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STRENGTHENING THE INTERNATIONAL MONETARY SYSTEM

Speech by the Honourable Mitchell Sharp, Minister of Finance, to the Annual Meetings of the International Monetary Fund and the International Bank for Reconstruction and Development, Rio de Janeiro, September 27, 1967.

...The most important item on our agenda relating to the International Monetary Fund is the resolution dealing with the establishment in the Fund of a new facility, based on special drawing rights, to meet the need, as and when it arises, for a supplement to existing reserve assets. Through close consultation with the Executive Director representing Canada on the Board of the Fund, and through our membership in the Group of Ten, Canada has helped to develop the plan proposed in the resolution. Although the plan is not completely in accord with Canadian views, we are strongly in favour of it and I should like to explain briefly why.

The total volume of reserve assets in the hands of national monetary authorities has so far been basically dependent on the supply of gold for reserve purposes and the balance-of-payments positions and reserve policies of a handful of major countries. There has been growing recognition of the inadequacy of this system in the modern world. A number of *ad hoc* arrangements have been devised in recent years which have succeeded in shoring up the system when it was threatened by sudden shocks. But a more fundamental change was necessary to ensure that aggregate first-line reserves of the world's payments system would be brought under the deliberate management of the nations of the world acting together to meet their combined needs. As the Managing Director has said, the international community should be able to control reserves, instead of reserves controlling the community.

The regulation of the total supply of international liquidity will be achieved by creating, in controlled amounts, a supplement to existing reserve assets. The amounts actually to be created will be decided later for a five-year period on the basis of the anticipated overall needs of member countries and the actual and prospective supply of gold and reserve currencies.

For this system to work it is essential that the supplement to existing reserve assets be acceptable and attractive to the national monetary authorities who will be expected to hold it and to exchange it with each other, and convincing to the world at large. To this end, special drawing rights are to be created in a separate account in the IMF, which member countries in balance-of-payments need may use, without challenge or commitments concerning

their internal policies, to exchange with the Fund or with each other for convertible currencies. These special drawing rights are to be endowed with certain characteristics (a moderate rate of interest and a gold-value guarantee) which will make them attractive to hold. Their transferability will be ensured by undertakings by member countries to use these new drawing rights in balanced relation with their other reserves and to accept them up to quite generous limits.

Another feature of the plan also designed to ensure acceptance and transferability is the requirement that countries using the supplement to the maximum amount of their allocation should restore, or "reconstitute", some part of their original holdings. We should have preferred the plan without this particular provision, as in our view the system will work best if the new facility is regarded by monetary authorities as being as freely usable as their other foreign-exchange assets. Naturally, all reserves must sooner or later be reconstituted by the ordinary processes of adjustment if countries are to be in a position to cope with recurrent imbalances in their payments positions. However, the plan is sufficiently flexible to enable it to be adapted in the light of experience.

The breadth of membership of the Fund ensures that the regulation of the supply of unconditional liquidity in the world will be responsive to the needs of the whole system. The arrangements under which the members must achieve a broad consensus of view on major decisions will ensure that we move forward at a deliberate pace in this bold undertaking. Similarly, the key role to be played by the Managing Director of the Fund in securing the essential consensus and in dovetailing the new facility with the supply of conditional liquidity is of great advantage. The Fund has had more than 20 years of experience in pioneering the frontiers of international financial co-operation, and the staff has learned to combine imagination and caution in approaching the problems of its diverse constituency. In the process, the Fund has evolved to meet the changing requirements of the world. The patient and wise leadership which the present Managing Director of the Fund has given convinces me that he is the person to entrust with the job of launching this new endeavour. These are the main reasons why Canada gives strong and enthusiastic support to the creation of a reserve facility in the Fund.

The resolution provides for a report concerning amendments to the Articles of Agreement and by-laws which the Executive Board may recommend apart from those necessitated by agreement to establish a new facility. These two sets of amendments are quite properly to be presented in two separate reports, and with the same target date, though the resolution does not provide that the acceptance of the special -- drawing -- right proposal is conditional on the acceptance of other amendments to the Fund Agreement. I do wish to stress the importance of speed in preparing the two reports. In our view, it is of the greatest importance that the establishment of the new facility proposed to us at this meeting should actually take place as quickly as possible.

The setting up of the new facility will be a major step forward in strengthening the international monetary system. It will not, however, be a universal panacea. If countries persistently mismanage their own economies, even the most perfect management of the supply of international liquidity will not shield them or their trading partners from the consequences. Balance-of-payments disequilibria will continue to be one of the clearest and most disturbing manifestations of such mismanagement. The improved management of international liquidity will contribute towards an environment favourable to an appropriate adjustment of national policies. The smooth functioning of the international system will still depend essentially upon the national policies of each of our countries.

Canada has had its share of difficulties in finding the right combination of policies to achieve our various goals. For several years members of the staff of the Fund have in our annual consultations pondered with us in a very frank and thoroughgoing fashion on the problems of formulating fiscal and monetary policies appropriate to the needs of the Canadian economy. In the past year or 18 months, we have been successful in moving the Canadian economy from an unsustainable rate of growth to one that is within our capacity, without completely interrupting the expansion. In the process our imports have continued to rise. But it is clear that we have been more successful in maintaining economic growth than we have been in achieving stability of costs and prices. It is our purpose, however, to combine continued growth with price stability (indeed, I doubt whether, in the long run, the one can be achieved without the other), and we intend to make use of every means available to us to restore the balance.

Let me now turn to matters related to the World Bank group. The most important item is the replenishment of the resources of the International Development Association. Both the level and conditions of the replenishment must be settled.

The Canadian Government has not taken a final decision on the level of replenishment. I have no doubt that, when it is asked to do so, it will be influenced primarily by the needs of the developing countries and their capacity to use aid effectively. As I indicated at last year's meeting, we believe that IDA should be replenished at a figure substantially higher than the present one. Some time ago, the President of the World Bank suggested a figure of \$1,000 million a year for three years; an alternative which has been discussed is an escalated increase ending in the third year at \$1,000 million and averaging \$800 million over three years.

An increase in IDA's commitment authority to \$1,000 million a year would involve an additional transfer of resources from developed countries of \$750 million a year, or about \$1.25 a head; an increase to \$800 million would involve one of \$550 million, or about \$0.90 a head. It would be difficult to argue that either one of these increases is excessive when contrasted with existing per capita incomes in developed countries of \$2,000 and in developing countries of \$160, or with the expected annual increase in these incomes of \$70 or \$3 respectively.

In the richer countries, which are able to afford to share their good fortune, budgetary problems and balance-of-payments difficulties do exist, will probably continue to exist and must be overcome. It is always tempting to go slow on aid as one of the easiest and quickest ways to help restore equilibrium. And yet, as I said at last year's meeting, it should not be beyond our capacity to manage our affairs in such a way as to effect these transfers of aid without undue strain on our economies. There will be agreement, I am confident, that the war against starvation, sickness, ignorance and poverty in less-fortunate parts of the world should be continuous and escalating. This will not be possible if the level of aid is to be treated as a residual item in national planning.

In the present circumstances, it may be necessary to build into IDA replenishment some balance-of-payments safeguards. We do not advocate such safeguards but we are prepared to accept them if this means that IDA could be replenished at a higher level. The safeguards should not affect a country's obligation to give more aid but only enable it to postpone the effective date. Their establishment should be related to balance-of-payments difficulties only, not to other objectives. They should be temporary and they should be of such a character as not to undermine or weaken in any way the basic principles which have governed the operations of the World Bank group and which have proven to be so successful in the past. IDA replenishment also raises the choice between multilateral and bilateral aid. The relative advantages and disadvantages of these two forms of aid have been discussed at great length and I do not wish to renew the debate here. Although it is evident that, in the immediate future at least, most aid will continue to flow through bilateral channels, there is nevertheless an evident need for more multilateral aid and an important part for it to play. As ministers of finance and governors, concerned as we are with the effective use of public funds, we can take some satisfaction from the soundness of investment in IDA and by IDA. The management and board of directors have rightly insisted that projects should be selected on their economic merits alone, that international competitive bidding should apply and that attention should be paid to the development policies of the borrowers. In addition, there is good reason to believe that the activities of the World Bank group create a climate within developing countries which enhances the effectiveness of bilateral programmes.

In conclusion, Canada attaches the highest importance to the early replenishment of IDA at a substantially higher level. This support is consistent with my Government's decision, made some time ago, to undertake steady increases in the Canadian aid programme. This decision has only recently been reaffirmed despite the efforts which we shall be making by budgetary policies and otherwise to limit the upward pressures on costs and prices to which I have already referred. We rank aid among our highest priorities and we are determined to follow policies that will release the required resources.