

INTERNATIONAL MONETARY FUND

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J. de Larosière, Chairman

Executive Directors

C. H. Dallara  
J. de Groote

M. Finaish

G. Grosche

A. Kafka  
H. Lundstrom  
E. I. M. Mtei

P. Pérez  
J. J. Polak  
C. R. Rye

A. K. Sengupta

Zhang Z.

Alternate Executive Directors

A. R. Ismael, Temporary  
M. K. Bush

G. Nguyen, Temporary

M. Sugita

T. Sirivedhin, Temporary  
G. D. Hodgson, Temporary  
H. A. Arias

M. A. Weitz, Temporary  
J. E. Suraisry

J. de Beaufort Wijnholds

R. Msadek, Temporary  
A. S. Jayawardena  
T. A. Clark  
I. Angeloni, Temporary

L. Van Houtven, Secretary  
K. Baer, Assistant

Also Present

Legal Department: J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell, J. S. Lizondo, D. J. Mathieson. Secretary's Department: B. J. Owen. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; W. J. Byrne, Y. Kawakami, T. M. Tran. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: J. Hospedales, M. Z. M. Qureshi, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: W.-R. Bengs, J. de la Herrán, J. J. Dreizzen, G. Ercel, R. Fox, V. Govindarajan, N. Haque, L. Hubloue, J. M. Jones, M. Lundsager, K. Murakami, E. Olsen, J. E. Rodríguez, M. Sarenac, A. A. Scholten, E. L. Walker, B. D. White.

# 1. THE SDR - A PROGRAM OF STUDIES

The Executive Directors resumed from the previous meeting their consideration of a staff paper on a program of studies on the SDR (SM/85/166, 6/11/85).

Mr. Angeloni remarked that Mr. Polak had helped to set the Board's discussion on the program of studies on the SDR on the right track by citing the conclusions of the report of the Group of Ten (G-10) on SDR matters. Developments in the international monetary system in the past 10-15 years had touched upon fundamental aspects of the SDR, and it was in the light of those developments that the functions of that instrument must be evaluated at the present meeting. The preparation of a staff study on the SDR was appropriate, even though it was unlikely to lead to major institutional changes in the short run. However, it would be desirable that the Board have the clearest possible idea of the future evolution of the SDR when making decisions related to it, even on an SDR allocation.

The main points relevant to an analysis of the possible functions of the SDR were mentioned in the staff paper, Mr. Angeloni observed. To summarize those functions, the SDR was an instrument for reserve diversification; for creating owned as opposed to borrowed assets; for conducting global monetary policy; and for use in private transactions. Each of those four points should be analyzed from two angles: first, on logical and institutional grounds, and, second, in the light of the changes that had occurred in the international monetary system.

The question of the diversification of official reserves raised the central issue of whether the existence of a monetary instrument consisting of a basket of national currencies offered reserve holders a better or easier way to meet their needs for asset diversification, Mr. Angeloni commented. As Mr. Rye had stated, on those grounds, the case for the SDR was relatively weak, since there appeared to be no major obstacles preventing reserve holders from creating their own baskets composed of national currencies in the desired proportions. There might be some incentive to use the SDR based on lower transaction costs and computational convenience, for instance, although the plausibility of the argument seemed weak. The staff would have to evaluate the strength of that case based on recent developments in the system and consider whether, on the one hand, exchange rate volatility seemed to have increased the need for portfolio diversification by reserve holders, and, on the other, the growth of currency markets had reduced transaction costs and facilitated asset diversification without recourse to an ad hoc instrument such as the SDR.

The question of the "owned" versus the "borrowed" nature of reserves deserved more serious consideration, Mr. Angeloni observed. In principle, international credit and borrowed reserves should have a positive role in channeling funds from surplus to deficit countries. In practice, the fact that assets and liabilities of reserve-center banks were of different maturities implied a certain risk and could be a source of instability.

In that context, an enhancement of the role of an independent, international asset such as the SDR could be helpful. The development of international capital markets in the past two decades or so might therefore have increased the significance of the SDR instead of undermining its role.

The most ambitious conceivable function of the SDR, and the most appealing to an economist, was as an instrument for conducting global monetary policy, Mr. Angeloni remarked. Such a policy could not be sought as a short-run objective, but the idea deserved to be kept alive, and its advantages and disadvantages should be weighed in the staff study. In that respect, the experience of recent decades was relevant. The development of private financial markets had shown that international credit could be expanded flexibly enough to accommodate a growing need for reserves and growing discrepancies in the financial balances across countries; however, the supply of funds had tended to fluctuate widely, from an expansionary phase in the late 1970s to a restrictive one in the early 1980s. Possibly, the SDR could contribute to dampening fluctuations in the supply of reserves, were it not for one major difficulty: even with a larger role for the SDR in the system, there was no guarantee that private markets, especially if they remained largely unregulated as at present, would be prevented from creating unwarranted fluctuations in the volume of credit.

The private usability of SDRs was closely connected with the use of the instrument in official exchange market intervention, Mr. Angeloni stated. The question deserved to be studied, alongside a comparative study of the success of the European Currency Unit (ECU). The success of a given basket in private transactions depended entirely on the need that was felt by the market for that specific instrument; for example, the ECU had proved to be particularly important as a tool for currency diversification because of the number of currencies that it contained and because of the volume of real transactions carried out in those currencies. A test of the market for the SDR had yet to be made.

Mr. Clark remarked that the review of the SDR would raise some central issues for both the Fund and the international financial system as a whole. That in itself was reason to proceed rather cautiously. He could endorse the staff's view of the issues to be covered, with two qualifications.

Granted the complexity of the SDR issue and the almost limitless opportunities for making ever more elaborate studies, his authorities would prefer to see the exercise conducted step by step rather than on too broad a front, Mr. Clark stated. Therefore, he agreed with Mr. Polak's general idea of focusing initially on the considerations that had led to the introduction of the SDR, the changes in the essential features of the international financial system since the SDR's creation, and the impact of those changes on the role originally envisaged for the SDR. Those topics could be dealt with in a single paper; depending on the outcome, the staff could proceed with other studies.

It would also be helpful to distinguish between "structural" questions and questions relating to global macroeconomic management, Mr. Clark suggested. Influences on the general stability of the financial system, for example, reserve composition and in particular the balance between borrowed and nonborrowed reserves, might be separated from issues relating to the regulation of the supply of reserves and surveillance over the policies of reserve currency countries. Clearly, it would not be possible to separate those two sets of questions completely. But as the staff had noted, the latter were apt to go considerably beyond the issue of the functioning and use of the SDR system. Despite the need to tackle those broader issues, eventually, he had no great expectation of reaching any clear conclusions on them in the initial stages of the study.

Mr. de Groote remarked that after a long period of uncertainty, a mandate seemed to be emerging, to provide direction to the Board's activities and to the staff's work on the SDR. The preoccupation with stability, which had underlain the Tokyo meeting of the G-10 and had been reflected in the G-10 report, had also been visible in recent statements made in leading industrial countries. The widespread preoccupation with stability had improved the chances for success in the work to be undertaken on the SDR.

The program of studies on the SDR would center on a number of questions, Mr. de Groote observed. First, should the rationale for the SDR be re-examined as if the asset did not exist, or should the exploration of how to improve the SDR start from its existing functions? For instance, were allocations in proportion to quotas and the present uses of the SDR given, or was there room for different approaches? Other related questions were whether the question of an SDR allocation should be discussed independently of the study of the role of the SDR, and whether the Board would have to consider the possibility of an amendment to the Articles of Agreement, if necessary, to put the study's conclusions into effect. Finally, should the work proceed slowly or quickly, and should it be carried out with some degree of intellectual honesty?

The exercise would miss its mark if it excluded a fundamental review of the rationale for the SDR, Mr. de Groote continued. Often, his chair had stressed the need to update the SDR, not only on the basis of its existing functions, but also within the framework of the present reserve-currency system. Some of the specific proposals that his chair had introduced in the past had been attempts to open the way for such improvements within the framework of the existing Articles of Agreement. As Mr. Dallara had recalled, the original purpose of the SDR had been to stave off the possibility of an overall liquidity shortage. He himself remembered only too well, from his early years as an assistant with the Board in 1963, the many publicly expressed fears about the massive destruction of liquidity that would result from a huge U.S. balance of payments surplus. The whole idea of the SDR had had its origin in those fears. Because a general liquidity shortage was still a possibility, the concept of the SDR remained valid, and its uses in meeting such contingencies should still be considered.

Two different problems merited more urgent consideration, Mr. de Groote remarked. First, a convertible multicurrency system--in which large shifts from one currency into another occurred, and given the desire to maintain freedom of capital movements--could provoke general instability in the system. Second, the Fund needed the resources to finance the process of adjustment. In fact, those two problems could be put more simply in the form of a question: should the SDR have the same role as reserve currencies, should the SDR complement those reserves, or was there no role for the SDR in the present system? Those two problems also epitomized the dual uncertainties in the present system. The role of reserves was to provide protection against uncertainty, and the role of the SDR should be studied in the same context, if it were to be effective. First, the study would have to examine the SDR's role in the system as a whole, a role that would take on added importance in the event of major shifts from one currency into another; the study should also focus on the SDR's role in Fund operations promoting adjustment. It was in light of those dual uncertainties that the concept of a safety net could best be understood. Various interpretations of that concept were possible, but at the very least it implied that appropriate resources and mechanisms would have to be at hand if the Fund were to play its contingency role. Otherwise, the concept would be meaningless.

The Board should agree to examine the full range of problems raised by members of the Board, Mr. de Groote commented. For that reason, the possibility of a substitution account should not be excluded, even if the idea had lost much of its attractiveness, especially in the light of major shifts from one currency into another. Nor did he see why the Board should exclude consideration of the link, which he viewed as a special mechanism to address the concerns of a group of countries relating to the mechanism for SDR allocations. Other issues that should not be ignored included the possibility of a role for the SDR as a last line of reserves in a multicurrency system, or as a source of financing of Fund-supported programs, along the lines of a proposal advanced by his chair.

In his statement, Mr. Polak had wondered whether the question of the extension of Fund credit through an SDR mechanism should be addressed after some progress had been made on the central question, Mr. de Groote observed. In his view, the use of the SDR in Fund operations and in support of the adjustment process was one of the central questions that should be studied from the outset as one of the possible new tasks for the SDR. Nevertheless, he agreed with Mr. Polak that no attempt should be made to prepare a catalog of all possible functions of the SDR.

Even though the Executive Board would discuss the question of an SDR allocation before the Annual Meeting, it was doubtful that the discussion would be conclusive, pending the outcome of the emerging fundamental reflection on the SDR, Mr. de Groote remarked. A decision on SDR allocations had been delayed previously because some Directors had found the justification--that of producing the requisite amount of global liquidity--to be lacking. Nevertheless, it was necessary to maintain the principle

that the SDR could function as a central reserve asset only if it existed in sufficient amounts. If an allocation could be justified when the Board re-examined the question in September, the decision on allocations should be taken before the Annual Meeting.

If the debate on the SDR led to the conclusion that an amendment to the Articles of Agreement was necessary to embody the new role foreseen for the SDR, the Executive Board should not flinch from the task, Mr. de Groote commented. The time might be at hand for the Chairman to devote less energy and skill to persuading banks to continue lending to countries that performed well and more to introducing some changes of his own into the system.

All the relevant problems should be studied with due speed--not in haste but not at a snail's pace, Mr. de Groote considered. It would be useless to discuss underlying techniques and principles if Directors could not gain political support for the ideas that they were discussing in the abstract. Therefore, he suggested that the Board emulate the example of those who had prepared the Ossola report that had provided the background for the SDR concepts, and given governments enough time to digest new ideas gradually.

In order to maintain a degree of intellectual honesty, Directors should keep an open mind, and even learn from the process of discussions, Mr. de Groote observed. That process had already begun for him in his reading of the staff paper and Mr. Polak's statement.

Mr. Weitz stated that his chair could go along with the topic suggested for study in the staff paper. All the questions raised by Mr. Sengupta should be studied carefully by the staff as soon as possible. Finally, his authorities and the Group of Twenty-Four attached great importance to a new allocation of SDRs, a matter that it would be preferable to discuss in detail in the Board meeting scheduled for late August 1985.

Mr. Pérez said that the proposed program of studies on the SDR was of great relevance not only for the Fund itself but for the stability of the international monetary system. It was easy to infer from the Fund's purposes, set out in Article I of the Articles of Agreement, that the Fund should fulfill its obligations primarily through the effective control of international liquidity. The creation and use of an international asset like the SDR appeared to be the key tool for that purpose.

The problems created by the instability of the international financial system had brought the SDR issue to the attention of the Group of Ten meeting in Tokyo, Mr. Pérez observed. However, the report of the G-10 Deputies (EBD/85/154, Sup. 1, 6/21/85) had sent mixed signals on the role of the SDR in the international monetary system. In paragraph 110, the G-10 Deputies had recognized that "the international monetary system has changed considerably since the original creation of the SDR scheme and that this has affected the rationale for the SDR, including the objective

of placing the SDR at the center of the system as the main reserve asset." On the basis of that sentence, there appeared to have been an important shift from the position maintained by the Fund since the Second Amendment, because Article VIII, Section 7 required members to "collaborate with the Fund...[in] making the special drawing right the principal reserve asset in the international monetary system."

However, the ensuing paragraph in the G-10 report stated that the SDR might "still have a useful role in meeting the long-term global need for reserves and in this context in providing a safety net for future contingencies," Mr. Pérez remarked. He saw in that statement a positive signal to the Fund to continue its efforts to improve the SDR mechanism and a broad agreement on the usefulness of the SDR, despite certain divergences of view on certain specific aspects.

The proposal to undertake a program of studies on potential ways of enhancing the effectiveness and usefulness of the SDR should not preclude the immediate consideration of an SDR allocation in the current basic period, Mr. Pérez stated. The reluctance of some countries to agree to a new SDR allocation severely limited the potential usefulness of the instrument and undermined the objective of the proposed study program from the outset.

Finally, the discussion would proceed more efficiently if a distinction were made between central questions, such as the allocation system, and other operational issues, Mr. Pérez said. He agreed with the order of priorities suggested by Mr. Polak and Mr. Sengupta but considered that once the Board had established priorities on all the relevant issues, it should set a tentative timetable for their discussion.

Mr. Ismael commented that in establishing the list of questions to be explored, priority should be given to the analysis of suggestions to strengthen the role of the SDR, especially as an international reserve asset and as a useful instrument for improving the stability of the international monetary system. His chair also shared Mr. Sengupta's view that the SDR deserved more attention as an instrument of economic development, and would welcome the examination of that question in the context of the proposed program of studies.

Mr. Finaish remarked that like most Directors, he continued to support the enhancement of the SDR in the international monetary system as envisaged in the Articles of Agreement. In keeping with that tradition, most Directors had continued to support an allocation for the past several years. He noted that doubts had been expressed recently by the Group of Ten on the rationale for the existence of the SDR in the present international monetary system. The proposed program of study on the role of the SDR could contribute to dispelling some of those doubts, thereby developing a consensus on the enhancement of the role of the SDR. However, studies of the evolving role of the SDR had previously been discussed



by the Board. Several of the issues now being proposed for discussion had been taken up. Consequently, care should be taken to avoid repetition and purely academic discussions.

The proposed program of studies on the SDR had identified a number of useful areas of study, Mr. Finaish stated. The successful completion of the exercise would help to clarify several aspects of the SDR and the international reserve system. Since the program of studies appeared to be quite comprehensive and to require considerable work, priorities and a timetable should be set to help in organizing the work as well as keep the total volume of work manageable.

A clear view on the official and private uses of the SDR and further improvements of the SDR would not emerge until agreement had been reached on the broader issues of the SDR and international monetary stability and other ways to use the SDR to improve the international monetary system, Mr. Finaish observed. Indeed, no clear decision had yet been made on the simplification of the procedures for operating in SDRs, even though the Board had discussed the staff recommendations on that subject. Similarly, unless the Fund membership were committed to the idea of developing the SDR as a reserve asset, there could be no consensus on extending the use of the SDR in the private market.

Therefore, the immediate task would be to ascertain the role of the SDR in the present-day system, as had been proposed in the staff paper, Mr. Finaish commented. The G-10 Deputies in Tokyo had taken the view that changes in the international monetary system, such as the expansion of international financial markets as well as the emergence of a multi-currency reserve system, had affected the rationale for the SDR. Indeed, those changes had been cited by those Directors who had opposed a new SDR allocation in recent discussions on the subject. Thus, the first paper in the program of studies should include a closer examination of the changes in conditions since the creation of the SDR and an analysis of what those changes might mean for the future role of the SDR. Some Directors had expressed the view that those aspects of the international monetary system relevant to the creation of the SDR remained virtually unchanged. According to their view, liquidity creation still depended on the policies of a few reserve centers, and the process of liquidity creation remained unstable and under minimal international control. It would be important, therefore, to assess what fundamental changes had taken place in the international monetary system and their bearing on the role of the SDR in the period ahead.

In assessing the role of the SDR, in the light of changes in the international monetary system, the approach should not be merely to see how the SDR could be adapted, in a residual fashion, to other developments in other components of the international reserve system, Mr. Finaish declared. Rather, as the SDR had not been conceived as a residual reserve asset, a broader approach might be to conduct a broader and more forward-looking examination of how a larger role for the SDR could contribute more constructively to the attainment of a more desirable international

monetary system. Finally, it should be remembered that the program of studies on the role of the SDR was of a long-term nature and should not obstruct a decision on the more immediate question of an SDR allocation in the present basic period.

Mr. Zhang said that he was in general agreement with Mr. Polak's statement, including his suggestion that the central issue to be taken up in the principal staff study should revolve around the changes in the international monetary system that had affected the SDR since its creation. However, it would be useful for future Board discussions to compile a short, analytical catalog of all the proposals that had been made for the SDR. It would also be useful if the staff could start exploring possible ways of making the SDR work as a safety net for contingencies.

The staff ought to refrain from writing technical papers on the SDR at present, as decisions on the SDR would be political in nature, Mr. Zhang considered. Moreover, in responding to the staff's request to identify the central issue for the principal study on the SDR, the Board should resist the temptation to treat every issue as the central issue. Furthermore, the Board had drawn conclusions already on many of the issues pertaining to the SDR, and it would be unfair to turn around and ask the staff to fit questions to those conclusions. Above all, the staff should be asked to prepare only a limited number of papers.

Mr. Mtei remarked that the primary objective of any study of the SDR and its future role would be to find ways of improving the functioning of the international monetary system, as had been recognized by the Deputies and Ministers of the Group of Ten. Therefore, as the SDR had been accepted as an integral part of the Fund by its members and as a vital element in the proper functioning of the international monetary system, it followed that the SDR should play a more important part in the system than it did at present.

For the program of studies to be useful, the staff would have to be selective because of the number of subjects proposed by it for consideration, Mr. Mtei noted. As for the paper under preparation by the staff on a possible allocation of SDRs, much of the ground had already been covered; he trusted that the Board discussion of the paper before the next Annual Meeting in Seoul would have positive results and that the political hurdles that had thus far stood in the way of an allocation would be overcome.

Judging from the study by the Group of Ten, most Deputies appeared to be satisfied that the need for international reserves was being met mostly by the functioning of the multicurrency reserve system, Mr. Mtei observed. Yet many countries lacked easy access to international capital markets and were unable to create reserves or to own reserves. Thus, the legitimate question, which had been mentioned by Mr. Sengupta, was what would happen to weaker member countries that did not have easy access

to the world's commercial capital markets if the need for international reserves were met entirely by reserve creation in the reserve-currency centers.

As the improvement of the international monetary system was the basic objective, tackling the four questions listed on page 4 of SM/85/166 should throw light on how the SDR could play the important role envisaged for it in the international monetary system, Mr. Mtei considered. All other topics, although perhaps interesting in their own right, would have to be secondary. In sum, the program of studies should be a large but single research project that would culminate in one main paper on the SDR and its possible uses for improving the international monetary system. Shorter papers on specific questions could be provided as supporting material. Meanwhile, another major companion issue was the evolution of the role and responsibilities of the Fund itself, especially if--or rather when--the SDR became the principal reserve asset in the system. In that context, the important questions would concern the decision-making process in the Fund, the effectiveness of surveillance, and the current formula for an SDR allocation.

The main paper to be prepared might be presented as a departmental memorandum, which could be used as background material for one or two seminars, an approach that would allow for a franker exchange of views on a subject that was still controversial and had many political overtones, Mr. Mtei concluded. Although the exercise would probably not be completed by the time of the Annual Meeting in Seoul, the Board could give a preliminary report to the Interim Committee with the hope that a final report could be submitted sometime in 1986.

Mr. Msadek noted that while a study on the role of the SDR in the international monetary system would be useful in the long run, meeting the long-standing and overdue need for an SDR allocation was of primary importance. Such an allocation had been called for by the Group of Twenty-Four, and, despite the opposition of some industrial countries, no clear reason had been advanced for the delay in allocations. The recent requirements of the United States for capital inflows had been causing a liquidity problem for a number of countries in the international capital market. A timely allocation of SDRs would enable a number of developing countries better to cover their immediate needs for financing international transactions.

Finally, he agreed with Mr. Sengupta's proposals for the organization of the program of studies, particularly the study examining the enhanced role of the SDRs in the international monetary system, Mr. Msadek said.

The Economic Counsellor observed that the purpose of the present informal discussion had been to establish priorities. However, Mr. Dallara had raised a question in suggesting that the study should focus on whether the original rationale for the SDR still obtained, and if so, why; if not, the study should examine what role there was for the SDR that was consistent with the Articles of Agreement. Perhaps Mr. Dallara's questions had been

meant to encourage reflections on a role for the SDR that was broadly consistent with the fundamental purposes of the Articles of Agreement, which enjoined the Fund to stay abreast of developments in the international monetary system. However, if the staff were asked to consider a role for the SDR that was in all ways consistent with the provision in the Articles of Agreement relating to the SDR, that approach might be too narrow to permit the kind of analysis that was needed for the study program to be constructive.

Ms. Bush explained that in raising two broad questions, Mr. Dallara had had two specific points to make. First, as other Directors had acknowledged, when the SDR had been created, the international monetary system had been significantly different. Since that time, international capital markets had become a major source of liquidity creation, and any study would have to keep that development in mind in determining whether or not there continued to be a role for the SDR and what that role should be. Mr. Dallara's second point--that the role of the SDR should be consistent with the Articles of Agreement--referred to the need to re-evaluate the SDR's role in the context of a system of flexible exchange rates, which had not existed when the SDR concept had been developed. Therefore, it seemed necessary to examine how the usefulness of the SDR had been affected by the changes in the international monetary system.

The Chairman considered that the thrust of the discussion had been the role that the SDR could and should play in the present-day world. Most Executive Directors had expressed the wish to attach some priority to the list of questions suggested by the staff for study, with the majority of Directors having been in favor of concentrating in the first paper on what had been called by some the central questions, namely, what had been described as the role of the SDR in the present-day world. The consensus was also that a place should be found in the main study for examining the potential contribution of the SDR to international monetary stability, together with some of the other proposals mentioned in the staff paper for improving the international monetary system, specifically those covered in points (i) and (ii) on page 4 of the staff paper.

Certain considerations that had been stressed during the discussion would form the basis for the study of that central issue, the Chairman observed. First, it was accepted that the SDR constituted an integral part of the Fund system. Thus, the question was not whether there was a future role for the SDR but what that role could and should be in present and foreseeable circumstances. Second, a number of Directors had asked for an assessment of the international monetary setting in which the SDR had originally been shaped in the late 1960s, and for an evaluation of the changes in conditions since then and their effect on the SDR mechanism. In order to determine how the SDR could be redesigned to fit into the system as it existed at present in the real world. In that connection, he had taken particular note of one of Mr. Sengupta's questions--all would of course be considered--of what the consequences would be for the

Fund and for the system if there were to be no more SDR allocations. Third, the possible contribution that the SDR could make to a safety net, the concept mentioned in the G-10 report, should also be part of the main study.

As for the more specific suggestions made in the staff paper for possible further improvements in the SDR, the Chairman added, most Executive Directors had expressed a preference for not taking them up in the main paper but for reverting to them at a later stage of the discussions. He had in mind improvements to enhance the quality of the SDR as an official reserve asset or as an asset with more uses in private transactions. Considerable interest had been shown in a comparative study of the SDR and the ECU, with the objective of finding out why the latter had gained momentum in the markets as an international asset whereas the former had not.

Finally, the Chairman said, since the main study would have to cover very broad issues, many Directors had stated that the question of an SDR allocation should be studied in the short term, on its merits, at the time scheduled, and should not be linked to the outcome of the longer-term, broad program of studies to be undertaken.

Mr. Polak remarked that from his standpoint, there seemed to be enough support for studying the use of the SDR as an instrument of intervention. The private use of SDRs had received considerable emphasis in the SDR conference in 1983, but the question had never been brought to the Board.

In response to a question by the Chairman, Mr. Polak noted that it would seem appropriate to study the issue in a background paper rather than as part of the main study.

Mr. Sengupta observed that the first SDR allocation had been made under a fixed-parity system, but, with the Second Amendment, the move away from that system had begun, and the question of the SDR as a principal reserve asset had already emerged. Thus, in evaluating the changes in the international monetary system and in the need to revise the concept of the SDR, the relevant comparison was not with 1969 but with the late 1970s.

Ms. Bush responded that the events surrounding the creation of the SDR would be essential background to the analysis; the later historical developments to which Mr. Sengupta had referred would of course be covered. Indeed, the most effective way to approach the study might be to look at the SDR's evolution in stages: first, at the events leading to the creation of the SDR and how the changes in the monetary system since that time had affected the SDR, and, second, at what role the SDR should play in the present system.

The Chairman reassured Ms. Bush that the study would be chronological and historical and would begin by describing the conditions at the end of the 1960s that had surrounded the inception of the SDR concept. The

broader issue was whether the study should be carried out in one or more stages, as Ms. Bush had suggested. The two-step approach was in fact inherent in the intellectual process, so that the only question was whether two papers should be prepared, with an interval.

Mr. Clark expressed support for the two-step approach to the study. It would be important to base the study on an analysis of the original rationale for the SDR, in order to determine how far that rationale was being changed in the search to find new uses for the SDR instrument, assuming that it was still in existence.

Mr. Polak said that it would be impossible to separate the study of the SDR--or of any other similar subject--into two stages. For example, a study of the role of the U.S. Federal Reserve System at present could not be undertaken in two steps, first by asking how the world had changed since the System had been created in 1913 and second by examining what new functions the Federal Reserve could assume.

Mr. Suraisry remarked that he agreed with Mr. Polak. The objective was to reach a judgment about the importance of the SDR in the international monetary system and its future role. Thus, it would be vital to combine the two stages.

Ms. Bush commented that the first part of the study could go further than she had initially indicated by recounting the history of the international monetary system since the creation of the SDR and analyzing the role of the SDR in the present system. The second part could evaluate whether changes or revisions in the system had been significant enough to affect the role of the SDR.

The Economic Counsellor, in response to a question by Mr. Zhang on how long it would take to complete the two-step study, stated that the entire project should be ready for the Board to discuss by spring 1986, well in advance of the autumn 1986 meeting of the Interim Committee.

The Chairman remarked that, as he understood it, Mr. Ruding intended to hold substantive discussions on the SDR at the spring 1986 meeting of the Interim Committee. The discussion on the matter at the Annual Meetings in Seoul in autumn 1985 would be preliminary.

The Economic Counsellor said that the staff would do its best to meet the wishes of the Executive Board.

Mr. Sengupta stated that historical studies were all well and good, as long as they preceded a serious discussion of the problems at hand, as Mr. Polak had stated. The history of the SDR could be traced back before 1969, to the Triffin Plan, and he was concerned that putting pressure on the staff to prepare a full study on the SDR within a few months would increase the probability that the paper would be largely a historical analysis of why the SDR had not done what it had been designed to do. The main issue--how to improve the SDR as an instrument--risked being

left aside. The complexity of current problems and the intellectual effort that would have to be made in tackling them argued in favor of giving the staff the support and the time that it needed to prepare a substantial document.

The Chairman noted that by the time of the spring Interim Committee meeting, the staff should be able to have studied not only the historical aspects but also the more action-oriented questions stemming from the consideration of changes in the international monetary system.

The changes in the international monetary system since the end of the 1960s had affected the role of the SDR, the Chairman observed. The scarcity of global liquidity toward the end of the 1960s had given way to an abundance of liquidity and an extremely strong and active inter-mediation process through the international banking system. The urgent need that had been felt at the time for an additional mechanism to create international liquidity was less apparent at present. Developments since the late 1960s had brought their own problems with them. Buoyant capital markets had led to overborrowing and to insufficient emphasis on surveillance and adjustment. After the eruption of the debt crisis, there had been a constriction of capital flows. Corrective measures were called for to achieve a combination of smoothly functioning capital markets and an efficient surveillance and adjustment process, which in turn would entail less destabilizing movements in reserve currencies; a mechanism for controlling international liquidity might well become necessary for that purpose once again. In sum, it would be impossible to embark on a study of the SDR without exploring the workings of the international monetary system in a broader sense.

Mr. Zhang wondered whether the Executive Board, in making an analysis of the SDR from a historical viewpoint, would not be taking a more backward look than the Group of Ten in its report, which had not questioned the historical aspects in depth.

The Chairman reassured Mr. Zhang that the study would not focus only on the historical aspects; in order to adapt the role of the SDR to existing circumstances, it would be important to analyze the changes in the system as they had affected the SDR. Moreover, it could not be overlooked that some member countries, which would have a large say in decisions on the future of the SDR, were interested in a historical analysis, as their speeches at past Annual Meetings showed. Repeatedly, the Governors of the Fund for those countries had stated that, because the present system was one of flexible exchange rates, multiple reserve currencies, and active capital markets--conditions that had not existed at the end of the 1960s--there was reason to doubt the rationale for the SDR. Those views would have to be answered if the study on an improvement role for the SDR were to be at all convincing.

Mr. Zhang remarked that he had been led to express his disapproval of a historical study by the forward-looking view of other major Fund members, who had seemed to show more concern in the G-10 report with planning for contingencies in the future.

The Executive Directors concluded their discussion of the program of studies on the SDR.

LEO VAN HOUTVEN  
Secretary