dynamic and hence uncertain economic environment and the question is not **whether** uncertainty should be confronted but rather **how** it should be confronted. In recent weeks the present author has repeatedly posed, to authorities concerned with these matters in developing countries, a question which is probably more nearly the right one: Since it seems that any attempt to maintain virtual fixity of exchange rates amongst major currencies over considerable periods of years nowadays entails the build-up of international financial crises, attended by restrictions of various sorts, internal and external, interruptions to external aid, and ultimate major movements of exchange rates, would not developing countries find preferable a system in which major exchange rates move more frequently but less violently, particularly if such movements can be related in some way to "objective indicators" which are known and understood by all concerned? To this question, whether the smoother adjustment is not preferable to the crisis-prone adjustment, the reply is always in favour of the smoother.

It would be reasonable to assume that more frequent movements of major exchange rates, albeit moderate in extent, are likely to be a feature of the system of the future. Fortunately, the additional difficulties arising for developing countries in such a system, while by no means negligible, are at the same time not entirely insuperable. For example these countries are already fully accustomed to the use, in commodity markets, of hedging against future price movements; they may now be well advised to explore actively and fully various ways of mitigating the difficulties and uncertainties that are likely to be involved in exchange movements. Those developing countries whose financial systems have as yet made little provision for "forward cover" in exchange rates would be well advised to explore this matter forthwith. In view of the very great variety of situations in different international exchange and commodity markets, and the differing financial systems in different countries, what is needed is expert advice and impartial technical assistance adapted to the particular circumstances of each country. In the provision of such advice and assistance the Fund ought to be able to be helpful. The technical assistance facilities recently provided under the auspices of the Commonwealth Secretariat might also be employed.

II. INTERNATIONAL RESERVES AND RESERVE CURRENCIES

There is widespread support for the proposal that the SDR should be developed, as soon as possible, into an accepted, and generally utilized, world reserve asset. Such support seems, naturally enough, to be strong amongst developing countries. The emergence of such a "neutral" asset, under international control, could offer some escape from various objections and uncertainties. Politically, it is preferable to avoid holding a reserve in the national currency of some other country. Economically, insofar as a country holds its reserves in

SDRs rather than in a reserve currency, it avoids the dangers attendant either upon the depreciation of that currency or upon the imposition of restrictions on its use. Unlike gold, which has in the past provided a form of non-national (neutral) reserve asset, SDRs are clearly under international control both in their creation and their disposition. Moreover it is conceivable that, in the future, contracts of various sorts, whether in commodity or financial markets, could be denominated in SDRs.

The issues surrounding the development of the SDR, and its replacement of reserve currencies, have been very fully explored in the Executive Directors' Report, and in other studies. No attempt is made here to enter into the very complex and perhaps controversial issues that will arise if and when the time arrives to convert sterling-reserves into SDRs. There are, however, some points that may deserve emphasis and elaboration.

The reserve-currency system today apparently stands condemned both by those who use reserve currencies extensively in their international reserves (and they include virtually all developing countries) and also by those in London and New York who provide reserve-currency facilities. (In Paris people tend to condemn all reserve currency systems except their own).

It is useful, indeed important, to distinguish between three different lines of criticism of reserve-currency systems. The first criticism is that reserve-currency systems, especially the dollar system, permit and indeed encourage inflationary enlargements of the **total** of world reserves; these are generated by deficits in the balance of payments of the reserve-currency country and are thus beyond the scope of any control system, whether traditional (gold) or international (IMF). This criticism, it will be noted, relates to the total of world reserves; the other two relate to the movement of reserves between two or more reserve centres and the associated changes, or prospective changes, in the exchange rates between two or more reserve currencies. Thus, most of the users of currencies as reserves have been confronted in recent years by substantial depreciations of "their" reserve currencies in terms of the currencies of such countries as Germany and Japan, from which their imports may be substantial and where they may have financial obligations. The providers of reserve currencies, on the other hand, have been confronted by exchange-crises resulting from massive outward movements of funds, both official and private, and by demands from official holders for guarantees in terms of other currencies. All three groups of critics look longingly to the emergence of SDRs as a means of reducing if not eliminating such problems.

While one cannot quarrel with these attitudes, one may also be warned that the emergence of the SDR into a form in which it can fulfil all the tasks proposed for it will certainly take a number of years (see Section IV of this paper for an explanation of the legal and procedural issues involved). All concerned will have to live with the reserve currency systems, or some modifications of them, until the new SDR system has been built and put fully into operation.

In other words, the monetary authorities of developing countries are confronted by at least some years in which they will have to make decisions, difficult but by no means impossible, as to how best to deploy their reserves, having regard to the possibilities of depreciation or appreciation of major currencies and the yield and liquidity of the various assets available in reserve centres. For some monetary authorities, these are relatively new issues, but they should be, in practice, quite manageable. Some monetary authorities may wish to obtain expert technical advice or assistance and, here again, help might be forthcoming under the auspices either of the Fund or of the Commonwealth Secretariat.

Lest, anyone, perhaps under French influence, should cast a nostalgic backward look at gold as a reserve asset it may be desirable to recall that the holders of earning assets in the form of reserve currencies have always come off better over the years than the holders of gold. The very occasional increases in the oficial gold price have never begun to compensate the supposedly shrewd holders of gold for the loss of interest that they suffer. In this regard, developing countries have been wiser and more far-sighted than others.

In considering the general phasing out or phasing down of reserve currency systems it is helpful to distinguish (more clearly than is usually the case) between those that are "organic" and those that are "artificial".

The original reserve currency system emerged organically between reserve-centres such as London, New York and Paris and their overseas dependencies. Each centre provided not merely the main source of development-finance for its overseas political or economic dependencies, but also a market for their staple products: New York for such areas as Latin America and Canada, London for most of the British Commonwealth and Empire, and Paris for the French Colonial Empire. In the "developing countries", local banking facilities were often provided by branches of reserve-centre banks; and the reserves of these banks were held, for central as well as overseas business, in the reserve centre. The currency system of the developing country was, in most cases, an extension of the currency system of the reserve-centre. And, as political and financial independence emerged, it was both convenient and sensible that reserves should still be held in the reserve-centre; not in gold nor in the currency of some other major industrialized country.

The essence of the system was that the reserve-centre provided an important range of marketing and financial facilities to its overseas associates, much of their overseas income accrued in the reserve currency, and it was a convenience for all concerned for them to retain certain liquid assets in the reserve centre. It is clear that both the D-mark and the yen are emerging, albeit reluctantly, as "organic" reserve currencies. Thus the possibilities of shifting reserves between reserve centres are actually increasing.

Entirely different is the reserve-currency system that has emerged in very recent years as between certain financial centres in industrialized countries. Traditionally, the main European central banks held nothing but gold in their reserves, apart from minimal working balances held in New York and London. In the past decade or so, however, some of these central banks, and latterly the Bank of Japan, have become, unintentionally and often unwillingly, holders of very substantial amounts of U.S. dollars. The American authorities persuaded them to hold these dollars, rather than convert them into gold thus drawing upon the rapidly dwindling gold reserves of the United States.

It will be seen immediately that this latter-day "reserve currency system" is both artificial and unstable. When the Europeans speak feelingly about the need to liquidate the reserve-currency system, and when they demand "convertibility" from the Americans, it is this system that they are usually thinking about. They consider that the ability of the United States to obtain, in effect, massive short-term credit from abroad has not only relieved it of the monetary disciplines that normally force other countries to bring their balances of payments under control but has in addition made it possible for Americans to buy up or buy into large profitable sectors of European industry. To make matters worse, these artifical reserve-dollars constitute a vast inflationary addition to world monetary reserves; if the European central banks could have withdrawn gold freely from the United States there would simply have been a transfer of gold reserves from one owner to another.

European ire is not directed with anything like the same intensity, if at all, towards the traditional "organic" reserve currency arrangements. Obviously, nobody would suggest that the total of world reserves has been inflated, or is in the least likely to be inflated, by the reserve-currency holdings of developing countries. The requirement that the reserves of the franc zone shall be held in Paris does not seem to be actively questioned. The gradual phasing-out of the traditional reserve-currency role of sterling has, however, been tied into the arrangements for the United Kingdom to enter the European Economic Community.

The question of "phasing out" can become a matter of definition: what, in the case of any reserve-currency holder, are properly considered to be "maximum working balances" and what are "reserve balances"? It may transpire that the mutual advantages of the traditional "organic" reserve currency systems (including the French) may be such that they will endure, in fact if not in name, for a longer time and on a larger scale than generally anticipated at this particular moment when anti-reserve currency passions are running particularly high.

Of course arrangements would have to be agreed between reserve-holders and reserve-suppliers as to what limitations could reasonably be placed on the size or use of official reserve (or working) balances. Some restraints on the international movement of official as well as private balances seem likely to be with us for some time to come. It is in nobody's interest that official balances, along with private balances, should rush from centre to centre aggravating exchange instability. However, in so far as a new exchange-rate system can be worked out (along lines suggested in Section I of this paper and elsewhere), the short-term incentives to move reserves from one centre to another should materially diminish. If, indeed, this turns out to be the shape of things to come, any steps taken at the present stage by monetary authorities in developing countries to become more adept and expert in deploying reserve assets, more or less permanently, as between several reserve centres will turn out to yield more lasting advantages than may today be anticipated.

When a reserve-currency system is phased out or phased down in favour of some alternative reserve-asset, the question naturally arises: What rate of interest will the new asset yield? This question is being asked about SDRs, particularly by developing countries which have traditionally regarded their reserve-currency holdings as a significiant source of foreign-exchange earnings. This attitude has been strengthened in recent years because of the relatively high rates of interest paid on short-term liquid assets in both London and New York. The attitude of some developing countries toward the interest to be paid on holdings of SDRs has thus appeared to be "the higher the better".

On this attitude two comments may be made. It is, of course, incontrovertible that interest earned on SDRs should relate in some degree to interest earned on reserve balances in London and New York, but this does not mean that, in order to make SDRs acceptable, the rates ought, broadly speaking, to be equal. On the contrary, relatively high interest rates in New York and London are in some measure a reflection of the weakness of the balances of payments of these two centres, the tendencies towards inflation in the two countries concerned, and the consequent erosion of the value of the dollar and the pound. If the SDR is to serve as a stable standard of value it should, as far as possible, be immunized from the effects of inflation and currency depreciation. The yield that will make it attractive must be related, not only to high yields in U.S.A. and U.K., but also to the low net yields in Germany, Japan and Switzerland. Indeed, the preference for holding it rather than reserve currencies should relate to its stability at least as much as to its yield.

Further, unless the SDR system is to change radically and in directions that seem unlikely, it will have to continue to be self-supporting, rather than subsidized. This means that the revenues to be raised by the IMF on account of the issuance of SDRs must be set against its payments of interest to holders of SDRs; if the yield is to increase it would seem to involve an increase in the charge. In part these revenues will come, if and when holdings of dollars and sterling come to be converted into SDRs, from New York and London; but in part, and increasingly as the years go by, they will come, as at present, from those countries to which SDRs are originally issued each year. Since there are strong reasons to favour increases in the issuance of SDRs to developing countries (see the next section of this paper), and since these countries are most unlikely to retain all the SDRs that are annually issued to them, it may be questioned how far these countries have a strong interest in high charges related alike to issuance and holdings of SDRs.

III. DEVELOPMENT AND THE LINK

All of the major issues involved in international monetary reform are political as well as economic, and of none of them is this more clearly true than of the proposal to associate, to link, the issuance of SDRs and SDR-like assets with the development needs of the developing countries. To the authorities of these countries the association seems sensible enough; with them the over-riding needs of development make it natural that financial institutions, including in many cases their own central banks, should be involved in provision for development requirements. But this, of course, is just the point which gives rise to profound and sincere worries on the part of authorities in certain other countries who have staunchly defended the integrity of national monetary systems by drawing a firm line between the processes of creation of money and the insatiable demands of political leaders espousing worthy causes.

Quite apart from any special issuance of SDRs based on the Link, there is at present opposition to any issue, or at least any substantial issue, of SDRs in 1973. The reason advanced is that the total of world reserves has, in the recent past, been greatly inflated; several countries have financed the balance-of-payments deficits of the United States by acquiring large amounts of additional "unwanted" dollars. However, as the recently-issued Annual Report of the IMF Executive Directors for 1972 makes abundantly clear, these additional reserves have come into existence under very peculiar circumstances, are held by a very few countries, and can scarcely be considered as a valid argument against continuation of the issuance of SDRs.

Nevertheless, such considerations strengthen the view that if the Link is to gain acceptance (and there are increasing signs that it will), it must be in a form or forms that not only meet the basic requirements of the developing countries but also give reassurance to those countries, those authorities, whose attitudes are more traditional. Indeed, the developing countries themselves have a very clear interest in the