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To: Members of the Executive Board

From: The Secretary

Subject: **Special Allocation of SDRs—Further Consideration of a Draft of the
Fourth Amendment of the Articles of Agreement**

The attached staff paper describes the terms and conditions of a special one-time SDR allocation, on the basis of the discussion at the Executive Board meeting of April 23, 1997.

The issue of the amount of the allocation is still pending. The Managing Director intends to call a brief meeting of the Executive Board on this issue at any time ahead of the Interim Committee if there are indications of a possible consensus on the amount.

Mr. Gianviti (ext. 38329) or Mr. Hagan (ext. 37715) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

**Special Allocation of SDRs—Further Consideration of a Draft of the
Fourth Amendment of the Articles of Agreement**

Prepared by the Legal Department

(In consultation with the Treasurer's Department)

Approved by François Gianviti

April 25, 1997

The attached explanatory note and draft amendment of the Articles reflect the approach endorsed by Executive Directors at the Executive Board meeting of April 23, 1997. In addition, an editorial change has been made in the second paragraph of the Introduction of the Explanatory Text to show that references to the relevant paragraphs of Schedule M were made both in Section A and Section B of the Explanatory Text.

Explanatory Text

Introduction

To enable all members of the Fund to participate in the SDR system, the Interim Committee, in its September 29, 1996 Communiqué, endorsed the Executive Board's proposal that all participants in the Special Drawing Rights Department should receive an equitable share of cumulative SDR allocations through an amendment of the Fund's Articles that would provide for a one-time allocation of SDRs, based on a common benchmark ratio of cumulative allocations to present quotas. The Interim Committee emphasized that such an amendment would not in any way affect the Fund's existing power to allocate SDRs on the basis of a finding of a long-term global need to supplement reserves as and when that need arises..

A draft amendment that provides for a special one-time allocation to participants ("special allocation") is attached as an appendix. Set forth below is an explanation of the draft amendment. Section A describes the terms that will govern special allocations made to the various categories of participants under Schedule M of the amendment. General features of the draft amendment, including the relationship between special allocations and allocations made pursuant to Article XVIII, are described in Section B. The description of the draft amendment contains references to the relevant paragraphs of Schedule M.

One of the important features of the draft amendment is its treatment of participants with overdue obligations to the Fund. As is discussed further in Section B, in the event that a participant is in arrears to the Fund at the time it receives the special allocation, the SDRs allocated to that participant will be deposited and held in an escrow account within the Special Drawing Rights Department and shall be released to the participant upon its discharge of all its overdue obligations to the Fund (paragraph 5). This mechanism would not apply to general allocations made pursuant to Article XVIII.

A. Categories of Recipients

1. Existing Participants

Under the draft amendment, the amount of SDRs that will be allocated to members that are participants as of [specified date] ("existing participants") will be an amount that will raise their net cumulative allocation-to-quota ratios to a level corresponding to a ratio of [] (the "benchmark ratio"). As a general rule, this ratio will be applied to existing participants' quotas as of [specified date] (paragraph 1). The application of the benchmark ratio to quotas as of [specified date] has the effect that changes in net cumulative allocations or quotas after [specified date] will not affect the size of the special allocation received by existing participants. As an exception to the above rule, existing participants that have not been able to increase their quotas under the Ninth General Review by [specified date], because they have

failed to discharge their overdue obligations to the General Resources Account, will be allocated an amount that is calculated on the basis of their proposed quotas under the Ninth General Review (as set forth in Resolution No. 45-2 of the Board of Governors of the Fund) rather than on the basis of their actual quotas as of [specified date] (paragraph 1). This proposed quota will be used as a basis for calculating the amount of allocation even if the participant never actually increases its quota under the Ninth General Review.

Each existing participant will receive its special allocation on the 30th day following the effective date of the amendment (paragraph 1) unless it has notified the Fund of its desire not to receive the special allocation (paragraph 4).

2. Future Participants

The draft amendment also makes provision for a special allocation to countries that become participants in the SDR Department after [specified date] but within three months of the date of their membership in the Fund ("future participants") (paragraph 2).

Regarding the method of calculation, the draft amendment sets forth a formula that attempts to achieve, to the extent possible, comparability of treatment between existing participants and future participants (paragraph 2(b) and (c)). A future participant will receive a special allocation that will result in its ratio of net cumulative allocation to quota being equal to the benchmark ratio applied to existing participants, as adjusted downwards, in proportion to the change in the total quotas of existing participants that has occurred since [specified date]¹ (paragraph 2(b)(i)), and upwards, in proportion to the change in the total net cumulative allocations of existing participants that are attributable to general allocations made after the specified date² (paragraph 2(b)(ii)).

Future participants will receive a special allocation on the 30th day following the later of: (i) the date of their participation, or (ii) the effective date of the fourth amendment (paragraph 2(a)), unless they notify the Fund of their desire not to receive the allocation (paragraph 4).

¹Changes arising from: (i) increases in quotas under the Ninth General Review that enter into effect after [specified date], and (ii) the quotas of new participants, will not cause an adjustment (paragraph 2(b)(i) and 2(c), respectively).

²The category of existing participants that would be used for purposes of determining the adjustment to be made would be limited to existing participants that have received all allocations made by the Fund since the specified date (paragraph 2(c)). This would ensure that a future participant would not be adversely affected by a decision taken by an existing participant to opt out of an allocation (which would reduce the amount by which the total of net cumulative allocations of participants would have otherwise increased and, accordingly, would also reduce the extent of the upwards adjustment).

[3. The Federal Republic of Yugoslavia (Serbia/Montenegro)³

As of [specified date], the Federal Republic of Yugoslavia (Serbia/Montenegro) (the "FRY") has not succeeded to membership in the Fund and participation in the Special Drawing Rights Department in accordance with the terms and conditions of Executive Board Decision No. 10237-(92/150), adopted December 14, 1992, and, therefore, is not an existing participant. Upon satisfying these conditions, it will not be eligible to receive an allocation as a future participant because it will have succeeded retroactively to the former Socialist Federal Republic of Yugoslavia's (the "SFRY") membership in the Fund and participation in the SDR Department, along with the four other successor states of the SFRY. Accordingly, the text of the draft amendment includes a provision that enables the FRY to receive a special allocation once it becomes a participant (paragraph 3).

With respect to the method of calculation, the draft amendment provides that the amount to be received will be based on the proposed Ninth Review quota offered to the FRY under paragraph 3(c) of the Executive Board Decision No. 10237-(92/150), as adjusted upwards in proportion to the change in the total net cumulative allocations of existing participants that are attributable to general allocations made after the specified date but prior to the date on which the FRY succeeds to membership in the Fund and participation in the Special Drawing Rights Department (paragraph 3(b)). The method of calculating this upward adjustment is the same as that used in the case of future participants.]

B. General Features

1. The special allocation to be made pursuant to the draft amendment will not be made on the basis of a finding of "long term global need". Rather, a sentence will be added to Article XV to provide for a one-time allocation of SDRs to existing and future participants in accordance with the provisions of Schedule M.

2. The special allocation will not in any way affect the Fund's existing power to allocate SDRs on the basis of a finding of "long term global need" in accordance with Article XVIII. The text of Article XVIII will not be modified. Moreover, a specific reference will be added to the first sentence of Article XV for the purpose of emphasizing that allocations made on the basis of "long term global need" will continue to be made exclusively in accordance with the provisions of Article XVIII.

³This paragraph will be eliminated if, by the specified date, the Federal Republic of Yugoslavia (Serbia/Montenegro) has succeeded to membership in the Fund and participation in the Special Drawing Rights Department in accordance with the terms and conditions of Executive Board Decision No. 10237-(92/150).

3. Participants will receive only one allocation under the draft amendment. Accordingly, the draft amendment will not establish a permanent mechanism for periodic harmonization of net cumulative allocation to quota ratios.

4. Unlike Article XVIII, the special allocation provision will operate without the necessity of a decision by an organ of the Fund; conversely, an organ of the Fund will have no authority to modify the operation of the provision.⁴

5. As noted in the Introduction, SDRs allocated to a participant with overdue obligations to the Fund when the special allocation is made will be deposited in an escrow account within the Special Drawing Rights Department and shall be released to the participant upon discharge of all its overdue obligations to the Fund. The concept of overdue obligations for purposes of this draft amendment is defined in paragraph 5(c) of Schedule M; it does not include arrears on maintenance of value obligations under Article V, Section 11.

During the period when SDRs are held in an escrow account, these SDRs shall not be available to the participant for any use. Moreover, during this period, the SDRs held in the escrow account would not be included in any calculations of the participant's allocations or holdings of SDRs for the purposes of the Articles other than calculations under Schedule M. Accordingly, they would not be subject to charges or assessments or give rise to payment of interest under Article XX. They would not be taken into consideration for purposes of calculating the extent of the participant's obligations to either reconstitute SDRs (Article XIX, Section 6) or accept SDRs from other participants (Article XIX, Section 4). Since SDRs held in an escrow account would not be available to the participant, they would not be taken into consideration for purposes of calculating a participant's reserves. If SDRs are held in an escrow account when the participant terminates its participation in the Special Drawing Rights Department or when it is decided to liquidate the Special Drawing rights Department, such SDRs shall be canceled (paragraph 5(b)).

Paragraph 5(d) clarifies that, except for the provisions of that paragraph as described above, the principle of separation between the General Department and the Special Drawing Rights Department and the unconditional character of SDRs as reserve assets shall be maintained.

6. Except for those SDRs that are held in an escrow account pursuant to paragraph 5 of Schedule M, the characteristics of SDRs allocated pursuant to a special allocation will be the same as those of SDRs allocated under Article XVIII.

⁴ However, the general provisions on the liquidation of the SDR Department will apply: allocations made under the amendment will be suspended if the Executive Board decides that the liquidation of the SDR Department may be necessary and will cease after a decision of the Board of Governors to liquidate the SDR Department or the Fund.

7. The draft amendment will also be without prejudice to the application of Article XVIII, Section 2(d), which sets forth the rules regarding the receipt of regular allocations by members that become participants after the commencement of a basic period. Under that provision, the Fund may authorize a new participant to receive regular allocations made during the remainder of the basic period.⁵ Accordingly, if a future member becomes a participant during a basic period when allocations are being made, it may be authorized to receive a regular allocation under Article XVIII in addition to its special allocation.

⁵A member that becomes a participant after the commencement of a basic period during which regular allocations are being made may receive such allocations during the remainder of the period only if the Fund so decides. In the past, the Fund has always authorized the receipt of allocations in these cases.

Draft of the Proposed Fourth Amendment

1. The text of Article XV, Section 1 shall be amended to read as follows:
 - (a) To meet the need, as and when it arises, for a supplement to existing reserve assets, the Fund is authorized to allocate special drawing rights in accordance with the provisions of Article XVIII to members that are participants in the Special Drawing Rights Department.
 - (b) In addition, the Fund shall allocate special drawing rights to members that are participants in the Special Drawing Rights Department in accordance with the provisions of Schedule M.
2. A new Schedule M shall be added to the Articles, to read as follows:

SCHEDULE M

Special One-Time Allocation of Special Drawing Rights

1. Subject to 4 below, each member that, as of [specified date], is a participant in the Special Drawing Rights Department [and has a net cumulative allocation of special drawing rights that is less than [] percent of its quota]⁶ shall, on the 30th day following the effective date of the fourth amendment of this Agreement, receive an allocation of special drawing rights in an amount that will result in its net cumulative allocation of special drawing rights being equal to [] percent of its quota as of [specified date], provided that, for participants whose quotas have not been adjusted as proposed in Resolution 45-2 of the Board of Governors, calculations shall be made on the basis of the quotas proposed in that resolution.

2. (a) Subject to 4 below, each country that becomes a participant in the Special Drawing Rights Department after [specified date] but within three months of the date of its membership in the Fund shall receive an allocation of special drawing rights in an amount calculated in accordance with (b) and (c) below on the 30th day following the later of: (i) the date on which the new member becomes a participant in the Special Drawing Rights Department or (ii) the effective date of the fourth amendment of this Agreement.

(b) For the purposes of (a) above, each participant shall receive an amount of special drawing rights that will result in such participant's ratio of net cumulative allocation to

⁶ The square-bracketed language will be eliminated if the benchmark is sufficiently high to ensure that all existing participants will receive a special allocation.

quota being equal to [] percent of its quota as of the date on which the member becomes a participant in the Special Drawing Rights Department, as adjusted:

(i) first, by multiplying [] percent by the ratio of the total of quotas, as calculated under 1 above, of the participants described in (c) below to the total of quotas of such participants as of the date on which the member became a participant in the Special Drawing Rights Department, and

(ii) second, by multiplying the product of (i) above by the ratio of the total of the sum of the net cumulative allocations of special drawing rights received under Article XVIII of the participants described in (c) below as of the date on which the member became a participant in the Special Drawing Rights Department and the allocations received by such participants under 1 above to the total of the sum of the net cumulative allocations of special drawing rights received under Article XVIII of such participants as of [specified date] and the allocations received by such participants under 1 above.

(c) For the purposes of the adjustments to be made under (b) above, the participants in the Special Drawing Rights Department shall be members that are participants as of [specified date] and [(i) have received an allocation under 1 above]⁷, (ii) continue to be participants in the Special Drawing Rights Department as of the date on which the member became a participant in the Special Drawing Rights Department, and (iii) have received all allocations made by the Fund after [specified date].

[3. (a) Subject to 4 below, if the Federal Republic of Yugoslavia (Serbia/Montenegro) succeeds to the membership in the Fund and the participation in the Special Drawing Rights Department of the former Socialist Federal Republic of Yugoslavia in accordance with the terms and conditions of Executive Board Decision No. 10237-(92/150), adopted December 14, 1992, it shall receive an allocation of special drawing rights in an amount calculated in accordance with (b) below on the 30th day following the later of: (i) the date on which the Federal Republic of Yugoslavia (Serbia/Montenegro) succeeds to membership with the Fund and participation in the Special Drawing Rights Department in accordance with the terms and conditions of Executive Board Decision No. 10237-(92/150), or (ii) the effective date of the fourth amendment of this Agreement.

(b) For the purposes of (a) above, the Federal Republic of Yugoslavia (Serbia/Montenegro) shall receive an amount of special drawing rights that will result in its ratio of net cumulative allocation-to-quota ratio being equal to [] percent of the quota proposed to it under paragraph 3(c) of Executive Board Decision No. 10237-(92/150), as adjusted in

⁷The square-bracketed language will be eliminated if the benchmark is sufficiently high to ensure that all existing participants receive a special allocation.

accordance with 2(b)(ii) and (c) above as of the date on which the Federal Republic of Yugoslavia (Serbia/ Montenegro) qualifies for an allocation under (a) above.]⁸

4. The Fund shall not allocate special drawing rights under this Schedule to those participants that have notified the Fund in writing prior to the date of the allocation of their desire not to receive the allocation.

5. (a) If, at the time an allocation is made to a participant under 1, 2, or 3 above, the participant has overdue obligations to the Fund, the special drawing rights so allocated shall be deposited and held in an escrow account within the SDR Department and shall be released to the participant upon discharge of all its overdue obligations to the Fund.

(b) Special drawing rights being held in an escrow account shall not be available for any use and shall not be included in any calculations of allocations or holdings of special drawing rights for the purposes of the Articles, except for calculations under this Schedule. If special drawing rights allocated to a participant are held in an escrow account when the participant terminates its participation in the Special Drawing Rights Department or when it is decided to liquidate the Special Drawing Rights Department, such special drawing rights shall be canceled.

(c) For purposes of this paragraph, overdue obligations to the Fund consist of overdue repurchases and charges in the General Resources Account, overdue principal and interest on loans in the Special Disbursement Account, overdue charges and assessments in the Special Drawing Rights Department, and overdue liabilities to the Fund as trustee.

(d) Except for the provisions of this paragraph, the principle of separation between the General Department and the Special Drawing Rights Department and the unconditional character of special drawing rights as reserve assets shall be maintained.

⁸This square-bracketed paragraph will be eliminated if, by the specified date, the Federal Republic of Yugoslavia (Serbia/Montenegro) has succeeded to membership in the Fund and participation in the Special Drawing Rights Department in accordance with the terms and conditions of Executive Board Decisions No. 10237-(92/150).