

billion, for instance, in the first half of 1965—determined by the uncoordinated decisions of several scores of central banks to liquidate not only their current accruals of sterling and/or dollars, but even outstanding balances accumulated over many years of past functioning of the absurd Monte-Carlo roulette glorified as the “gold-exchange” standard.

The common-sense agreement reached in Rio is that gold cannot be expected to provide more than a fraction of future reserve needs, and that further piling-up of dollars and/or sterling IOU's can no longer fill the gap without raising strenuous objections against the indefinite financing of the large and persistent U.S. and/or U.K. deficits implied in such a “system.”

These objections spring from three sources. The first is the increasing uneasiness of foreign central banks about the ability of the U.S. and the U.K. to preserve the convertibility of their currencies at the present gold price, in the face of their declining gold holdings and increasing reserve liabilities. The net reserve position of the United Kingdom has long been negative—liabilities exceeding assets—and that of the United States has fallen precipitously from about \$23 billion at the end of 1949 to \$11 billion ten years later, and *minus* \$3 billion today. In the same period, the reserves of countries other than reserve centers have more than tripled, passing from \$18 billion to \$54 billion, while those of the two reserve centers together, net of their indebtedness to central banks and the IMF, have dropped from \$18 billion to *minus* \$8 billion.

The second objection raised against the system is that it exempts the U.S. and the U.K. from the so-called balance-of-payments discipline, as long as they can finance a large portion of their deficits (50 to 60 percent over the fifteen years 1950–1964) by passing on their IOU's to the central banks of the creditor countries. On the other hand, this discipline risks to be brutally restored at any time, under the rules of the system, if foreign central banks decide to cash into gold not only the dollar and sterling IOU's currently acquired by them, but also some of those piled up over many years past.

This happened in 1965 when foreign countries liquidated about \$1400 million of their foreign exchange holdings, instead of adding about \$1400 million to them as they had done yearly, on the average, over the previous five years. The trouble with such delayed balance-of-payments “discipline,” is that it may place unbearable strains on the reserve currency countries and, as a consequence, on the international monetary system itself. The gold absorbed by the non-reserve center countries in 1965 was about ten times the amount available from current production and huge USSR sales. It thus came mostly from a depletion of U.S., IMF and BIS gold stocks, which could not continue at such a rate without bringing about a collapse of the world monetary system.

The third objection is political, rather than economic. It is that some of the surplus countries cannot be expected to finance indefinitely, through dollar and/or sterling accumulation, U.S. and/or U.K. deficits ascribable to policies with which they deeply disagree, such as an excessive rate of direct American investments in their own market, the escalation of the war in Viet Nam, etc.

The fact is that foreign exchange reserves—other than largely reciprocal U.S. and U.K. holdings—have actually declined, by about \$250 million to June 1967, since the end of 1964. This contraction would have been much larger indeed if foreign exchange liquidation by the developed countries (\$2.8 billion) had not been largely made up by continued accumulation (\$2.6 billion) by the underdeveloped countries, far more dependent on U.S. assistance, particularly in Latin America (\$600 million) and Asia (\$900 million). Further accumulation of dollars as reserves thus tends today to become limited to an informal “dollar area,” just as sterling reserves have long tended to become confined to the “sterling area.”

The cessation—or rather decline—of both gold and foreign exchange as reserve components since the end of 1964 has finally convinced the world of the need to organize collectively the deliberate creation of a new kind of international reserve asset, in the form of special drawing rights on the International Monetary Fund. This was hailed by many Governors as a “milestone in the evolution of the international monetary system,” bringing under rational policy decisions by the international community a process of reserve creation left up to now to the hazards of gold production, gold speculation, fluctuations in the balance of payments of two countries, and waves of confidence, or diffidence, in their currency.

I trust that this enthusiasm will prove justified in the long run. It is, however, premature as of now. Rational decisions—and particularly firm commitments—regarding the amounts of new reserve assets to be created will remain out of reach, as long as no parallel agreement is reached regarding the additions to overall reserves to be expected from gold and foreign exchange. New reserves well in excess