PRESENTATION OF THE EIGHTEENTH ANNUAL REPORT[1]

BY THE CHAIRMAN OF THE EXECUTIVE BOARD AND MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Pierre-Paul Schweitzer

I feel very deeply honored to be addressing you today and to be presenting for the first time the Annual Report of the Fund to the Board of Governors. But the joy it should give me to be in my present position is overshadowed by the great sorrow and sense of loss I feel at Per Jacobsson's tragic and untimely departure. We have already heard moving tributes to him from President Kennedy and Governor Carli. I think the highest tribute we in the Fund can try to pay to Per Jacobsson's memory is to strive to maintain the stature and the effectiveness of this organization which he did so much to promote, and to be worthy of the ideals and the inspiration which he imparted to it. May I be allowed to add my personal expression of sympathy to Mrs. Jacobsson and to her daughters, who played so important a role in his life and added so much to the charm of the relations we had with him.

Before I proceed to discuss the more general developments reviewed in the Annual Report which you have before you, I would like to welcome the Governors of the 20 member countries who have joined the Fund since the last Annual Meeting. They are Algeria, Burundi, Cameroon, Central African Republic, Chad, Congo (Brazzaville), Congo (Leopoldville), Dahomey, Gabon, Guinea, Ivory Coast, Jamaica, Malagasy Republic, Mali, Mauritania, Niger, Rwanda, Trinidad and Tobago, Uganda and Upper Volta. In addition, we have received an application for membership

[1] October 1, 1963.

from one more—Kenya. We extend a warm welcome to the Governors and the representatives of all these countries. The total membership of the Fund is now 102—almost three times as many as had joined the Fund when the Articles took effect at the end of 1945.

In the fiscal year ended last April, as mentioned in the Annual Report, 18 countries purchased the equivalent of $580 million from the Fund and the equivalent of $807 million was received in repurchases. Both purchases and repurchases were less than in the previous fiscal year, when the very large United Kingdom drawing took place; they represented, nevertheless, a substantial volume of financial support extended by the Fund to a good many of its members. In addition, the Fund has at present stand-by arrangements in effect with 20 countries under which $1.8 billion is available, including the recently renewed stand-by of $1.0 billion with the United Kingdom and the $500 million stand-by arrangement with the United States, concluded only two months ago.

The United States stand-by was clearly one of the most important events in the Fund since the conclusion of the period covered by the Annual Report. The United States had not previously resorted to the Fund, although the financing of its balance of payments deficit has been assisted by the Fund's operations. This stand-by is evidence of the readiness and the ability of the Fund to assist all its members, be their quotas large or small. In addition, I should like, in a few words, to place the stand-by in the context of the policies we have been pursuing with respect to the currencies to be used in drawings from, and in repayments to, the Fund. The criteria appropriate to these operations have been gradually worked out in recent years and given concrete form in a Decision of the Executive Directors in July 1962. In conformity with these criteria, the Fund, having regard to the continuing balance of payments deficits of the United States, encouraged countries to make repurchases to the Fund in U.S. dollars and to draw in other currencies. As a result, in the course of the last financial year, the Fund increased its holdings of U.S. dollars by $340 million, and assisted to this extent in the financing of the United States' balance of payments deficit.

For some time, Fund holdings of U.S. dollars have been in the vicinity of 75 per cent of quota, beyond which they cannot, under the Articles of Agreement, be accepted in repurchase. This threatened to cause inconvenience to the many countries which prefer to make their repurchases in dollars since they accumulate them in their reserves. In July of this year, however, the difficulty was resolved when the Fund entered into a stand-by arrangement authorizing the United States to draw other member currencies to the equivalent of $500 million during the next 12 months. The United States intends to use this facility to sell such currencies for dollars at par to other members to be used by them to make repurchases to the Fund. In this way not only will repurchases be facilitated but the United States will continue to receive balance of payments assistance similar to that formerly provided by repurchases in dollars.

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Another important development with respect to members' access to Fund resources was the Decision of the Executive Directors in February of this year regarding the Compensatory Financing of Export Fluctuations. By this Decision, the Fund created a new drawing facility which, we hope, will greatly benefit primary producing countries adversely affected by temporary declines in their export earnings.

It has always been one of the recognized functions of the Fund to provide financial assistance in case of balance of payments difficulties arising from export shortfalls, and there have been many instances of countries drawing on the Fund under such circumstances. Yet it was felt that this problem had become sufficiently pressing to deserve special consideration. The Executive Directors and the staff spent many months in studying and discussing it. Indeed, this was the last major task to which Mr. Jacobsson devoted his efforts. The Decision which finally emerged and which is published in the Annual Report is, in my opinion, a useful further development of the basic principles and aims of Fund policy.

In essence, it establishes a new facility to provide assistance to members experiencing balance of payments difficulties arising from export shortfalls. This facility will become available in cases where the shortfall is temporary and largely caused by circumstances beyond the member's control, and where the member is willing to cooperate with the Fund in an effort to find appropriate solutions for its balance of payments difficulties, where such solutions are needed.

Given these conditions, a country is assured that its request for a compensatory drawing will be met in amounts not normally exceeding 25 per cent of the member's quota. Besides facilities available under these liberal terms, members may, of course, draw under the Fund's ordinary drawing policies for the purpose of meeting difficulties arising from export fluctuations.

Furthermore, in order to enable members to have the full benefit of the facility, the Fund will be willing to exercise its authority to waive the limits which are prescribed in the Articles, firstly, on the amount that a member may purchase within any 12 months and secondly, on the Fund's holdings of a member's currency, which should not exceed 200 per cent of its quota. The latter is a new development in the Fund's policy; hitherto, there has been no waiver of the 200 per cent limit.

I have been glad to note that the Fund's new policy on compensatory financing has been well received both by Fund members and by international organizations. In particular, the United Nations Commission on International Commodity Trade has concluded that the new facility can make a substantial contribution toward solving the problems arising from export fluctuations in primary exporting countries.

So far only one country—Brazil—has made a compensatory drawing under the new facility. But the Fund stands ready, in accordance with the Decision, to extend compensatory drawings to other countries whenever the need arises. The fact that no further requests have been made so far is, I believe, largely attributable to the rather favorable developments in primary product markets over the last 12 months, which have tended to raise export earnings of primary exporting countries; I shall briefly revert to this encouraging development a little later.

The Decision on Compensatory Financing also referred to the question of members' quotas in the Fund. These serve both to define the amounts that members may draw from the Fund and to determine to a considerable degree the size of the Fund's resources. The thorough review of quotas in 1958 and 1959, arising from a Resolution adopted by the Board of Governors at their New Delhi Meeting in 1958, resulted in a general increase in quotas of 50 per cent, although there were a number of increases of more than 50 per cent. As the years pass, however, changes inevitably occur in the relative importance of different countries in the world economy, in their relative need for temporary balance of payments assistance, and in their relative ability to provide the resources for such temporary assistance to others through the medium of the Fund.

Under the Articles of Agreement, the quotas of all members are reviewed every five years, and on this occasion a review is also made of their general structure. At any time, however, a member may request the adjustment of its quota. Moreover, the Executive Directors, in their Compensatory Financing Decision, have declared that ". . . where adjustment of the quotas of certain primary exporting countries, and in particular of countries with relatively small quotas, would be appropriate to make them more adequate in the light of fluctuations in export proceeds and other relevant criteria, the Fund is willing to give sympathetic consideration to requests for such adjustment." In pursuance of this paragraph of the Decision, the Directors, on the requests of El Salvador, Honduras, and the Syrian Arab Republic, have recommended to the Board of Governors increases in the quotas of these members. The Executive Directors have also adopted a Decision under which members that require assistance to facilitate the payment of the gold portion of these quota increases can obtain such assistance from the Fund.

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The Fund's relations with individual countries extend far beyond its financial transactions. The annual consultations under Article XIV of the Fund Agreement, and those which since 1961 have been conducted with Article VIII countries, provide for continuing contact between the Fund and its members and account for a substantial part of our work. These consultations have provided the means for a periodic exchange of views between the members concerned and the Fund on monetary and financial developments. By giving the Fund a deeper understanding of the problems and policies, particularly of the larger industrial countries, they have assisted the Fund in its role of maintaining and defending the international monetary system, as well as helping individual members to deal with their balance of payments difficulties. In addition, in the Article XIV consultations, the Fund's reviews of members' restrictive systems and the advice which it has given through the consultation procedure have, over the years, played an important role in the substantial reduction of exchange restrictions and discriminations. In this process we have seen, for example, the considerable reduction in the application of bilateral payments arrangements among Fund members. These consultations, as well as others undertaken when particular needs arose, have also been important in enabling the Fund to assist members to simplify multiple currency systems and to move toward realistic unitary rates of exchange.

Another important form of Fund cooperation with members consists in the provision of technical advice and assistance. In a number of instances, Fund staff members have been assigned upon request to provide such assistance to the national authorities of countries adopting programs designed to establish the conditions of internal and external stability necessary for sound economic development. Technical aid has also been given to help the authorities of newly independent countries, including some not yet members of the Fund, to deal with the many problems facing them.

In recent years the Fund has found a growing demand among less developed countries for technical assistance in strengthening their fiscal systems and in establishing central banking arrangements along sound lines. We are taking new steps to meet these demands. We are establishing a technical staff specialized in fiscal matters, especially taxation, budget, and financial controls. This Fiscal Affairs Group will be available to participate in Fund technical missions and to work with officials in member countries in efforts to improve the effectiveness and scope of their fiscal systems, thus contributing to their financial stability and to their economic development. In addition, the Fund is setting up a panel of outside experts, mainly from established central banks, whose services the Fund could provide from time to time for technical assignments on various aspects of central banking, such as the setting up of new central banks or improving existing organizations and filling executive or advisory positions.

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I turn now from what has been happening inside the Fund to what has been happening in the world at large. As outlined in the Annual Report, the structure of international payments, in recent years, has been dominated by the external deficit of the United States, with the corresponding surpluses appearing now in one group of countries and now in another. The main characteristics of the United States' international transactions are a large surplus on ordinary commercial transactions in goods and services, more than offset by deficits arising from U.S. Government expenditures abroad, from a substantial investment of U.S. private long-term capital, and from an outflow of short-term capital. This underlying pattern continued in the first half of 1963 and, in fact, the deficit worsened. A rise in the surplus on goods and services account was more than offset by a considerable increase in the capital outflow, including larger direct investment in Western Europe, and by a rapid expansion, starting late in 1962, of new Canadian security flotations on U.S. markets.

During 1962, the extreme surplus positions of most continental European countries, which in earlier years had been the counterpart of the U.S. deficit, were largely eliminated. Only France continued to show a major surplus by the end of the year. On the other hand, there were marked improvements in the balance of payments positions of Japan and the United Kingdom, while a number of primary producing countries also achieved better results. In the current year the surplus in France has persisted, although it is now attributable to a greater extent to capital inflow. Apart from an inflow of capital into Germany, the position of other countries in continental Europe has, on balance, not changed much. In the United Kingdom, despite a continued improvement on trade account, other factors (including a rise in overseas private investment and withdrawal of foreign funds in the first quarter) have led to a slight deficit. On the other hand, many of the primary producers have continued to acquire reserves at a substantial rate.

The present international payments situation has many favorable aspects. The improvement in the payments balances of the less developed countries is desirable in itself, and is unlikely to constitute any enduring drain on reserves elsewhere. Even before the recent measures in the United States aimed at tempering the outflow of capital, policies in Canada and Japan were such as to reduce their increase of reserves to small proportions. The United Kingdom's balance of payments, though probably in smaller surplus than in 1962, appears reasonably stable. The fairly expansionary fiscal program may be expected to lead to some rise in imports. But if exports continue to expand as they have in the past year there should be a sufficient surplus on goods and services account to provide resources for the continuation of capital exports and aid on a reasonable scale. The stand-by arrangement for $1 billion which the United Kingdom has entered into with the Fund should help the Government achieve its objectives of more rapid economic expansion without giving rise to inflation.

There is some cause for concern in the continued U.S. deficit, the accelerated flow of capital to Western Europe, and signs of renewed growth in the exchange reserves of certain continental countries. But, notwithstanding these developments, there are encouraging features. It is probable that private capital outflows from the United States in the last year or two have been greater, and those from Europe smaller, than correspond to the true saving and investing potential of the respective areas. Quite apart from the proposed Interest Equalization Tax, the other fiscal measures currently being proposed by the Government of the United States to raise the level of domestic activity and the attractiveness of home investment, while they may have adverse effects on the balance of trade, may also, for a time at least, have an even greater favorable impact by making the domestic capital market more attractive to both foreign and domestic lenders. The recent tendency to a convergence of short-term interest rates in most countries and the downward movements in the long-term interest rates of the United Kingdom and some other European countries should work in the same direction, subject to the possible effects of anti-inflation measures which may be taken by some other countries. Any improvements that might be made in the structure of European capital markets, along the lines recommended by the Lorain Committee in France and the De Voghel Commission in Belgium, should make these markets relatively more accessible to borrowers. With the foreign exchange reserves of most European countries in a comfortable position, the existing restrictions on foreign borrowing in European markets might well be re-examined, though in some European countries the high level of interest rates still presents a formidable obstacle to the export of capital. Finally, a number of industrial countries whose wealth is rapidly increasing should be in a position to expand substantially their assistance to less developed countries.

Exclusive emphasis should not be laid, however, on the rectification of capital flows. The balance of payments of the United States cannot be said to have attained a satisfactory equilibrium until there is a surplus on goods and services sufficient to provide a flow of capital exports and aid, especially to the less developed countries, on a scale consistent with the capacity of the huge American capital market. The tendency, in recent years, for wages and domestic prices to rise faster in Europe than in the United States promotes the attainment of such an equilibrium. As yet, however, these changes in relative domestic price levels seem to have had little effect on relative export price levels, or on the competitive strength of the different industrial countries in export markets. Moreover, domestic demand in Europe may be slackening and it is unlikely, and indeed undesirable, that the rise in labor costs and prices in Europe will be allowed to continue at anything like its recent pace.

I should, however, not wish it to be inferred that we should underestimate the great underlying strength of the United States' payments situation. I might particularly emphasize that in the last decade new U.S. private investment abroad exceeded the balance of payments deficit by $7 billion, and this increase in the level of

U.S. assets abroad has led to a steadily rising stream of income from foreign investment. But, as has been stressed by President Kennedy, the restoration of a sound and lasting equilibrium in the U.S. balance of payments will call for determined and patient efforts over a number of years, with strong emphasis on keeping costs stable or falling. Other countries in a surplus position can help if they maintain the impetus of their growth. It is not realistic to expect quick removal of imbalances in the structure of international payments but, fortunately, the United States has ample reserves and other sources of international liquidity to finance an orderly adjustment, compatible with the objectives of a high level of employment and a satisfactory rate of growth.

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The payments position of the less developed countries in 1962 was somewhat more favorable than in the previous year, and this improvement was not due to aid or to capital inflow. In fact, the inflow of private capital was quite a bit smaller than in 1961 and the rise in government loans and grants was insufficient to make up for this. The most encouraging development, and the one mainly responsible for the net improvement, was the increase in export earnings. In contrast to developments in 1961, when a moderate rise in the export volume of the less developed countries had been almost entirely offset by the decline in the prices for their products, export earnings in 1962 increased at nearly the same rate as the export volume. The downward movement in the prices of basic commodities, which had persisted for some time, was reversed late in 1962 and recovery has continued into 1963. There has been a further gain in exports in the early part of this year and, with price developments more favorable, it may be hoped that the payments position of the less developed countries will show a further improvement.

However, as uncertainties still exist in the payments picture, I welcome the fact that, in general, these countries are taking the opportunity provided by this improvement to strengthen further their reserve positions. For though recent developments have improved the payments positions of the less developed countries, this should not obscure the fact that over the last decade the growth in their export earnings has been sluggish. Imports of primary products have not kept pace with the growth of national income or of manufacturing production in the industrial countries; moreover, export receipts of the less developed countries have been adversely affected by a worsening of their terms of trade. This reflects to a certain extent displacement of primary products by the rapidly rising use of synthetic materials. Moreover, there are other obstacles which the less developed countries encounter in most of their foreign markets. Even some tropical products, grown exclusively in those countries, are subject to import duties or high consumption taxes imposed by industrialized countries. For the most part, however, the trade barriers which the industrial countries impose against imports from the less developed countries are maintained for the protection of domestic output of temperate climate foodstuffs, raw materials, and manufactured goods. The importance of this last item should not be underestimated. Many of the developing countries are becoming increasingly equipped for the production of manufactures, and access to export markets is important for the diversification of their economies.

More generally, it is vital that ways be found to improve the exchange earnings of the less developed countries, on which they depend to finance both their growing import demands and the service of their growing foreign debt. A two-pronged attack is now being made on this important problem. On the one hand, many of the industrial countries are considering what they can do to allow freer access to their markets, for both primary and manufactured products of the less developed countries, even though this may involve some domestic economic adjustments. On the other hand, consideration is being given to international arrangements, in which the importing countries would cooperate, aimed at maintaining at a tolerable level the prices paid for primary products. I very much hope that ways may be found to deal successfully with these problems, notably through the GATT and at the forthcoming United Nations Conference on Trade and Development.

The growth in exports, and indeed the growth in the real income of the less developed countries, has also been adversely affected by the persistence of inflationary tendencies within those countries.

For the most part these tendencies are closely linked with efforts to accelerate economic development and to raise the living standards of their rapidly growing populations. There are also, however, sharply rising expenditures in some countries for nondevelopment purposes which add to the problem. Domestic resources from savings and taxation in these countries are meager and inadequately mobilized and the available foreign funds are not sufficient to bridge the gap. This tempts many countries to turn to inflationary finance, mostly through government borrowing from the banks.

Experience over many years has shown that the inflationary process in the end hampers rather than promotes real growth, and the Annual Report this year has emphasized again the close and organic relation between financial stability and economic growth. We in the Fund draw much encouragement from the growing awareness of this fact in the less developed countries, very many of which have taken steps, frequently in close cooperation with the Fund, designed to achieve and preserve a sound and stable currency and financial structure which will contribute effectively to economic growth. It is indeed one of the most important functions of the Fund in its relations with the less developed member countries to assist them in every way possible—through technical advice and by providing financial support—to realize the objective of sustained economic growth.

The Fund cannot itself provide long-term loans for development. However, success in the fight against inflation helps to restore an environment attractive to foreign investors and favorable to the repatriation of domestic capital, and one in which governments and international institutions can feel more confident that assistance in the form of loans and grants will be put to effective productive use.

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I turn now to the subject of international reserves and liquidity which has attracted increasing interest over the past year and to which, as you will have seen, the Executive Directors have devoted a chapter in their Annual Report.

The provision of an appropriate level and distribution of international liquidity is an essential aspect of any effective international monetary system and is important to the pursuit of the main economic objectives of the community of nations, such as high employment, satisfactory growth without inflation, exchange stability, and an expansion of international trade. At the same time, we should bear in mind that these desirable objectives cannot be achieved through liquidity measures alone. Other forms of international cooperation are equally of importance. I have in mind efforts to push ahead with the removal of obstacles to trade and payments, and to achieve a measure of international coordination of interest rate and other financial policies, and also, where practicable, to encourage the coordination of other economic policies.

People often speak of international liquidity as if it were a sort of money used in the financing of international trade. Trade financing, however, is ordinarily carried on by means of private trade credit or private bank credit. International liquidity, on the other hand, consists of international reserves and other resources which are at the disposal of monetary authorities and which serve to finance balance of payments deficits, and thus provide time to make any adjustments that may be required to eliminate those deficits without resort to measures that would be damaging to the prosperity of the countries concerned or to the rest of the world.

Reserves constitute the most definite and easily measurable form of international liquidity. By "reserves" we mean official holdings of gold, foreign exchange, and positive, or "gold tranche" positions in the Fund, which indicate the amount which a member can draw from the Fund without increasing the Fund's holdings of its currency beyond 100 per cent of its quota. One of the factors which gives rise to pessimistic views of the future adequacy of international liquidity is the tendency for the rate of growth of world reserves to slow down. Fears are sometimes expressed that, as the United States succeeds in its efforts to eliminate its payments deficit, the effect may be to slow down the growth of foreign exchange holdings and therefore of total reserves. But it is not always realized that reserves are not the only means of financing payments deficits. Other forms of international liquidity, though perhaps less readily available than reserves, are nonetheless of great importance. A country's borrowing potential should be recognized as an alternative form of liquidity. Facilities that countries may have to draw upon the Fund or to draw upon each other, their access to other international financial institutions, and their general ability to borrow abroad—all provide them with a greater or lesser degree of assurance of being able to finance payments deficits. These facilities are not, in my view, made less valuable by the fact that their utilization depends in some cases on the condition that timely action should be taken to rectify the balance of payments deficits which they serve to finance.

Much of the progress that has been made over recent years in providing the means of financing deficits and preserving the stability of exchange rates relates to these types of liquidity other than reserves. For example, there are the inter-central-bank credits, which helped to defend sterling in 1961, and the more extensive and formalized network of swap arrangements established over the last two years by the United States with as many as ten industrial countries and with the Bank for International Settlements, to an aggregate value of $1,550 million. The very fact that such arrangements were in existence helped to keep the exchange markets calm despite several events that occurred during the year which threatened confidence. Last year also saw the United States begin borrowing from abroad in foreign currency as a further instrument for the defense of the balance of payments. As for the Fund, the formal entry into force of the General Arrangements to Borrow in October 1962 provides the Fund with the means of extending massive support to members whenever this is necessary to forestall or cope with an impairment of the international monetary system. The establishment by the Fund of its new compensatory financing facility may also be regarded as an additional element of liquidity, provided more especially for the less developed countries of the world.

The network of credit arrangements between individual countries that has been worked out over the past two years provides a valuable additional bulwark for the international monetary system. We in the Fund welcome this striking illustration of the progress made in cooperation between monetary authorities in recent years. It is likely to be particularly useful in calming apprehensions that might otherwise disturb the foreign exchange markets at times of crisis and in deterring or offsetting spasmodic movements of short-term capital.

Such arrangements are necessarily of a short-term nature, and give rise to claims of a bilateral character. Other suggestions have been put forward for multilateral arrangements under which lending countries would acquire claims on an international institution rather than directly on the debtor country. The International Monetary Fund, of course, already provides a means whereby a creditor country gives assistance indirectly to a debtor country to meet the latter's need and thereby acquires a generalized international claim which can be used to meet its own external financial needs on a later occasion.

Perhaps I may be excused for expressing my belief that insofar as it is found necessary from time to time to expand the level of world liquidity by international action, the Fund will be found to be the instrument through which the bulk of the required expansion can most suitably be carried out. The provision of supplementary international liquidity is, after all, one of the principal reasons for which the Fund was set up and is a matter with which it is concerned from day to day. The Fund's policies and practices are not static. They have been modified and adapted to meet changing world conditions over the years. They can be further modified to enable the Fund to continue to play an effective role both in the provision of liquidity and in the implementation of its other principal function, namely, that of guardian of a code of international good behavior in the currency sphere. In time to come, it may be found that to enable the Fund more fully to achieve its purposes, changes may be needed in the legal provisions governing its operations. Even if a case for the amendment of the Articles were made out, and this has not yet been demonstrated, we may expect that in the evolving international monetary system of the future, primary reliance will be placed on an ever-improving Fund.

In my view the members of the Fund, taken as a whole, are not at present being prevented from adopting or carrying out desirable policies by any shortage of international liquidity. But it is wise and prudent to look into the future to consider what difficulties might arise and to devise ways of meeting them. This has been the habit of the Fund. All the main developments in the policies and practices of the Fund, whether it be quota increases, drawing policies, the General Arrangements to Borrow, or Compensatory Financing, have been preceded by long periods of study which have laid the foundation for positive action. In the coming year the Fund will develop and intensify its studies regarding international liquidity, the functioning of the international monetary system, and the effective role of the Fund in this field. At the same time there is a wholly understandable interest in this important range of problems which extends beyond the Fund, and I have no doubt that other bodies, groups of countries, and individual members will be engaged on similar inquiries. We welcome all forms of international cooperation in this field, and I am sure the efforts of the Fund will be helpful to all members who are engaged in the important task of subjecting to critical examination the international monetary system. It is a system which is serving us well, but which can without doubt over the years be even better equipped to meet the needs and stresses which may develop in the future.