in any 12-month period. Larger drawings may be met only if the Fund is satisfied that a country is taking measures to deal with its payments problem.

The Fund is committed in various ways to much larger use of reserve credit by its members. To meet these commitments, the Fund will have to have more resources. In part this will come later from the subscriptions to the general increase in quotas. The difficulty in the past has been that drawings have been overwhelmingly concentrated on the currencies of the Group of Ten. At a time of unusually great need by its members, the Fund has had to resort to borrowing to

meet their drawings—from the Group of Ten under the General Arrangements to Borrow and more recently from the oil-exporting countries and other members to fund the Oil Facility. If the Fund is to meet its large commitments in the future, it must be able to use the currency of any member under appropriate conditions. The amendment of the Fund Agreement will provide that the Fund's holdings of every currency should be usable in its operations in accordance with its policy—presumably the currency of any country that has a payments surplus and adequate reserves. Within the next six months, before the amendment comes into effect, members will have to make satisfactory arrangements for the use of their currencies by the Fund.

The most important new step taken by the Fund to help developing countries is the establishment of the Trust Fund for their benefit. The resources of the Trust Fund will come from that part of the profits of the sale of the Funds' gold for the benefit of developing countries which is not distributed to them directly in proportion to their quotas. The resources of the Trust Fund will be augmented by voluntary contributions and some countries have already stated that they will make such contributions. The Trust Fund is being established and the initial sale of gold for its benefit are both being done under existing powers. As the amendment makes no provision for its permanent operation, its continuing operations will depend on later increases in its resources. They could be increased from the profits of additional sales of gold for the benefit of developing countries, and the Fund will have such power under the gold amendment to the Articles of Agreement. If this power is to be exercised, it can be done only with the approval of a large majority of the total voting power. In any case, such additional sales of gold would not be made for four years—that is, after the first 25 million ounces are sold. Additional resources could also come later from voluntary contributions by members. The resources of the Trust Fund will be used to provide balance of payments assistance on concessionary terms to low-income countries, initially those with a per capita income not in excess of SDR 300 in 1973.

ROLE OF THE INTERNATIONAL MONETARY FUND

The first purpose of the Fund as stated in its Articles of Agreement is "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." In the 30 years of its existence, the influence of the Fund has waxed and waned. Its influence declined in the past ten years as the Bretton Woods system of fixed par values broke down and the international monetary system passed through a series of crises involving the currencies of its largest members, particularly the dollar. Nevertheless, the Fund remained the one institution through which all countries could collaborate in finding a solution to their common problems. The fact that the agreed reform is being made through amendment of its statutes is evidence that the Fund remains the central institution for collaboration on international monetary affairs. The effectiveness of the reform, however, will depend not only on these amendments, but on the influence of the Fund in securing the collaboration of its members in restoring a well-functioning international monetary system.

The most dramatic change is in the exchange system which was regarded at Bretton Woods as the *raison d'être* of the Fund. It should be emphasized that the system of fixed but adjustable par values was a great advance over the gold standard because it allowed a country to adjust the parity of its currency to the state of its domestic economy rather than requiring the domestic economy to be adjusted to a fixed parity that could not be changed except under the stress of a great national emergency. Nevertheless, the Bretton Woods system was too inflexible. It failed to recognize that conditions could arise under which many members would be unable to determine or maintain an appropriate par value for an extended time. It is interesting to note that the Fund Agreement made provision for suspending the general obligation of members to maintain exchange rates based on existing par values in an emergency. (Article XVI, Section 1(a) (i).) If such a suspension had been voted, its extension would have required the approval of the Board of Governors and ultimately an amendment of the Fund Agreement. The change in the established system of fixed par values was made without invoking the emergency provision, but followed a process similar to that in Article XVI, although over a much longer period. The amendment legalizing floating exchange rates, without restricting the right of groups of countries to maintain stable exchange rates for their currencies in terms of each other, corrects a defect in the Bretton Woods system.

The Fund had only very limited powers to induce a member to change an inappropriate par value and the fact is that some major currencies remained undervalued or overvalued for extended periods. In this respect, the influence of the Fund may be greater under the new exchange regime. The Fund has been given the positive duty to oversee the international monetary system in order to ensure its effective operation. It has a mandate to exercise firm surveillance over the exchange rate policies of members and to adopt specific principles for the guidance of all members on such policies. This responsibility applies to countries with fixed rates as well as those with floating rates. Under these powers, the Fund could establish standards for determining whether a surplus or deficit country should undertake adjustment of its balance of payments through a change in the par value of its currency on the basis of the changes in its reserves and in the structure of its balance of payments. Similarly, the amendment imposes on the Fund the duty to set guidelines for countries with floating rates. While these guidelines will have to be very broad, they should provide a basis for requiring countries to avoid large fluctuations in exchange rates not related to changes in underlying economic conditions.

Much of the influence of the Fund has come from its role as a provider of reserve credit. The latest increase of quotas will greatly augment its resources. The disposal of 50 million ounces of its gold holdings will provide it with SDRs and currencies it can use in its operations. The liberalization of drawings on the compensatory financing facility will be of great help to countries exporting primary products, particularly developing countries. The Trust Fund for very low income countries is an innovation. It will probably be maintained for an extended time from the profits of further sales of the Fund's gold, although that will require a large majority of the total voting power. The increase in its resources will make it possible for the Fund to have greater influence on the policies of its members. The Fund must make sure, however, that these resources are used only for reserve credit to meet temporary deficits in the balance of payments.

The main area in which relatively little progress has been made is in the integration of the diversity of reserves and in the control of the growth of aggregate reserves. The international monetary system will continue to have a multiplicity of reserve assets—gold, reserve currencies and SDRs—although very little use will be made of gold and perhaps much greater use will be made of SDRs in international settlements. So long as there is a multiplicity of reserve assets, the international monetary system could be disrupted by changes in the preference of countries for holding one rather than another reserve asset. For obvious reasons, members of the Fund will not exchange their gold and reserve currency holdings for SDRs, certainly not under present conditions. If the use of the different reserve assets is to be integrated in the future, it will have to be done by establishing a Reserve Settlement Account in which countries earmark all of their reserve assets and use them *pro rata* in international settlements. Such a reserve system is not feasible while the pattern of international payments is seriously unbalanced and perhaps not until there is a widespread system of fixed par values.

The importance of SDRs as a component of aggregate reserves will become greater when the Fund resumes making new issues. Even if the Fund were to be cautious in the issue of new SDRs, it would be unable to control the growth of aggregate reserves unless the growth of foreign exchange reserves were halted. That would require countries to avoid increasing their foreign exchange reserves. While there is much to be said for such a policy as a means of improving balance of payments discipline, it is not feasible so long as some countries—at present, the oil-exporting countries as a group—have very large overall balance of payments surpluses and are increasing their holdings of reserves. Under such conditions, the availability of foreign exchange to add to the reserves of surplus countries provides an indispensable flexibility to the international monetary system. When a well-balanced pattern of international payments is restored, it may be feasible to control the growth of aggregate reserves. If that is to be linked with settlement of payments deficits in reserve assets, it will be essential to provide safeguards that assure the reserve currency countries that their surpluses will also be settled in reserve assets.

In the long run the influence of the Fund will be determined by developments in the world economy rather than by changes in its statutes. If the present monetary instability subsides and countries are better able to fulfill their obligations to maintain orderly exchange arrangements and to promote exchange stability,

the Fund will have great influence through its oversight of the international monetary system. Its standards and guidelines may give it greater influence on the exchange policies of its members than the most rigid requirements on par values and stable exchange rates. Furthermore, if the Fund is successful in operating as a monetary authority providing reserve credit, and not as a supplementary source of resources for development, it will be able to influence the financial policies of its members to help them toward attaining greater monetary stability and a better-balanced payments position. Ultimately, the influence of the Fund will depend on what its members want it to be. In this respect, the Council of Governors, if it accepts the responsibility, will be decisive. If the Fund has the confidence of the Council, it will be able to perform the primary function for which it was created—to be a center for international monetary collaboration in the interest of all its members.

STATEMENT BY PROFESSOR HENRY HAZLITT

I am gratified by the privilege of submitting testimony to this distinguished committee on the present proposed amendments to the IMF agreements.

My name is Henry Hazlitt. I am the author of fifteen books, most of them on economic subjects, and one of them specifically on "What You Should Know About Inflation." From 1934 to 1946, I was a member of the New York Times Editorial Board, and wrote most of that publication's economic editorials. From 1946 to 1966, I wrote the signed weekly "Business Tides" column for Newsweek magazine. From 1966 to 1969, I wrote a twice-a-week internationally syndicated column for the Los Angeles Times Syndicate. My book on foreign aid, "Will Dollars Save the World?", published in 1947, was condensed to 5,000 words by the Reader's Digest and published in all twenty of its international editions. I testified on the original foreign aid proposals at that time at the request of both the House and Senate Committees in charge of the implementing legislation.

The bill before your committee might most appropriately be labelled: "A Bill to Promote Further American and World Inflation and Increasing International Economic Chaos, and to Make it Almost Impossible for the World or Any Individual Nation Ever To Restore a Sound Monetary System."

This is not its actual title. Officially it is a bill "to provide for amendment of the Bretton Woods Agreements Act, and for other purposes." It is advocated by the Treasury Department. Secretary Simon, testifying in its favor, called it "the single most important piece of legislation in the international monetary sphere since the Bretton Woods legislation itself." In one sense he was right. It would work more havoc in that sphere than any legislation passed by Congress since it accepted the Bretton Woods Agreements of 1944.

To view these latest proposals in perspective, it will help to recall a little history. Thirty-two years ago, a group of officials from some forty nations, under the leadership of Lord Keynes of England and Harry Dexter White of the United States, decided to set up a monetary system that would be a huge improvement, they thought, over the classic gold standard because it would drastically reduce the monetary role of gold. Only one currency, the U.S. dollar, would have to be convertible into gold—and even then no longer at the demand of anybody who held dollars, but only at the request of foreign central banks. All the other currencies were to be kept convertible merely into the dollar. With the dollar anchored to gold, and all the other currencies tied to the dollar, stability would be assured, and the need for gold reserves would be minimized.

The system seemed to relieve every other country but the United States from strict monetary discipline. If any country got into trouble it was assured almost automatic loans and credit to bail it out. The agreement also provided that any nation could at any time devalue its currency by up to 10 percent, and explicitly stipulated that "the Fund shall raise no objection." The real but unstated and unacknowledged purpose of the Bretton Woods Agreements, as the present writer pointed out at the time (in "The American Scholar," Winter 1944-45) was "to make resort to inflation easy, smooth, and above all respectable."

As early as 1949 the system started breaking down. The British pound was devalued 30 per cent on Sept. 18 of that year—from \$4.03 to \$2.80. Twenty-five other countries devalued within the following week. In succeeding years there were hundreds of devaluations of currencies in the Fund.

What had been overlooked from the beginning was the erroneous increase in the burden and responsibility that the Bretton Woods arrangements put upon the

United States. For the other countries could hold dollar reserves on the assumption that this was just as good as holding gold reserves. But their currency stability was, in fact, made dependent on the soundness of the dollar.

Yet successive U.S. governments remained completely oblivious of the gravity of the responsibility we had assumed. Our officials kept undermining the dollar—by foreign aid, huge domestic spending, chronic and mounting budget deficits, and by pushing down domestic interest rates and increasing the money supply. By 1968 we had practically ceased keeping the dollar convertible into gold, even by central banks. And on August 15, 1971 we abandoned the gold standard even officially.

Our repudiation of our solemn commitment was followed by mounting inflation, devaluations, and monetary disorganization everywhere. There seemed no longer any point in maintaining fixed exchange rates. There was not even any agreement on what they could be fixed to.

So what is our government now proposing as the cure? It is proposing to intensify everything that caused the disease.

The chief effect of the International Monetary Fund from the beginning has been to serve as an engine of inflation. The IMF is to be continued. Not only that; it is to be given more resources to play with. The United States is to be asked to turn over enough more dollars to increase its quota in the Fund by the equivalent of 1,705 million Special Drawing Rights (SDRs). And the IMF is to have its powers of inflation increased still further by being allowed to create more SDRs and by the relaxation of certain rules to make the SDR "a more usable asset."

What is an SDR? It is paper money—a credit on a book—and it is to be issued as a "reserve" against national paper currencies. What is an SDR worth? That's an interesting question. When originally created in 1968, it was defined in terms of gold—though never convertible into it. It is now defined "in terms of a weighted basket of the market exchange rates of 16 major currencies, with the dollar representing approximately one-third of the basket." So even the nominal value of the SDR is changing every day and even every hour. But suppose you wanted to convert it into something definite? Something you could measure, weigh, feel, touch, or bite. What is par? You still don't seem to get the idea. It has no par. And the basket of currencies in terms of which it is defined has no par. The American dollar, one-third of that basket, is no longer to have any par. Nor any other currency. Now do you understand?

And yet, Secretary Simon tells us, the U.S. and other members under the new legislation accept "an obligation . . . to collaborate with the Fund toward the objective of making the SDR the principle reserve asset of the international monetary system." It is not only to be "an asset" but the "unit of account."

How can it serve as an asset and a unit of account when its own value is constantly fluctuating, and has to be recalculated every minute? Tomorrow, say, the German mark rises in terms of the dollar and the dollar correspondingly declines in terms of the mark. Has the mark risen or the dollar fallen? In olden days, when we had par values and gold standard, the answer was easy and immediate, and suggested who should take the appropriate corrective steps. But now? Ah yes, we have the SDR, the "unit of account." But the value of the SDR is itself determined by the value, among other currencies, of the mark and the dollar, and has just been changed by the change in their value. Talk about relativity! Which is measuring which? Which is the image and which the mirror. Have we entered Wonderland? Or a lunatic asylum?

What is to happen to gold, which for centuries served this international unit-of-account function among others? Gold is to be treated as if it were something far more dangerous than heroin. We quote from the summary of Secretary Simon: "The new provisions of the IMF Articles of Agreement also promote the process of phasing gold out of the system—by abolishing the official price of gold and gold's role as common denominator of the system, by eliminating all requirements to use gold in transactions with the Fund, and by providing specific authority for future disposal of the Fund's gold holdings."

That isn't all. Not only must gold continue to be dumped on the market, depressing the price so that our monetary mismanagers can avenge themselves on the "gold bugs"—that is, on the people who seek a refuge for their otherwise evaporating paper money savings—but government or central bank buyers must be prevented from entering the market as buyers.

As Secretary Simon says elsewhere, in addition to the present proposed legislation, "important side arrangements have been agreed among the Group of Ten—

the major gold-holding nations—to assure that gold does not re-emerge as a major international monetary asset.” Their understanding provides that participating nations “will not act to peg the price of gold” and “will agree not to increase the total stock of monetary gold.” That is, they will agree not to be buyers, no matter to what temptingly low levels the IMF sales reduce the price of gold.

The Fund is to be “prohibited from accepting gold except by specific decision, by an 85 per cent vote.” It is to be “empowered to dispose of its remaining gold holdings,” and it is to be turned in effect into another giveaway agency. The proceeds of its gold sales are to be “used for the benefit of developing countries.” Let us remember that it is the American people’s gold that is to be simply given away.

This is madness. Currencies are depreciating and in chaos everywhere because the world’s monetary managers and officeholders, and specifically our own, did not have the integrity to abide by the requirements of the gold standards. So now, instead of acknowledging that this was mainly if not solely the result of their own bad faith and endless issuance of excessive paper money, they seek to make the gold standard itself the scapegoat, and to get legislation passed that would immensely increase the harm already done and tend to perpetuate international currency chaos.

If we ask what should be done instead, the first and main part of the answer is simple. Abolish the IMF. It has been from the beginning mainly an engine promoting international inflation. Whatever stabilizing function it may once have served ceased completely on August 15, 1971, when the U.S. openly abandoned gold convertibility for the dollar. The IMF’s continuance now is inexcusable.

Gold, the only real asset of the Fund, should not be sold, but should be returned to the individual nations that originally turned it over to the Fund. It should be given back in proportion to each nation’s present quota in the Fund. No further printing of SDRs should be permitted. Outstanding SDRs should be cancelled, and their holders compensated in gold at approximately the closing open market price of that metal (in terms of SDRs) on the day before the decision is reached and announced. This gold would be deducted pro rata from the amounts each country would otherwise receive back from the Fund in proportion to its quota.

Then each country would be on its own, and once more fully responsible for the soundness of its own currency. If it got into trouble, it could claim no automatic credit from other countries, but would be obliged to turn to private creditors. That might do something to restore discipline.

Inflation in most individual countries would no doubt continue for a while, but countries would at least cease exporting their inflations to each other.

For a variety of reasons, government return to a gold standard would probably not for a long time be practicable. But what Congress can and should do immediately is to provide that contracts calling for payment in gold (or, for that matter, in silver, platinum, or what not) voluntarily entered into by private parties, shall not only be legal but enforceable in the courts. When governments can no longer compel everybody to do business in their depreciating paper currencies, the prospects for monetary reform will be appreciably nearer.

MR. YEO’S ANSWERS TO QUESTIONS SUBMITTED BY MEMBERS OF THE SUBCOMMITTEE

Question 1. How will the system of floating exchange rates be managed under the Jamaica agreement? How will countries who ignore the Fund’s principles be called to account? What would you recommend that the United States do to make certain that the IMF does in fact exercise firm surveillance over the exchange rate policies of members? By accepting these amendments and the quota increase is the United States relinquishing bargaining leverage which could be used to promote adoption of sound adjustment principles?

Answer. The new Article IV sets forth members’ general obligations to pursue underlying economic stability and to avoid action to manipulate exchange rates or the system to prevent effective balance of payments adjustment or gain unfair competitive advantage over other members. The Article specifies that countries may adopt exchange arrangements of their own choosing, subject always to their general obligations. It directs the IMF to oversee the operations of the system and the compliance of members with their obligations. And it directs the Fund to exercise firm surveillance over members’ exchange policies

and to establish principles for the guidance of members with respect to those policies.

These obligations and principles will form the basic framework for operations of the system. The IMF will have a variety of means for assuring that the principles are followed by members once they are agreed: informal consultations; informal reports on members' policies; published reports. Ultimately, if a member ignored the IMF's recommendations, the IMF could suspend its rights to use IMF resources or require the member to withdraw from the IMF. The IMF is directed by the proposed new Article IV to exercise "firm surveillance". This is the desire of the IMF membership, and the U.S. will press in the IMF for the effective application of this provision.

Acceptance of the amendment does not mean that the U.S. is relinquishing "bargaining leverage" for adoption of sound adjustment principles. To the contrary, recommendations for adjustment are likely to be much more effective and acceptable if they come from an international organization rather than from an individual country; and the amendment will provide the essential legal framework for development of needed principles in the IMF. U.S. failure to accept the amendment would negate this agreed legal framework and would seriously undermine our ability to negotiate with others on monetary matters.

Question 2. Under the proposed new Article IV of the Articles of Agreement, each member country undertakes an obligation to direct its economic and financial policies toward the objective of fostering orderly economic growth with "reasonable price stability". What is the meaning of that undertaking? What is meant by "orderly economic growth" and "reasonable price stability?" There is little, if any consensus in this country about the meaning of those goals, about the relative burdens of inflation and unemployment. How can we expect any consensus on this point in the international community when there are widely divergent views on the relative importance of inflation and unemployment and, hence, about the direction of economic policy? How is the IMF to decide, in light of this divergence of view, whether a country is "fostering orderly economic growth with reasonable price stability" and, hence, whether a country may have access to IMF credit?

Answer. The philosophy of the new Article IV is that monetary stability results, not from maintaining (or trying to maintain) par values, but from developing conditions of underlying economic and financial stability in IMF member countries.

As part of this fundamental orientation each member undertakes an obligation to "endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard for its circumstances."

Obviously there can be no single simple definition of "orderly economic growth" or "reasonable price stability" which would cover all nations and all time periods. Orderly economic growth might not mean exactly the same thing for the U.S. economy and for that of Papua-New Guinea, to take the largest and one of the smallest members. Nor might reasonable price stability be the same in the context of 1970's, for example, as in the early 1960's.

These two specific phrases are objectives against which nations policies are to be measured and their performance tested. But the assessments must be on a case by case basis taking full account of the individual country's situation. Such assessments will reflect the judgment of the IMF—through its Executive Board and perhaps other IMF bodies—based on case study, and thorough examination of all circumstances. Only in this way can it be determined whether a country is fulfilling its obligations to work toward economic and financial stability.

Question 3. Under the proposed amendments, the Fund is called upon to adopt "specific principles" for the guidance of members with respect to exchange rate practices? What principles are likely to emerge? Why weren't they a part of the new agreement? Does their absence mask fundamental differences in attitude and approach? If so, is there any reasonable expectation of their being ironed out in the future? What principles should govern exchange rate practices?

Answer: Specific IMF principles to be established under proposed new Article IV have not yet been agreed. However, the fundamental approach is fully agreed and is specified in the new Articles; this fundamental agreement will form the basis for development of specific principles. The IMF Executive Board is beginning its work on specific principles, with a view to putting them in place when

the amended Articles take effect. In developing these principles, it will be important to preserve a substantial degree of flexibility and adaptability. This is one reason why it was not considered desirable or appropriate to write specific guidelines into the new Articles—the Articles constitute a constitution, not a contract. Flexibility is needed for several reasons:

The basic procedural approach may be changed, e.g., through a decision to apply par values (by an 85 percent majority).

The individual characteristics and circumstances of each country must be taken into account on a case-by-case basis, within a general framework of agreed objectives and obligations.

The system, countries' perceptions, and international guidelines must be permitted to develop and evolve as the world economy evolves.

The important points are that the basic approach must be right, and that we avoid such precision and rigid detail in establishing the overall framework that the system exceeds its bounds because of the inability of the rules to adapt to real, compelling needs. This is what happened under the present par value provisions of the IMF Articles. The par value system could not be sustained, but no other system was legally tolerated. The consequence was a breakdown of compliance with the law. This is an extremely dangerous, potentially infectious situation. We are fortunate that countries have maintained the collaboration and cooperation that have developed with 30 years of adherence of the purposes of the Fund. But the rule of law, and one that respects the dynamics of the world economy, must be restored.

Question 4. In 1972 Secretary Shultz proposed at the annual IMF meeting that the level of reserves might be used to indicate whether a country was following an appropriate adjustment policy. That was under a pegged rate system, of course, but some economists have proposed that a reserve-level indicator would also be useful under a system of managed floating. In your opinion would it be useful to have objective indicators or "presumptive guidelines" for judging the appropriateness of exchange rate policies of IMF members?

Answer. Some role for objective indicators or "presumptive guidelines" may prove useful and appropriate as part of the process of reaching judgments about exchange rate policies, and this question will be considered carefully as the principles to be established under Article IV, Section 3 are developed.

Question 5. One of the problems with the floating exchange rate system is that the rates fluctuate too, widely. Do you have any suggestions for reducing fluctuations, for dealing with "disorderly market conditions"?

In that regard, what role should bilateral or other arrangements outside the IMF, play in helping other countries meet balance of payments difficulties? The recent Group of Ten \$5.3 billion loan to the U.K. is an example of assistance outside the Fund. To the extent that such assistance permits a country to avoid changes in its economic policies doesn't it undermine the very purpose of the amended Articles, viz, to force a country to adjust its economic policies in order to foster orderly economic growth?

Answer. Implicit in the first question is the view that "fluctuations" in exchange rates are an indication of "disorderly market conditions." This is not necessarily true. Fluctuations can represent perfectly rational and desirable market responses to changing economic and financial conditions. If rates fluctuate widely, it is likely to be because the underlying economic trends in the countries concerned are diverging widely. The way to reduce the wide fluctuations is for countries to achieve the orderly underlying conditions that are prerequisite for exchange stability. That is the philosophy of the new Article IV. It will also discourage those economically irrational situations known as "disorderly market conditions."

Both multilateral and bilateral balance of payments financing should be directed at the same objective—promoting a smoothly functioning international monetary system in a manner consistent with members' obligations in the IMF.

The IMF provides medium-term financing (usually 3 to 5 years), normally conditional and keyed to an economic program designed to correct the problem causing the need for the financing, usually requiring weeks or months to arrange, and multilaterally negotiated and implemented through the institution of the Fund. Credit from the Support Fund, supplementing the IMF, would also be made available on a medium-term basis and only in connection with policy conditions. Bilateral currency swaps such as the credit package recently arranged for the U.K., provide short-term financing (usually 3-6 months), normally

aimed at dealing with disorderly market conditions, can be mobilized quickly in event of emergency, and are implemented through one or several bilateral agreements. Somewhat more extended bilateral credit may also be appropriate in certain circumstances, as is discussed in more detail in the answer to question 17.

The two types of arrangements thus differ in term and character, and in all cases should be complementary, not competitive. This complementarity was recently exemplified by the recent \$5.3 billion swap with the United Kingdom, where the funds were made available for a maximum of six months to the U.K. to deal with a disorderly foreign exchange market. However, if funds could not otherwise be repaid within that period, the U.K. would draw from the IMF, undertaking the economic program necessary for such drawings. In other words, if the U.K. financing needs turned out to be not just a result of disorderly markets but something more fundamental, the U.K. would adopt the needed corrective measures.

Question 6. Although the amendments legitimize floating rates and leave members free to select their exchange rate arrangements, there is a provision for the Fund, by an 85 percent majority vote, to reinstate a general par value system. Under what circumstances if any, would you recommend that a general system of par values be reinstated?

Answer. We do not at present foresee circumstances that would lead the United States to recommend adoption of a general system of par values.

Question 7. The IMF has already agreed to dispose of $\frac{1}{2}$ of its total gold holdings, with $\frac{1}{6}$ th to be restituted to Fund members and the proceeds from sales of the other $\frac{1}{6}$ th to be allocated to a Trust Fund for the benefit of developing countries. The overall goal of the amended Articles is to phase gold out of the international monetary system entirely. How, and under what circumstances, should the remaining gold holdings of the IMF be disposed of? Is there any agreement on that among Fund members right now?

Answer. Decisions on the disposition of the remaining 100 million ounces of IMF gold holdings have not been considered. The proposed new Articles (Article V, Section 12) provide that the IMF may, by an 85 percent majority vote, decide to dispose of these holdings by sales at market-related prices or sales at the book value of approximately \$42 per ounce to IMF members.

Question 8. What factors or principles will govern the rate of disposition of the $\frac{1}{6}$ th of the Fund's gold holdings which the Fund has already decided to sell? Is there a danger that the Fund will be under pressure from, say, France and South Africa, to go slow in disposing of those holdings in order not to depress the price of gold? What is the United States attitude in that regard? Will the U.S. go along with any attempt to stagger or delay IMF gold sales in order to avoid depressing the price of gold? Is there anything to prevent the Fund from behaving in that fashion? And won't the same concern, namely, fear of depressing the price of gold, generally tend to slow down future IFM dispositions of its gold holdings?

Answer. The IMF has decided that the $\frac{1}{6}$ th of Fund gold holdings (25 million ounces) to be disposed of for the benefit of developing countries will be sold over a four year period. Of the 16 auctions planned for the first two years, two have been concluded and the third is scheduled for September 15.

It is the United States' view that the best technique for disposing of the gold is through a series of regularly scheduled auctions, along the lines followed thus far. In that way, the amounts are sold over a reasonable period and do not have an exaggerated market impact, and the market knows what to expect. In our view, markets function best when uncertainty is reduced, and the IMF will obtain a greater return for its gold than if there is uncertainty about what the IMF plans to do. With regularly-spaced auctions, the IMF will sometimes get a relatively high price, sometimes a relatively low price, but over the whole period will get a fair price as determined by market forces.

The United States and other countries have agreed to eliminate the official price of gold and not to try to peg the price at any particular level. It follows that we do not think there is a particular price of gold that is "correct", nor would we regard any particular price as "too low" or "too high" if determined by the market. We would not favor delaying the planned gold sales on grounds that the price has declined. It should be emphasized that neither the IMF nor the U.S. has a price objective for gold—no one is trying to drive down the market price of gold. The purpose is simply to convert the 25 million ounces of IMF gold into usable currencies, in an orderly way, for the benefit of the IMF General Account and the Trust Fund.

It would be a mistake to exaggerate the impact of IMF gold sales on the price. During 1973 and 1974 the price of gold rose sharply, from around \$65 per ounce to nearly \$200. Since then, the price has declined for a variety of reasons: Americans failed to buy large amounts for investment—as some had anticipated—when prohibitions were removed; industrial and jewelry demand fell sharply when the price was high; recession in major countries reduced demand; better performance with respect to inflation restored confidence in certain currencies; and balance of payments deterioration in major producing countries reduced the prospects of withholding supplies. The IMF sales added only a moderate amount to total supplies coming on the market—which, even with IMF sales, are below the levels of a few years ago.

Question 9. Will the agreements actually result in phasing gold out of the international monetary system? The Group of Ten arrangement, under which the major industrial countries agreed to limit their total gold purchases and not to peg the price of gold, lasts only two years. If the Group of Ten arrangement expires, will the place of gold as a reserve asset be likely to grow? Should the United States press for an extension of that arrangement? Why was it limited to two years? What additional measures should be taken to reduce the role of gold in the monetary system?

Answer. The U.S. believes that the agreement effectively places gold on a one-way street out of the monetary system. The Group of Ten arrangement is a transitional safeguard, designed to protect against possible reemergence of a central role for gold during a period in which the basic legal position of gold under the IMF Articles is being changed importantly, and while the process of disposing of IMF gold is getting underway. An initial period of two years for these arrangements appeared reasonable and was generally satisfactory. Whether the arrangements should be extended beyond two years will have to be decided in the light of circumstances and experience toward the end of the two year period. In any event, we do not believe additional measures are needed at this time. Current experience is providing convincing evidence of the unsuitability of gold as a basis for the monetary system.

Question 10. There has been some discussion of "substitution accounts" as a means of consolidating reserves and thereby reducing the risk of sudden shifts from one reserve asset to another. The IMF's Committee of Twenty recommended establishment of a "substitution account" in the Fund for members to exchange gold or reserve currencies for SDRs, but the Jamaica agreements did not include a "substitution account". Do you favor the establishment of "substitution accounts" as a way of reducing the risk of sudden shifts from one form of reserves to another? Would "substitution accounts" tend to reduce the role of the dollar as a reserve currency, and, in your judgement, would that be good or bad for the United States? Would amendment of the Articles be necessary before "substitution accounts" could be established in the IMF?

Answer. The question of a possible "substitution account" for currencies and gold was studied by the IMF's Committee of Twenty, in the context of a monetary system based on par values and official convertibility of currencies into other reserve assets. The C-20 did not reach a decision on the desirability of such an account, nor did it recommend the establishment of such an account. Since the C-20 deliberations, the system has evolved substantially, away from the par value/official convertibility orientation that was the focus of much of the C-20's work, and the possible roles and purposes of a substitution account have become less clear. Partly as a consequence of this evolution, interest in the subject has diminished, and proposals for creation of a substitution account were not a major part of the Interim Committee's work. The Interim Committee agreed that the subject should be kept under study, but did not include it in the package of amendments that has been agreed upon.

Question 11. The Jamaica agreements state that the SDR should become the principal reserve asset. Do you agree with that objective? If so, what measures need to be taken to make the SDR the principal reserve asset? If not, what should the principal reserve asset be?

Answer. The United States and the rest of the IMF membership have agreed "to collaborate to ensure that their policies on reserve assets are consistent with making the SDR the principal reserve asset in the system."

The proposed amendments incorporate major changes in the provisions relating to the SDR to make it a more important and useful instrument. Specifically:

The SDR replaces gold as the main instrument for IMF transactions.

The SDR replaces gold as the numeraire of the system, the unit of account for the IMF.

Provision is made for changing the procedure for valuation of the SDR if that becomes desirable in light of the evolution of the system.

The scope for voluntary transactions in SDR by members, without meeting the requirement of balance of payments need, has been greatly enlarged.

The provisions for prescription by the IMF of various types of transactions in SDR have been eased.

The concept of "other holders" (i.e., entities that are not participants in the SDR facility but who may accept, hold and use SDRs in transactions) has been broadened, and the variety of transactions that other holders may engage in has been liberalized.

The rules for designation of countries to accept SDRs may be changed at any time, and not only at five-year intervals as at present.

The rules for reconstitution (repurchase of SDRs to restore holdings to at least 30% of allocations on average over 5 year period) may be reviewed at any time, not only at 5 year intervals, and may be changed by a 70 percent majority vote instead of 85 percent.

All countries must collaborate to ensure that their policies on reserve assets are consistent with making the SDR the principal reserve asset in the system.

Together these changes represent a major liberalization of the rules applying to the SDR, a major increase in its use in the IMF, both as a transactions medium and as unit of account. At this time, SDRs represent a relatively small portion of total assets included in nations' monetary reserves—consisting also of members' IMF positions, gold and foreign exchange holdings—and we do not foresee a major change in this situation at this point. More radical proposals discussed during the reform negotiations for expanding the role of the SDR—for example by substituting SDRs for currency balances—did not command widespread support at the present stage of monetary evolution.

Question 12. The Jamaica agreements have been criticized for failing to provide an effective system for controlling the growth of international liquidity, and therefore contributing to world inflation. Is this a serious problem which should be given high priority in future negotiations? What arrangements would you suggest for controlling international liquidity? Does the increase in quotas and the increase in IMF special credit facilities add significantly to international liquidity? What about the Eurocurrency markets—should they be included in a system to manage international liquidity?

Answer. Some have expressed concern that the new system does not establish formal IMF control over the level and growth of international reserves. This matter was discussed at great length in the reform negotiations. But no group, neither the developing countries, the oil exporters, nor the industrial nations showed any willingness to accept the restrictions on their ability to borrow, lend, or acquire currencies that would be necessary to establish quantitative limits on reserves. There is in addition considerable doubt in many quarters that placing such power of decision in an international body would be either effective or desirable. An attempt to do so would be likely to result only in long and inconclusive negotiations that could postpone, possibly indefinitely, the badly needed revision of the Fund Articles on which international agreement has been reached. At the very least, the time for such a move would appear to be well in the future, not now. The proposed increase in IMF resources is not large in terms of total reserves, but it is particularly significant in that it will enable the IMF to maintain its role as a provider of conditional credit to its members, to complement needed programs of balance of payments adjustment.

Question 13. At Jamaica and in other recent decisions, the IMF has adopted and expanded so-called "special facilities" which provide credit to member countries in addition to normal IMF credits. The "special facilities" include the Compensatory Financing Facility, the Buffer Stock Facility and the Extended Fund Facility. In addition, a Trust Fund has been established to distribute to developing countries on a concessionary basis the proceeds from the sale of one-sixth of the Fund's gold. These arrangements raise concern that the Fund is being converted into an aid-granting agency. Is the IMF being used to extend foreign aid without going through the process of Congressional authorizations and appropriations? Are these new functions consistent with the purposes of the Fund?

Answer. The IMF is not becoming an "aid-type" institution. While the IMF has established several "special" facilities, some of which are directed to balance of payments financing problems of a sort more characteristic of developing countries than of industrial nations, it is important to note that:

In all cases, financing is provided to meet balance of payments needs and not for project or other development programs;

The IMF requires economic and financial policy conditions appropriate to the particular payments problems for which the facility is designed and to the economic circumstances of the country concerned; and

In no case is use of any IMF facility restricted to developing countries. Consistent with the Fund's basic principle of uniform treatment of members, use is open to any IMF member whose payments problems and needs fulfill the requirements of the particular facility.

With respect to the special facilities of the Fund

The oil facility was used much more heavily by developed than by developing members;

The buffer stock facility has been used only in very limited amounts, by only five developing members in connection with one international buffer stock (tin), but is open to any member that qualifies.

The compensatory finance facility is designed mainly for producers of primary products and has been drawn upon by both developed and developing countries;

The extended Fund facility has been drawn upon twice, in both cases by developing members, but would in principle be open to any member implementing a major program of structural balance of payments adjustment;

The temporary expansion of access to the regular IMF resources applies to all members, on the basis of the IMF regular conditions.

The Trust Fund—designed to provide emergency balance of payments support to the poorest members on highly concessional terms—does represent a departure in that it is limited to a particular group and will provide financing on concessional terms. It is for this reason that it is a separate legal entity, with no IMF liability involved. Its purposes are the same as the IMF's in that it will provide balance of payments financing, and it will provide financing only when IMF requirements of balance of payments need and policy conditionality are fulfilled.

Question 14. The debt of developing countries has been growing quite rapidly in recent years. Isn't the level of indebtedness and debt service becoming a severe problem, and if so, does it help to ease the access of these countries to IMF credit? Would it be better to allocate SDRs to meet part of the need? Should future issues of SDRs be linked to development finance? Should SDRs be allocated to the World Bank and to regional development banks, as some economists have proposed?

Answer. The debt problem of developing countries will not in our view be helped by creating large amounts of unconditional liquidity, for example by SDR allocations, at this time. There has been massive financing of balance of payments deficits in recent years. The need now is for greater emphasis on adjustment, facilitated by conditional financing—for example, through regular IMF credit.

It would be a mistake to agree to "link" the SDR to aid or development financing, through development lending institutions or otherwise. A link would seriously undermine the SDR, and shift its basic character from a monetary instrument to an aid instrument. We are opposed to any such link. The SDR-aid link is not included in the package of proposals.

Question 15. The Fund is in the process of selling one-sixth of its gold for the benefit of developing countries. Would you favor or oppose further sales of Fund gold beyond the amount already being sold? If so, should the same formula be used? I have in mind the provision whereby the larger middle income countries have been permitted to skim off some of the cream before the poorest countries get their share, the so-called "direct access" question.

Answer. We would hope that the IMF would eventually dispose of all of its gold holdings, although we have no specific proposals at this time for sales beyond the amounts that have already been agreed, nor for the techniques that should be used for such sales.

Question 16. Why do we need the Exchange Stabilization Fund at all? Its original purpose was to stabilize the exchange value of the dollar. Efforts to

stabilize the dollar's exchange value would be inconsistent with the goals of the amended IMF Articles, wouldn't they? In what circumstances, then, should the resources of the Exchange Stabilization Fund be used?

Answer. The Exchange Stabilization Fund, since its establishment in 1934, has been an important tool in carrying out U.S. international monetary and financial policy to promote a smoothly-functioning world economy. While U.S. participation in the International Monetary Fund provides the core of U.S. international monetary cooperation, the ESF has continued to serve an extremely useful role in complementing the work of the IMF. Indeed, it was the Bretton Woods legislation in 1945, authorizing U.S. participation in the IMF, that established the ESF as a permanent fund, with Congress expressly recognizing the need for its continued existence.

While the ESF in the past was used in the context of a par value system, to stabilize the exchange value of the dollar, the ESF will continue to have an important function under the new monetary arrangements.

A central principle of the proposed amendments to the IMF Articles of Agreement is that orderly exchange arrangements can best be assured by fostering orderly underlying economic and financial conditions and an international monetary system that does not produce erratic disruptions. Within this context, each member "undertakes to collaborate . . . to assure orderly exchange arrangements and to promote a stable system of exchange rate." Consistent with the current international exchange arrangements—where the exchange value of the U.S. dollar is determined by market forces and is not maintained at any particular rate relative to one or more other currencies—and our obligations under the amended Articles of Agreement, the Secretary of the Treasury will need the capability to counter disorderly exchange market conditions. Use of the ESF to promote a smoothly-functioning international payments system in the future will continue to be adapted to reflect the evolution of the international monetary system and the U.S. obligations in the IMF.

Question 17. The bill amended in the House to delete the provision of the Gold Reserve Act of 1934 requiring an annual audit of the Exchange Stabilization Fund, substituting therefore a requirement that the Secretary of the Treasury make an annual report on the operations of the Fund to the President and to the Congress. Why shouldn't the Exchange Stabilization Fund, which after all is a \$2 billion plus resource, be subject to an audit of all its operations? And why shouldn't its use be restricted to short-term lending exclusively, so that it doesn't compete with the IMF?

Answer. Due to a technical error in the comparative type of H.R. 13955 in both the House Committee on Banking, Currency and Housing and the Senate Foreign Relations Committee reports, it appears in those reports that Section 10 of the Gold Reserve Act of 1934 is being amended by H.R. 13955 to substitute an annual report of the ESF by the Secretary of the Treasury for the prior statutory requirement of an annual audit of the ESF. In fact, this change in Section 10 of the Gold Reserve Act was made by P.L. 91-599, December 20, 1970. H.R. 13955 does not change the existing statutory audit requirements.

In 1970, Congress amended Sections 10(a) and 10(b) of the Gold Reserve Act to:

(1) Delete from the Gold Reserve Act the provision requiring a Treasury audit of the ESF and substituted a requirement for an annual report on the operations of the ESF by the Secretary; and

(2) Provide for a GAO audit of the ESF's administrative funds.

Treasury in fact has continued to conduct annual audits of ESF operations, despite the repeal in 1970 of that requirement. Two audits are made of the ESF: one, by an Audit Committee selected from the audit staffs of Treasury bureaus not connected with the ESF; and, the other, by the departmental staff of the Office of the Secretary. The Audit Committee's Report is made part of the Annual Report of the ESF submitted by the Secretary to the President and the Congress.

In authorizing the GAO audit of ESF administrative expenses, the Congress fully recognized that an outside audit of ESF operations might hinder immediate and responsive action through use of ESF in international financial operations. House Report 91-1057 (91st Congress, 14-15), commenting on the statutory authorization of a GAO audit, specifically states:

"The ESF deals in extremely confidential and highly sensitive monetary transactions with foreign governments. It is important not only that such transactions and the arrangements underlying them remain confidential, but also that nothing be done which would in any way impair the confidence of foreign governments

in the continuing confidentiality of such transactions. The prospect of decisions of the Secretary of the Treasury with respect to transactions through this Fund being subjected to possible public question and debate would undoubtedly be disturbing to markets and to foreign governments, and would therefore hamper the use of the Fund by the Secretary of the Treasury for its intended purpose.

"The committee recognizes . . . that foreign exchange operations and other aspects of international financial policy must not be subject to premature disclosure. Broad discretion must be left to the Secretary of the Treasury on the matters that must not be disclosed."

These concerns and conclusions of the Congress in 1970 are equally valid today, so that a GAO audit of ESF operations would not only be unnecessary but also inappropriate.

Although the ESF is likely to be used primarily for short-term lending, a statutory requirement that it be used for short-term lending exclusively would not be appropriate and would unnecessarily impair U.S. flexibility, especially in unforeseen circumstances, in implementing our international monetary policy. While operations have on occasion been used to complement IMF lending, no question of "competition" with the IMF would be expected to arise. The FSF—with such limited resources—in fact could not "compete" with the IMF as a major source of balance of payments financing.

In the terms of the recent swap arrangements with the United Kingdom, both the Treasury and the Federal Reserve provided short-term credit, with a clear understanding that the credit would not be extended for a longer period and that the U.K. would, if necessary, draw from the IMF for longer-term financing where appropriate policy conditions would be applied. Thus Treasury policy is in accord with the policy objectives of the proposed amendment to H.R. 13955. However, to place that limitation in a statutory provision could impair necessary U.S. flexibility in negotiating and arranging appropriate financing packages in the future and so be undesirable from the viewpoint of the Congress as well as the Treasury.

For example, it is conceivable that, in some instances, use of the ESF for a somewhat more extended period may be necessary. External factors (such as natural disasters, trade embargos, unforeseen economic developments abroad, etc.) may lead a country which has obtained a short-term credit from the ESF to seek an extension of that credit. It is also conceivable that political assassination or other unanticipated catastrophic event might justify a longer extension of credit, and the possibility of ESF operations in such cases should not be excluded. In none of these cases would the ESF compete with the IMF, and in all of these cases it well may be in the U.S. interests to provide somewhat more extended ESF financing.

MR. YEO'S ANSWERS TO QUESTIONS OF SENATOR HELMS

Question. If there is a system of floating, adjusting exchange rates, do the loans made by the IMF simply postpone needed adjustments? Particularly, are the longer-term loans of the Trust Fund postponing the adjustments in currency values that should be made under the new system?

Answer. Widespread floating of currencies does not eliminate all balance of payments problems and does not eliminate all need for official balance of payments financing. Of course, the currencies of most countries at present are not floating but are pegged to one or more other currencies. Moreover, those countries whose currencies are floating (the large industrial countries for the most part) do not allow them to float freely, but intervene in varying degrees. The purpose of IMF credit is not to avoid adjustment, but rather to provide temporary financing while adjustment takes place. Thus IMF drawings are conditional, and ordinarily tied to the introduction of an adjustment program designed to correct the balance of payments problem which caused the need for the financing. Trust Fund financing is of the same character—provided in each case only if there is a finding of balance of payments need, and if the borrowing country adopts appropriate adjustment measures. Thus financing facilitates balance of payments adjustment rather than postponing it.

Question. If IMF quotas are looked upon as bank deposits, a resource available to the U.S., shouldn't it be included in the normal budget process just as other Federal loan programs? I note that the \$2 billion loan authority for the Secretary

is for funds already appropriated. Is it not inconsistent that these IMF loan funds would be appropriated and the quota increase be exempt from this process?

Answer. It is because IMF quota subscriptions are similar to bank deposits that they should *not* be treated the same as Federal loan programs. Payment of an IMF quota subscription is an exchange of assets—we provide dollars and receive drawing rights, which we can use in case of need. Under Federal loan programs we do not receive such a drawing right. This treatment of IMF quota subscriptions was introduced following recommendations from the President's Commission on Budget Concepts in 1967. It differs from the technique followed in earlier quota increases, and for U.S. loans to the IMF under the General Arrangements to Borrow, authorized before the adoption of the concept proposed by the Commission.

Question. I am aware of the question of the legality of the IMF establishment of the Trust Fund, but would you provide for the record your analysis of this matter? Would you agree that the Board of Governors of the IMF is the final determiner of what is "legal" under the Articles of Agreement?

Answer. The IMF Trust Fund was established by the entire IMF membership and without objection, by an Executive Board decision on May 5, following the agreement in Jamaica in January that action should be taken both to start without delay establishment of the Trust Fund financed largely through profits on the sale of 1/6 of the IMF's gold, and to "restitute" 1/6 of the IMF's gold to all members in proportion to quota. Gold sales to finance the Trust Fund, as well as the agreed restitution, will be conducted over a period of 4 years.

Establishment of the Trust Fund and its financing through gold sales is legally authorized under the present IMF Articles of Agreement. The IMF will replenish its holdings of usable currencies through sales of gold to members at the current "official price" (about \$42 an ounce). The IMF has often replenished its currency holdings pursuant to Article VII, Section 2 in this way, and the gold held by the IMF was, from the outset, intended to be used precisely for this purpose. The IMF needs these usable currencies to finance its rapidly expanding balance of payments financing operations. These members will then resell, at the same price, the gold received to the Trust Fund. The Trust Fund will auction the gold and use the profits to provide balance of payments financing on terms appropriate to the needs of developing members in the immediate period.

This financing of the Trust Fund is an appropriate use of the IMF's gold. The secondary result of the IMF's replenishment operation—i.e., financing the Trust Fund, is fully consistent with the IMF's purposes, including the objectives of promoting international monetary cooperation, maintaining orderly exchange arrangements among members, and providing balance of payment financing to members.

On the question of determining what is "legal" under the IMF Articles of Agreement, Article XVIII provides that any question of interpretation of the provisions of the Fund Articles raised by an IMF member, in the first instance shall be submitted to the Executive Directors for their decision. Any member of the Fund may appeal a decision of the Executive Directors to the Board of Governors, whose decision is final. This procedure is in accordance with the procedure established by the charters of most international financial organizations; and, it is wholly appropriate for the IMF members to determine the scope and manner in which they intend to be bound by their acceptance of the IMF Articles of Agreement.

Question. I understand that the U.S. position at the Jamaica meeting favored the establishment of the Trust Fund. Could you explain the justification behind this position? Would the Treasury, in its efforts to remove gold from its role in international monetary matters, favor a simple restitution of gold to the members of the IMF, in accordance with the provision in the Jamaica agreement to dispose of one-sixth of the IMF gold?

Answer. The U.S. favored the establishment of the Trust Fund on the basis that it would help to meet two long-held U.S. objectives. First, it facilitated an orderly balance of payments adjustment process, by providing badly needed balance of payments financing for the poorest developing countries at a time when those countries were faced with particularly severe needs resulting from the sharp increase in oil prices, severe world inflation and deep recession. Second, it promoted in a meaningful way phasing down the role of gold in the monetary system by transferring gold from monetary reserves to private hands through the sale of gold for usable currencies.

The U.S. did not initiate proposals for "restitution" of gold to members, but accepted a compromise in which 1/6th of the IMF's gold would be sold through the Trust Fund and 1/6th sold to members for "restitution". From the point of view of a large number of IMF members, "restitution" has the disadvantage that it takes an asset owned by the IMF—gold—and uses it in a way that an overwhelming share of the benefit—the profits on such IMF gold sales—accrues to a small number of the large industrial countries.

Question. Would you explain the rationale behind the recent procedure change in the IMF gold auctions?

Answer. Since opinions among the 128 IMF member countries differed on the technical question of what is the best procedure to be followed in IMF gold auctions, and there is little empirical evidence available as a guide, it has been agreed that there should be some experimentation with alternative techniques. Thus the first two gold auctions utilized the procedure of "common price"—that is, all successful bidders received gold at the lowest price accepted from any such bidder. The third auction will utilize the procedure of "bid price"—that is, each bidder will pay the particular price he bids and will not receive gold at a common price. With experience it may be possible to reach a consensus as to whether one procedure or the other yields the best return.

Question. Mr. Aliber addressed the question of the instability in world gold markets. He said, "It is extremely important to many countries. Many of these countries are friends and allies. No U.S. interest is served by the large instability that we have had in the gold market. No great costs would be imposed on the United States in participating (in) arrangements in limiting gold price movements." Would you address this question, and would you comment on the U.S. position on any delay in the IMF gold auctions to allow the price to stabilize?

Answer. The United States has agreed with the other members of the Group of Ten that "there be no action to peg the price of gold." Pegging the price would be contrary to the agreed decision to phase down the international monetary role of gold. In the proposed amendment of the IMF Articles, both the Fund and members agreed "to avoid the management of the price, or the establishment of a fixed price" of gold.

It would be noted that the U.S. has no objectives with respect to the price of gold, and has not sought to depress the price or introduce instability into the gold market. The aim of the U.S. and of the IMF is to dispose of the agreed amounts of IMF gold in an orderly manner. The best way of accomplishing that objective is in our view to provide for regularly-scheduled auctions of moderate size. In that way, the market will know what to expect and can accommodate itself to the IMF sales. On some occasions the price received by the IMF may be relatively high and on other occasions relatively low, but over the whole four year period the Fund will receive a fair price as determined by the market. In our view, to introduce uncertainty into this market by arrangements under which the IMF might delay, accelerate or change the scheduled auctions would be a destabilizing factor and would hurt rather than help the gold market.

Question. Would the Treasury Department favor a set date to restore the freedom of Americans to use gold clause contracts? Would the Treasury favor an amendment of this kind on the IMF legislation?

Answer. As Secretary Simon stated in his letter to you on May 6, the Gold Clause Joint Resolution, by making unenforceable contract provisions for the payment of the obligation in gold or in an amount of dollars measured in gold, helps to assure that gold will not again assume a monetary role through widespread use in private transactions. Secretary Simon, at that time, also expressed concern that the emergence of gold clauses which might result from repeal of the Joint Resolution, could call into question the strength of the dollar and undermine our efforts to control inflation and maintain confidence in our currency. For these reasons, the Joint Resolution appears to us to have a substantial and important rationale and its repeal at this time would be unwise.

In our view, careful and thoughtful consideration should be given to the bill you introduced on June 14 to repeal the Gold Clause Resolution. However, because of its importance and our concerns regarding its repeal, it should not be handed hastily in the context of the Bretton Woods legislation. Rather, the Gold Clause Resolution can and should be considered on its merits. At an appropriate time, officials from this Department would be happy to participate in

full, frank, and open discussions on this matter and to examine our concerns in light of all the points of view expressed in those hearings.

Question. What is the purpose of the \$2 billion loan authority requested in the bill? How will Congress be notified of the time and reasons behind any exercise of this authority?

Answer. This question refers to the existing authority in present law for \$2 billion which can be made available to the IMF under the General Arrangements to Borrow together with funds from other IMF members for the purpose of forestalling or coping with an impairment of the international monetary system. This authority has existed for 14 years and no change in this authority is proposed in the present legislation. The statutory change that appears in H.R. 13955 is merely a technical change resulting from a renumbering of the IMF Articles as they are proposed to be amended.

Any activation of the GAB and U.S. participation in such loans to the IMF would be announced publicly.

Question. Why does the bill call for IMF compensation to the U.S. representative, rather than U.S. compensation? What is the difference in benefit levels?

Answer. The IMF Articles as originally approved in the Bretton Woods Act envisage that Executive Directors, while representing the governments appointing or electing them, would be IMF employees and paid by the Fund. The Articles provide that the Board of Governors will determine the compensation to be paid Executive Directors. The Articles also provide that Governors will not be compensated by the IMF—other than meeting reasonable expenses for attending annual meetings—since the position of Governor is not a full time position. The provision in Section 2 of H.R. 13955 relating to salaries of U.S. representatives to the IMF merely extends the present statutory provision (Section 3 of the Bretton Woods Agreements Act) to the U.S. councilor and alternate should the IMF Council be established. The amended Articles do not provide for remuneration being paid by the Fund to Councilors and alternates. (A comparison of IMF and U.S. Government compensation is covered in the response to following question.)

Question. There has been some press attention to the salary levels of IMF staff. Would you provide an analysis of this situation and a report on U.S. actions in this regard? How do IMF staff salaries differ from those of comparable Federal Government employees?

Answer. The IMF salaries (and those of other international institutions) are generally higher than U.S. Civil Service salaries, and the gap at the more senior levels has expanded during recent years when there has been a ceiling on senior U.S. Civil Service salaries. The U.S. Government has been concerned at the growth of salaries in the IMF and other international institutions, and has made strong efforts aimed at restraining salary increases, with some success. In 1975 the U.S. Government was successful in introducing tapering to increases in these senior salaries. In 1976 a vigorous U.S.-led campaign caused management's proposed increase in staff salaries to be defeated and a more moderate one to be adopted. In August 1976 another U.S.-led effort caused a proposed increase in the salaries of the Executive Directors to be voted down by a 2 to 1 margin. This is the second year in succession that proposed increases in Executive Directors' salaries were defeated by a Governors' vote.

Question. Under the Percy amendment, or under present procedures, what access is there to records of how the U.S. representative votes on various loans? Are the votes of the U.S. representative always consistent with American policy objectives as they apply to foreign aid programs?

Answer. Under IMF procedures, votes on individual issues are not made public. U.S. representatives are fully prepared to meet appropriate Congressional requests for information on U.S. votes. In the Executive Board, where decisions on individual IMF transactions are made, the U.S. Executive Director is instructed by the U.S. Governor of the Fund (the Secretary of the Treasury), with U.S. international financial and monetary policy coordinated by the National Advisory Council (NAC). The NAC, which includes in its membership the Secretary of State, the Assistant to the President for Economic Affairs, the Chairman of the Board of the Governors of the Federal Reserve System, and officials of other appropriate agencies, provides a mechanism for assuring that U.S. foreign policy and other considerations are taken into account in the determination of U.S. policy with respect to the IMF.

Question. International liquidity is at an extremely high level. Can you say that additions to the IMF quotas and the subsequent added loans IMF will

make will not be inflationary? Would you refer to the arguments made in Mr. Robert Heller's article in the "IMF Staff Papers" of March 1976?

Answer. IMF quotas differ in character from other forms of international liquidity, in the IMF resources are available for conditional credit—that is, they are associated with programs of adjustment designed to correct, rather than add to, inflation and other economic problems. Moreover, the proposed increase in IMF quotas, at 44.6%, only partially makes up for the decline in the size of quotas relative to levels of international trade. Since 1970, when the last general increase in IMF quotas occurred, world trade has almost tripled. Mr. Heller's article analyzes the effects of increases in unconditional liquidity on world inflation.

Question. Congressman Paul expressed concern with the newly established Executive Council. Would you comment on the points he raised? Would you comment on the powers and responsibilities of this new body?

Answer. Concerns about possible establishment of a permanent IMF Council are not warranted. This is an administrative matter that is completely internal to the IMF. It does not involve an expansion of the IMF's powers—it does not mean a "supra-national Fed"—and it does not involve any diminution of the U.S. voice in the IMF. The Council, if established, would succeed the present IMF Interim Committee. The only difference is that it would have formal decision-making powers, to the extent the IMF Board of Governors chooses to delegate such powers to the Council, in contrast to the Interim Committee's advisory role. The experience of the past few years has indicated that it may be desirable to have a decision-making body in the IMF that involves senior policy officials from member governments, but which is more streamlined and manageable than the 128-member Board of Governors.

All important powers in the IMF are vested in the Board of Governors. The Board of Governors will be able to retain those powers, delegate certain powers to the Executive Board, as it does not, or to the Council, if that body is established. This is not an expansion of the IMF power but simply a question of distribution of authority *within* the IMF. The Board of Governors would make the decision to establish the Council—by an 85 percent majority vote—and would decide on the distribution of authority as among the Board of Governors, the Council, and the Executive Board.

The U.S. representative on the Council would be the Secretary of the Treasury, who is U.S. Governor of the Fund. Other countries would be represented at a comparable level. The U.S. vote would be precisely the same in the Council as it is in the Board of Governors and the Executive Board, and the votes required for various decisions are exactly the same. The fact that a question is decided by one IMF body or another does not change the voting structure or the majorities required for decisions.

Provision in the amended Articles for possible establishment of the Council is fully appropriate, involves an internal organizational matter, and fully protects the interests of the United States.

Question. Would you comment on what sort of measures the Fund would take against nations that "manipulate" their currencies? Would you define "manipulation?" I realize that this may be difficult, but does not the definition of this term determine the nature of one of the most important aspects of this legislation?

Answer. In the proposed amended Articles, each member country undertakes an obligation "to avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage." A finding that a country was in fact engaged in such a manipulative practice would be made in light of all the circumstances of the case—a judgment that the country was through its practices preventing adjustment or gaining an unfair advantage. It would be a mistake to try to define such situations in advance. Case history and experience will need to be developed in the IMF as a basis for determining whether this obligation is being fulfilled.

Question. Mr. Sidney Brown commented on the need to postpone passage of this legislation. Would you comment on what real changes might result in the international economic situation if the U.S. doesn't hurriedly pass this bill?

Answer. The international monetary system is presently operating outside the law. It is important that we correct that situation, and restore a legal framework for international monetary cooperation and for encouraging countries to operate in an internationally responsible manner.

The process of ratification of amendments is a complicated one—60 percent of IMF member countries with 80 percent of the total vote must approve the amendments—and it may take 12–18 months even if the United States acts promptly. The United States played a leading role in the negotiations, and many nations await U.S. action before pressing ahead with their own legislative processes. If the United States does not enact the legislation in the present session, the whole process gets pushed back a year—and the amended Articles, and the needed quota increase, would not become effective for a long time. This would be contrary to fulfillment of U.S. objectives in the international monetary area and would be inconsistent with the posture of the United States—as formally expressed by Congress in 1973—to expedite realization of the much-needed reforms.



