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# INTERNATIONAL MONETARY FUND

## Minutes of Executive Board Meeting 87/102

3:00 p.m., July 10, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| | P. E. Archibong, Temporary |
| | Wang X., Temporary |
| | J. Prader |
| | R. Morales, Temporary |
| | S. K. Fayyad, Temporary |
| G. Grosche | A. Bertuch-Samuels, Temporary |
| J. E. Ismael | J. Reddy |
| A. Kafka | |
| | R. Comotto, Temporary |
| | W. N. Engert, Temporary |
| | N. Toé, Temporary |
| | I. A. Al-Assaf |
| | C. Noriega, Temporary |
| | M. Fogelholm |
| H. Ploix | S. de Forges |
| | J. de Beaufort Wijnholds |
| C. R. Rye | |
| G. Salehkhou | |
| | L. E. N. Fernando |
| | A. Vasudevan, Temporary |
| K. Yamazaki | |
| S. Zecchini | N. Kyriazidis |

L. Van Houtven, Secretary and Counsellor
R. Gaster, Assistant

Also Present

Administration Department: G. F. Rea, Director. European Department: A. L. Bovenberg. External Relations Department: J. E. McEuen. Legal Department: R. H. Munzberg. Research Department: P. Isard. Treasurer's Department: G. F. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; P. B. Clark, S. I. Fawzi, R. W. Furstenberg, D. K. Gupta, O. Roncesvalles. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, I. Puro. Assistants to Executive Directors: F. E. R. Alfiler, M. Arif, V. J. Fernandez, G. K. Hodges, L. M. Piantini, S. Rebecchini, S. Rouai, H. van der Burg.

1. SDR IN RESERVE MANAGEMENT PRACTICES OF MONETARY AUTHORITIES

The Executive Directors resumed from their previous meeting (EBM/87/101, 7/10/87) their consideration of the staff paper on the SDR in reserve management practices of monetary authorities (SM/87/63, 3/17/87).

Mr. Prader made the following statement:

> The staff's approach is useful and potentially fruitful, as it shifts the focus of our discussions on the SDR from the domain of theory to the more practical level of an empirical inquiry into the actual practices of monetary authorities. The fuller and more certain information thereby obtained on countries' actual behavior--in the place of speculation about their motives and actions--is itself vitally important to our discussions of the SDR. In addition, monetary authorities will themselves find that the process of answering the Fund's questionnaire and evaluating the results has been one of learning and reflection. The survey also revealed any discrepancies that may exist between countries' official declarations and actual preferences, which should help to sweep away some of the confusing rhetoric that has often characterized discussions of the SDR by opponents and proponents alike.
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> Representing as I do a constituency which has strongly advocated the SDR and has rather actively utilized it, I was amazed by one of the general findings of the survey--the "generally negative evaluation" of the SDR--which was reflected in low holdings of SDRs and the low priority assigned to the SDR in reserve management. Another surprise was the survey's revelation of a rather striking lack of ingenuity in making use of the SDR, a phenomenon which seems to contradict the conventional wisdom that money managers are sophisticated and innovative professionals eager to seize on any investment opportunity.
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> Together, these two salient results of the survey suggest that it is negative perceptions of the SDR's characteristics which adversely affect the flow of information about possible ways to utilize it: money managers in central banks, having such perceptions, would tend to spend little time and imagination on strategies for its use. The fact that only a few countries hold enough SDRs to cover their SDR-denominated liabilities to the Fund is evidence for this point.
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> The negative views of the SDR's characteristics common to both industrial and nonindustrial countries indicate that the SDR poses problems unrelated to countries' preferences and interests, and demonstrates the need to correct some of the SDR's deficiencies. This opportunity to benefit from the proposals put forward by the survey's respondents and by the staff should not be missed.

The lesson to be drawn from the survey is clear enough: given the SDR's present properties, countries' willingness to hold SDRs would not increase even with new allocations. The survey provided vivid illustrations of the major reasons for the low demand for SDRs, and clearly shows that before any additional allocation, several aspects of the SDR--primarily its liquidity and usability--must be improved if the SDR is to succeed as a reserve asset. This harsh reality cannot be ignored unless we wish to suffer through further endless discussions--whose negative outcome everyone knows in advance.

References to the Articles of Agreement seem to loom large whenever the subject arises of eliminating some of the barriers to the improvement of the SDR's attractiveness for reserve management. The Articles are not forever sacrosanct against a perceived need to reform them, but in the meantime, references to SDR restrictions contained in the Articles should not prevent us from implementing some specific minor technical proposals such as those submitted by the staff.

In general, our constituency can go along with most of these proposals. Reducing the administrative procedures involved in SDR transactions by cutting the reporting requirements would be most helpful: at present, these transactions are more like communications between government agencies than commercial transactions. In addition, the confidentiality of these transactions is not presently being protected, which explains the Austrian and Belgian authorities' criticism to the recording of SDR transactions in Fund documents. A simple report to the Treasurer's Department would suffice, enabling it to perform all necessary calculations.

Another obvious and fundamental weakness of the SDR is that SDR operations mainly take place within the framework of the quarterly designation plan. An alternative is offered by arrangements to buy and sell SDRs within a specified range, independently of the designation plan. Two countries in my constituency--Austria and Belgium--have entered into such arrangements, and as our experience has so far been positive, we can recommend that other countries follow suit. One major disadvantage of the SDR--its lack of liquidity--could in particular be diminished by increasing the number of buy-and-sell arrangements. In fact, I wonder why more countries have not followed the Austrian and Belgian examples.

Only the reform of the SDR in the direction of more market-like arrangements would give the SDR some momentum. We would be interested to know if any other constituencies feel the same way. The present survey is a useful first step to providing such momentum and it might now be appropriate to prepare some of the proposals and initiatives suggested in the report for the consideration of our authorities during the upcoming meeting of the Interim Committee.

Finally, we support both an extension of the survey to more countries, and the undertaking of similar surveys from time to time in the future. That would maintain enthusiasm for reforming the SDR, and would enable us to test our views against the realities of revealed reserve management preferences.

Mr. Noriega made the following statement:

We welcome the contribution of this report to a better understanding of the views of monetary authorities in member countries on how the characteristics of SDRs compare with those of other assets in managing their foreign reserves. This presentation of the topic helps to clarify those issues which have precluded a wider use of SDRs and those aspects which merit further analysis. However, we are aware that caution needs to be exercised when making inferences based on the results of this survey. As in general we endorse the considerations presented by the staff, which tend to promote the use of SDRs, I will organize my comments along the lines of the report.

Let me begin by reiterating what we have said on previous occasions: that firm support by major industrialized countries is needed to increase the attractiveness of SDRs, and the discussion on operative matters cannot ignore this more basic consideration. Here, however, we will concentrate only on the operative issues mentioned in the report. The report seems to suggest that two measures may be adopted in order to promote liquidity: a lowering of transaction costs and a widening of the market. However, the first measure should be seen as a prerequisite of the second. The time and "red tape" involved in SDR transfers should indeed be reduced to make transactions competitive with those of commercial institutions--we see no reason why Fund transactions should take longer than those for commercial banks--and the report would have been enriched if the staff could have suggested means of accomplishing this improvement in efficiency.

The issue of reducing reporting requirements is intimately linked with the possibility of increasing the number of holders, since presumably new users would require a different method for monitoring their transactions. In principle, we think that one-sided reporting--by the holder only--should be sufficient, even under current practices.

As an enlarged role is envisaged for the Fund in the future, it is becoming increasingly important to accept an enlargement in the number of users. This, however, will certainly require new arrangements, and we support the opinion expressed on a previous occasion by Mrs. Ploix that the catalog of authorized operations be replaced with a broad authorization subject only to a few limitations, particularly those imposed by the Articles.

Both the enlargement in the number of holders and the authorization to introduce market-making arrangements will have to be made simultaneously.

Confidentiality is an important element in promoting usability, in addition to the points just made regarding the number of holders and the creation of new arrangements, as well as those measures related to the simplification of transactions and operations. The inclusion of new holders, particularly private financial institutions, would require revision of the policy on confidentiality currently pursued by the Fund, and more aggregate reporting and the relaxation of publicity requirements should be considered.

The finding that the share of SDRs within total reserves is small, and that their role in reserve management is insignificant, is not surprising given the relatively small overall amount of SDRs. However, independently of the fact that new allocations would be a major factor in the enhancement of the SDR, it would certainly be useful to provide more information to the holders on its characteristics. Every effort should be made by the Fund to increase its member countries' awareness of the potential advantages associated with holding SDRs. Reducing the exposure of SDR liabilities and lowering costs in transactions with the Fund do constitute major arguments favoring SDRs' use.

Further research like that submitted to us on this occasion is useful, and we look forward to discussing the paper being prepared on the possible authorization for commercial banks to hold and use SDRs. However, a second canvassing of opinions on how the SDR compares with other foreign assets in reserve management would probably produce the same basic findings. What is really important to decide at this stage--and here I fully agree with Mr. Salehkhou--is whether there is support from major industrial countries for enhancing the use of the SDR in the short run.

Mr. Zecchini made the following statement:

We welcome this sample survey of the attitudes of monetary authorities with regard to the use of the SDR in the management of their reserves, since it provides strong evidence and support for the arguments put forward by several Board members in repeated discussions on the SDR. The arguments that we are referring to are mainly two: first, the restricted supply of SDRs does not allow the monetary authorities to consider their allocated SDRs as a significant operational instrument for managing their reserve positions. Second, in spite of the very low risk involved in holding SDR reserves, there are several aspects of SDR assets that are not conducive to an expansion of demand for them. These aspects pertain to the SDR's liquidity, usability, valuation, and confidentiality of transactions. In fact, these shortcomings can explain much of the SDR's lack of success as an alternative reserve asset. They also constitute one of the reasons why the evolving and increasing demand for reserves has been met by other means and currencies. It is a political argument, not a rational one, to suggest that there is no need to enhance the SDR because in a market-dominated multicurrency reserve system countries can acquire better reserves. Specifically, this argument is tantamount to recognizing or even accepting the end result that follows from the continuous resistance of some major countries to the SDR for most of the 1980s. As of now, however, the SDR is not a perfect or better substitute for assets denominated in reserve currencies in central banks.

In contrast, this chair attaches considerable importance to the objective of enhancing the role of the SDR in line with the ultimate target of making the SDR the principal reserve asset in the international system as specified by Article VIII, Section 7 of the Articles of Agreement. To this end, we will concentrate our comments on possible ways to make the SDR a more attractive reserve asset which can satisfy the demand for reserves. Significant measures are required to increase the attractiveness of the SDR for both official and private holders. Several of these measures--especially those pertaining to the usability of the SDR--can only be taken by the Fund itself, since they involve the removal of restrictions or limitations that the Fund imposes on the utilization of the SDR. Other measures, such as those required to raise the liquidity of the SDR, imply a supportive role on the part of the Fund--in the sense of supplementing market mechanisms or member countries' initiatives. Several possible measures can be derived from the questionnaire.

Turning to the specific proposals for enhancing the use of the SDR by official holders, let me comment in turn on liquidity, usability, and reserve management measures.

A high degree of liquidity is an essential feature of any reserve asset. Eighteen out of 27 countries indicated on the questionnaire that the liquidity of the SDR at present compares unfavorably with that of other international reserve assets. A widening and deepening of the market for SDRs will therefore greatly improve its relative attractiveness. To this end, it will be advisable for both the Fund and some major member countries to engage in market making. The Fund's involvement is necessary in order to signal the full support of the institution for the development of the SDR. As for the specific mechanism of the Fund's involvement, serious consideration should be given to both the creation of a pool of SDRs and reserves for Fund use, and the use of the General Resources Account to support a market in SDRs. The involvement of countries in market making is also necessary, so as to increase the number of market makers and to improve the efficiency of the market.

At present, market-making activity is seriously hampered by the Fund's prohibition on the use of commissions, and by the fact that exchange rates and interest rates on the SDR cannot be adjusted to clear the market for official SDR transactions. Improving the liquidity characteristic of the SDR will therefore require that we remove these restrictions. To this end, we might wish to consider a review of Article XIX, Section 7, which requires the use of "equal value" exchange rates in all SDR transactions.

The liquidity of the SDR should also be improved by lowering transaction costs. As indicated in the staff paper, this will require reducing the time and the amount of reporting necessary for a transfer.

Turning now to the measures for improving the usability of the SDR, we should aim at two parallel objectives: to enlarge the number of the holders of SDRs, and to increase the number of transactions in SDRs.

With respect to the first objective, we should consider opening a private holders' account in the SDR Department, and the establishment of links between the official SDR circuit and the private one. These measures will help to broaden the private use of the SDR, and will therefore enhance the scope for use of the SDR in foreign exchange intervention by the monetary authorities.

The Fund can also play a significant role in increasing the number of transactions in SDRs. Consideration should be given to broadening the scope of Fund operations denominated in SDRs, especially purchases and repurchases within the General Resources Account. Three operational suggestions could be implemented: the series of Board decisions authorizing specific operations should be replaced by "single authorization," allowing any transaction or operation to be carried out in SDRs, provided that it complies with the limitations expressly envisaged by the Articles of Agreement; at present, SDRs can be sold by the Fund to a member for payment of charges only in the 30 days preceding the day when that payment is due, and we should consider extending that period considerably; and steps should be taken to allow the Fund to borrow official SDRs, and to allow administered accounts to hold SDRs. At present, the Articles of Agreement do not provide for administered accounts to hold SDRs. It is paradoxical that participants and other holders can engage in operations that are not possible for the Fund, and the peculiarity of this situation is apparent in the proposal that we approved on a lapse of time basis a few days ago, when we allowed operations in SDRs for the settlement of Trust Fund obligations that will be conducted through the Bank for International Settlements. While that proposal was certainly a step in the right direction, a more radical step to correct these serious limitations is now warranted.

Finally, several countries indicated in the questionnaire that they considered the SDR to be a relatively unimportant reserve asset because it constitutes a small fraction of global reserve assets. We in fact believe that within certain limits an increased supply of SDRs would change member perceptions of the importance of the asset, and thus SDR demand. In other words, a "critical mass" must be established, in order to overcome the costs associated with familiarizing national officials with the characteristics and the techniques of the new financial instrument.

An increase in the supply of SDRs will also require the Fund to address the issue of promoting a more balanced distribution of SDR holdings among members. To this effect, during the Board discussion of this issue last year, we proposed the introduction of cost disincentives in order to stabilize the share of SDRs in non-gold reserves. The use of SDRs could be paid for at a penalty rate by a member country whose SDR holdings fall below a set minimum for a prolonged period of time.

It should be clear, however, that a more effective and substantial role for the SDR in the reserve management of monetary authorities should mainly be sought through improving the liquidity and usability features of this asset, along the lines described above. These improvements are essential not only for the transactions purpose of holding reserve assets but also to serve the investment and precautionary functions properly.

Mrs. Ploix made the following statement:

In the Board discussion on considerations pertaining to a resumption of SDR allocations in the fifth basic period (EBM/87/55, 3/27/87 and EBM/87/56, 3/27/87), I circulated my statement, the second part of which was devoted to the item under discussion today. I have no reason to change my position.

The staff paper confirms a widely known situation--that the SDR does not compare well with alternative assets. We thus share the staff view that obviously the characteristics of the SDR must be improved, with a view to fostering its role not only as a reserve asset and as a means of payment, but also as a portfolio instrument. For outsiders the Fund's attitude toward this matter seems schizophrenic: it is astonishing to hear the Fund simultaneously advocate the opening and developing of capital markets, while doing its best to restrain the usability of its own instrument. In the present climate of widespread deregulation, the Fund would be well advised to opt for a more open approach, instead of resorting to coercive policies--minimum holdings or reconstitution requirements--which further handicap the SDR. In this respect, I welcome the recent proposal in EBS/87/149 aimed at allowing the use of the SDR as a medium of payment for Trust Fund obligations.

More specifically, all the current cumbersome rules should be eased. If the SDR is to compete effectively with other reserve assets, it must be as tradable as any other portfolio instrument. As we know, the ease of using a financial asset is measured not only by the purely financial costs that its use entails, but also, to a large extent, by the nonfinancial restrictions that the potential users must deal with: liquidity and usability are two sides of the same coin. All the suggestions described in the paper must therefore be thoroughly reviewed with that comment in mind.

Time constraints on transactions are the most obvious operational costs, especially when compared to transactions involving other reserve assets. These rigidities are understandable when the transaction is made through the designation process, although they could be mitigated. However, they are not justified when transactions are made by agreement.

Consequently, we would accept a reduction of the delays in arranging transactions by agreement; the use of a more recent exchange rate than the one prevailing three business days before the value date of the transaction; a simplification of the reporting requirement--instructions from the holder transferring SDRs would be sufficient. The usefulness of sending lengthy legal documents instead of simple payments instructions appears limited, to say the least.

SDR holders could be given even more leeway to engage in SDR transactions and operations by agreement. Recent years have been characterized by the so-called innovative process in the financial markets, leading to a sharp increase in the variety of operations and instruments in these markets. Should the Fund continue to maintain a catalog of authorized operations, this catalog would quickly grow to an astounding size. We would thus favor the replacement of this system with a broad authorization, subject only to a few limitations--including those imposed by the Articles, such as "equal value" exchange rates, restrictions on the use of gold, and the requirement of reporting pertinent information. Such a broad authorization would not necesarily oblige the Fund to behave as a market maker, or as a buyer of last resort; these are two completely different issues.

The lack of confidentiality that deters some countries from using their SDRs could easily be corrected by somewhat relaxing the publicity requirements, as confidentiality is sufficiently protected by the length of time between the transactions and their publication in internal Fund papers.

As far as the transactions by designation are concerned, a far-reaching solution should also be looked into, namely, the abrogation of the requirement of need. Such a requirement has already been abrogated for the reserve tranche.

In a completely different area, the idea of authorizing commercial banks to hold and use SDRs is worth studying; I look forward to reading the paper under preparation on this subject.

For the time being, my authorities do not have a firm opinion on these proposals, but would favor thorough analyses of these issues in order to foster some progress. In the same vein, we would be very interested in further comparative studies on potential markets for the ECU and the SDR, since any change in one market has a bearing on the analysis of both assets. Such moves could imply changes in the rules and regulations or even in the Articles of Agreement, which the staff might study with an open mind before our next discussion. I am not advocating a "big bang" opening of a worldwide, efficient SDR market, but only studies of slight modifications to obviously outdated regulations and, unfortunately, practices.

Promoting one of the Fund's financial products will not jeopardize the financial integrity of the institution. I therefore join Mr. Grosche in his support for Fund efforts to increase the awareness of its member countries on the potential advantages associated with the holding of SDRs.

Mr. Yamazaki observed that the staff paper notes that some respondents to the survey suggested that an increase in the volume of SDRs relative to other assets could make the SDR more attractive, or at least might lead to increased attention being paid to SDRs by reserve asset managers. Nonetheless, he wished to reiterate his position that the resumption of SDR allocations should be judged solely on the basis of the existence of a long-term global need.

The SDR had the attractiveness of safety and stability, both of which are essential characteristics of reserve assets, Mr. Yamazaki said. In addition, as the staff paper suggested, there were--even in the current system--some potential advantages to the SDR of which some members were not fully aware. For example, by transferring SDRs, a member country could borrow freely usable foreign exchange through transactions by designation at a relatively low interest rate for an indefinite period without any conditionality, provided that the country was judged to have a balance of payments need at the time of the transfer. Thus, the SDR was a sort of credit line in case of need with very easy terms. Aside from that, as the staff paper also indicated, there was the potential advantage of covering exposure to risk arising from SDR-denominated liabilities, while SDRs could also be held as an investment vehicle. Above all, the Fund should first enhance the awareness of such potential advantages; promoting an IMF Institute course on this subject might help to serve that purpose.

Mr. Archibong made the following statement:

I commend the staff for their efforts to ascertain the attitudes of monetary authorities toward the SDR in the area of reserve management practices. As the first survey of its kind, it is useful despite its weaknesses, which particularly include its limited scope. The analysis tends to indicate some possible actions that might be pursued to improve the monetary characteristics of the SDR, and hence its attractiveness and usefulness as a component of monetary reserves.

As the survey shows, safety and stability are the principal advantages of the SDR over all other assets. This is not surprising. Defined as a basket of currencies, the SDR offers monetary authorities a balanced reserve asset whose value in terms of alternative reserve currencies is very stable. To the extent that monetary authorities--central banks--hold their reserves in the form of SDRs as a long-term choice, the risk that currency switching will contribute to exchange rate instability is minimized.

Against these benefits, liquidity and usability emerged as unfavorable characteristics accounting for the relatively low priority given to the SDR in reserve management. Although there were a few dissenting views on this, the message appears quite clear: monetary authorities are particular as to the assets that they are willing to hold as part of their reserves. The limited liquidity and usability of the SDR makes it appear unsuitable to the reserve needs of many monetary authorities.

These findings have been noted in previous staff studies on SDR-related issues, with which the Board has concurred. Here I will stress some of the staff suggestions that might correct the SDR's shortcomings as a reserve asset.

A reduction in the time and procedures involved in transactions could enhance the ease and speed with which SDRs can be converted to a means of payment. This change merits consideration, and I would be inclined to support it.

For the SDR to be directly usable, the restrictions hampering its use will have to be progressively liberalized. In this regard, it might be necesary to increase the number of authorized holders, and to include the private sector. Market-making arrangements that would enable members to buy and sell SDRs to each other should also be explored; the staff is correct in emphasizing that "more liquid markets tend to be associated with the more continuous presence of both buyers and sellers." This obviously underscores the need to make special efforts to liberalize and broaden the use of SDRs.

Some survey respondents reportedly regard the SDR as a relatively unimportant reserve asset "because it is a small fraction of global reserve assets," which implies that an increase in the stock of SDRs might enhance its attractiveness. In an earlier study, the staff noted that the increased use of the SDR depended on the Fund's own activities, and stressed that the SDR would be best served by a general expansion of the Fund's activities that could be effectively achieved through an increase in the Fund's quota; a new SDR allocation to be used to finance the Fund's operations; and the development of a set of flexible and market-oriented operations and mechanisms in SDRs. I share the staff view that the Fund clearly has an important role to play in influencing and promoting the usability of SDRs, even if that means effecting amendments to the relevant provisions of the Articles of Agreement.

I tend to agree with one of the respondents that, on balance, the attractiveness of the SDR as a reserve asset has not yet been fully recognized. Compared with other reserve currencies, an SDR-denominated portfolio clearly outperforms others in terms of the risk/return trade-off. Even in its present form, the SDR has great potential for becoming an important reserve asset. The Fund could, among other things, promote awareness of the potential advantages of holding SDRs by deliberately publicizing its attractiveness, particularly for serving the precautionary and investment functions of holding reserves. This publicity, coupled with other measures designed to increase the liquidity and usability of the SDR, could encourage monetary authorities to hold large amounts of it in their portfolios of reserve assets.

Mr. Templeman made the following statement:

We found the replies to the staff survey on attitudes toward the SDR in the reserve management practices of monetary authorities to be interesting and rather uniform across countries. In general, we are not surprised by the findings that the reserve management of SDRs is given a rather low priority and that the basic approach is rather passive; that the less attractive characteristics of the SDR concern its liquidity and usability; and that the more attractive features are its safety and stability.

I would like to concentrate the remainder of my remarks on the question of whether there are things which could be done to improve the attractiveness of the SDR, without changing its essential characteristics and without the need for an expenditure of significant resources by the staff and the Board.

Concerning possible ways to improve the liquidity of the SDR, we have no problems with the idea of lowering effective transaction costs by reducing the "red tape" through the acceleration of transaction and settlement times to two days--if this is a practical possibility. We also have no problem with market making on a voluntary basis by one or more members of the Fund, but U.S. authorities would not be interested in underaking such a task. We do not know whether it would be appropriate for the Fund, itself, to try to make a market for the SDR, either through managing a pool of SDRs and usable currencies or credit lines, or by transacting in SDRs for this purpose through the General Resources Account. Some preliminary indication from the staff as to how such arrangements might work would be helpful. But we would not want to devote a major effort to such a scheme, if that is what would be required.

Concerning ways to improve the usability of the SDR, we are not ready to support authorizing private parties to hold SDRs, nor the use of the SDR in exchange market intervention. We do wonder if there are additional official holders that might be added to the list of 16 non-Fund holders, who would constitute a meaningful addition to the usability of the SDR. We recall that some of the simplification ideas presented in the 1982 and 1983 staff papers--referred to on page 27 of the staff paper--raised a number of problems for my authorities at the time, and we still have doubts about proceeding along those lines. Confidentiality does not seem a major problem, and we are not very sympathetic to such ideas as reporting SDR transactions on a more aggregate basis.

The more promising ideas in the staff paper seem to involve building on the more attractive features of the existing SDR: its safety and stability. In fact, we believe that that mix of safety and yield offered by the SDR should already be fairly attractive to many holders for precautionary and long-term investment purposes. It is interesting that views on the relative attractiveness of the yield of the SDR were more varied than were comments on most other characteristics of the SDR. As we have indicated in the past, the yield feature may be one of the more promising variables to consider when assessing ways to make the SDR more attractive.

The second area where the SDR might be used more widely concerns the acquisition of SDRs in advance in order to hedge against exchange rate risk and, eventually, to make payments against SDR liabilities as they fall due. Not only could the Fund try to make member countries more aware of the desirability of SDR acquisitions for this purpose, but it could actually facilitate such arrangements, as outlined on page 28 of the staff report. Of course, the Fund itself has an interest in this area because of its growing arrears problem. While the contribution of efforts in this area to the resolution of the overall arrears problem may be modest, this is still a useful matter to pursue. We also agree that IMF Institute courses may be helpful, in general, in pointing out the attractive features of the SDR, for consideration by member country officials when they return to their home countries.

Finally, I must recall the point which we made at the discussion of the Board's work program in May, concerning the limited amount of time which we believe that the Board should dedicate to papers on SDR-related subjects in coming months. Therefore, I would not support a second canvassing of opinion on this subject at this time, nor a broadening in the scope of any such further survey.

Mr. Rye made the following statement:

I broadly agree with the views put forward by Mr. Grosche in his statement; as he says, we should treat the results of the survey with a great deal of caution, and should avoid drawing firm or far-reaching conclusions. Clearly, however, the majority of members surveyed considered the SDR a relatively unattractive reserve asset; this is not a surprise, particularly since monetary authorities can generally obtain the advantages of the SDR with a higher yield simply by replicating the currency composition of the SDR in their asset holdings.

To be sure, some of the reasons given for the unattractiveness of the SDR--in particular, illiquidity and administrative delays--suggest that some remedial action would be both possible and worthwhile. However, another common reason was that the SDR constitutes only a small proportion of a country's international reserves and is not worth managing. Given the likelihood that the required support for a further SDR allocation will at best continue to be lacking for some time to come, this problem is unlikely to be resolved soon. And even if that support should miraculously materialize, for most members a further SDR allocation would only marginally influence the proportion of SDRs in total reserves. In addition, the tendency for SDRs to find their way eventually into the reserves of major industrial countries means that the low proportion of SDRs in the portfolios of many countries would probably be little changed.

However, I have no objection to the proposal to lessen the "red tape" associated with SDR transactions, provided that such transactions remain within the Fund's Articles. The various proposals to publicize more widely the advantages of the SDR also raise no problem.

The possibility of enlarging both the number and the types of transactions in, and authorized holders of, SDRs, could be seen as consistent with the intention expressed in the Fund's Articles to make the SDR the principal international reserve asset. If, however, commercial banks could approach the Fund to redeem SDRs received from any Fund member, this might have adverse implications for control through the designation plan. Moreover, there seems to be some question whether SDR balances with the Fund could be converted by banks into more liquid assets and perhaps thereby frustrate the liquidity management efforts of the authorities. I would be interested in staff comments on this point, as it does seem to support Mr. Grosche's opposition to any idea of broadening the scope of the SDR as a general means of payment.

I would have no objections to further work on this subject, if it were the consensus of the Board that the results were likely to prove sufficiently interesting to indicate its desirability.

Mr. Vasudevan made the following statement:

The effort to elicit the views of some member countries on the SDR in reserve management through a questionnaire is commendable, for its novelty, and because it authenticates reported attitudes to the SDR's role. However, since the responses are from 27 members only, there is always a risk that their views are not wholly representative of those held by the wider membership. This approach could therefore be usefully extended to cover more members.

Unsurprisingly, nearly all respondents indicated that the SDR is not given high priority in reserve management decisions. No particular level of SDR holdings is usually targeted, and 12 of the 27 respondents hold SDRs equivalent to less than 20 percent of their net allocations. The main point is that the liquidity and usability of the SDR are constrained by the limited possibility of converting it into other currencies on a spot basis, and by the restrictions that exist on the use of SDRs by the private sector, especially commercial banks.

The staff gives considerable attention to the view expressed by some respondents that an increase in the aggregate volume of SDRs would enhance the attractiveness of this asset, and indicate that they are not impressed by this argument. We however see considerable merit in it, and in the corollary: that additional allocations of SDRs would help to realize the objective of making the SDR the principal reserve asset. While the SDR is not as liquid as other reserve currencies, it is still encashable, though with some lag and administrative procedures, and it can be held for precautionary and investment purposes. Its role as a transaction balance is limited, therefore, except for meeting obligations to the Fund. Additional allocations, together with improvements in the liquidity and usability of the SDR, would clearly ensure higher average holdings of SDRs. Even without considerable improvements in liquidity and usability, average SDR holdings are likely to increase if the total stock of SDRs is expanded, given the SDR's precautionary and investment functions. This hypothesis does need to be tested empirically, and I wonder whether a related question could be included if and when the survey's scope is expanded.

The survey shows that while many members regard the stability and safety of the SDR as its two favorable characteristics, liquidity and usability problems have constrained the role of the SDR as a reserve asset, and our efforts should focus mainly on improving liquidity and usability: members could be allowed to acquire SDRs in advance as a hedge against exchange risk with a view to making repurchases; members could meet their obligations to other multilateral financial institutions through SDRs placed in members' accounts with the Fund.

The introduction of market-making arrangements would also enhance liquidity. Here the Fund's role, outlined on page 25 of the staff paper, seems substantial, and although the Articles presumably do not disallow the Fund from taking such initiatives, some clarification in this respect would be appreciated. The number of authorized holders and the types of transactions should also be enlarged, and SDRs would be more widely used if most central banks were regarded as "prescribed holders," and were permitted to settle their transactions in SDRs. The development of efficient arrangements for clearing payments in private SDRs between banks and between countries would also help to enhance the use of SDRs.

The suggestion that the Articles be amended to allow private sector accounts in the SDR Department--particularly accounts held by commercial banks--appears worth pursuing, and we look forward to a forthcoming staff paper on the linkage of official and private SDR transactions, in the context of facilitating foreign exchange market intervention in SDRs.

While those who need SDRs the most would like the yield on them to be low, we consider that the current yields on the SDR make it sufficiently attractive to hold. There are no definitive studies, as far as we know, examining the rate of return on the official SDR, but a study published in the IMF Staff Papers in March 1984 showed that the private SDR had an above average total return during the period of the study--1977-82--regardless of the currency used as the unit of account. The study indicated that gyrations in interest and exchange rates tended to make the use of the SDR as a unit of account more attractive to most international market operators.

Finally, the advantages of holding SDRs need to be advertised more widely, a point underlined on page 28 of the staff paper. While it is true that the transaction costs involved in SDR transfers are large, in the form of time and "red tape," and should be reduced, the acceptability of the SDR is the crucial element in making the SDR a genuine and a freely usable reserve asset.

Mr. Kafka made the following statement:

The paper on the SDR in the reserve management practices of monetary authorities is another piece of technical work by the Fund staff in its continuing efforts to enhance awareness of the potential advantages of widening the role of the SDR. More important, the paper brings out in stark relief the limited possibilities for enhancing the SDR in light of the absence of real political support for its role as a reserve asset. Nevertheless, it provides a framework for action for improving the attractiveness and usefulness of the SDR if its share of monetary reserves is to be increased.

We are not surprised by the general finding of the survey that the SDR is not given high priority in portfolio management practices of monetary authorities. Leaving aside considerations of liquidity and usability, the absence of SDR allocations since 1981 has clearly reduced the proportion of SDRs in individual and aggregate reserves, and this has limited the possibility for active management of an SDR portfolio. Monetary authorities are left, therefore, with one option in dealing with this reserve asset--relatively unimportant in their view--and that is to ensure that any operations in SDRs are cost effective--limiting deviations in SDR positions from net cumulative allocations to minimize interest payments and utilizing this source of credit in any active short-term borrowing program. Clearly, the conclusion can be drawn that an increase in the stock of SDRs would induce monetary authorities to spend more time and effort on managing SDRs, especially since we are now aware of the significantly lower carrying costs of reserves created by the SDR system vis-à-vis those created by private markets--a conclusion of the staff paper discussed by the Board in March (SM/87/63).

But more fundamentally, and as the survey confirms, liquidity and usability considerations preclude the SDR from developing into a fully fledged internationally traded currency, not to mention the problems of confidentiality associated with the disclosure function when activating its use. The survey provides little evidence of active demand for SDRs that is motivated by a preference to hold the asset without reference to the need to use it in transactions with the Fund. In fact, in these circumstances, existing mechanisms--both designation and transactions by agreement--are viewed by the majority of survey participants as sufficient to meet this need, notwithstanding the formal procedures involved when compared with practices among commercial banks and security dealers; and this is because this function is purely precautionary. It seems to us, therefore, that it will be highly desirable if the SDR is to serve the transaction function associated with reserve assets, including, eventually, intervention in foreign exchange markets to improve the ease and speed at which the SDR can be converted to a means of payment which more closely approaches current banking practices with respect to other reserve assets. In other words, its liquidity and usability must be enhanced; if not, because of its less than ready usability and, therefore, convenience, the SDR will continue to be better suited to serving longer-run functions associated with holding international reserve assets. Yet, we wish to reiterate that, in the absence of further SDR allocations, interest in SDR holdings must continue to decline. The potential of the SDR to fulfill its various functions, therefore, will be crucially dependent on forging a consensus on the desirability of resuming SDR allocations to supplement the long-term global need for reserves and, in the process, of making the SDR the principal reserve asset of the international monetary system. Indeed, it is suboptimal, in our view, to continue to rely on a system in which countries add to their gross reserves primarily by borrowing on international credit markets while many others have limited or no access to those markets.

We believe, nonetheless, that measures to make the SDR more attractive to hold will be an essential and important step toward enhancing its liquidity and usability, even if a large-scale allocation of SDRs is not made. The staff should, therefore, proceed with its proposed examination of some possible avenues for SDR enhancement as outlined in the paper.

We see considerable merit in improving the SDR's liquidity in terms of both lowering transaction costs--through speeding up transaction and settlement time--and widening the market through various market-making arrangements, whether concentrated on the Fund or through voluntary two-way arrangements. The expansion of the number of prescribed holders to include private sector institutions, the simplification of operations in SDRs, and improving the confidentiality of individual usage could facilitate the process of expanding the breadth and depth of the market for SDRs and, therefore, also the liquidity and usability of the SDR. The Fund also has a role in publicizing the attractiveness of the SDR in serving the various functions of holding reserves. For this reason, we can support an expanded survey to canvass additional opinion.

Mr. Fogelholm said that he welcomed the study as an input into the Fund's ongoing discussion on the role of the SDR in a broader and longer-term perspective. Clearly, if the role of the SDR was to be enhanced, the asset had to be made more attractive than it currently appeared to be.

One of the main conclusions of the inquiry was that the SDR was not currently suitable for making day-to-day transactions, owing to its existing characteristics, Mr. Fogelholm remarked, and it seemed fairly unrealistic to assume that the SDR could, in the near future at least, be developed into a means of payment or a mechanism for extensive foreign exchange market interventions.

What remained then, in practice, was to try to develop the attractiveness of the SDR in serving the precautionary and investment functions associated with holding reserves, Mr. Fogelholm considered. That was certainly easier said than done. Many misconceptions seemed to exist, however, and in general member countries lacked information about the use of SDRs as reserve assets. He therefore agreed with other speakers that the Fund could, on appropriate occasions, advertise the positive characteristics of the SDR: its stability, safety, and utility as a hedge against exchange rate fluctuations, and also its liquidity in cases of balance of payments need.

He endorsed many of the more specific staff proposals described in Section IV of the study, Mr. Fogelholm continued. The Fund should in particular explore ways to reduce and simplify its administrative procedures, including reporting requirements, as well as the possibilities of increasing the number of prescribed holders. However, like Mr. Grosche, he did not favor the suggestion that the Fund should become an active market maker of SDRs, a function that should be left to member countries, if they wished to adopt it. Nor should the Fund assume the role of "buyer of last resort" for SDRs, for the reasons given by Mr. Grosche in his statement.

The staff had raised the question of a second canvassing of opinion, Mr. Fogelholm noted. He did not see a great need for that, as he could not imagine that it would generate any major new findings. Instead, the Fund should concentrate its resources on improving the usage of, and demand for, the SDR.

Mr. Comotto said that the paper before the Board was the result of an imaginative initiative by the staff. Unfortunately, the main finding was much as expected: there was an overwhelming lack of practical interest in the SDR. It was not a question of the relative quantity of SDRs in total reserves. As Mr. Grosche had noted, allocations would not of themselves improve the attractiveness of the SDR. More was not necessarily better.

On balance, the passivity of reserve managers toward the SDR largely reflected its inherent characteristics, Mr. Comotto considered. It seemed to be the victim of its own stable and secure qualities. There was little need to actively manage it. Moreover, in a market with limited entry and exit, and for an asset with no maturity or range of maturities, and a yield insensitive to demand and supply, there were no incentives, imperatives, or, indeed, possibilities to trade within the asset, and few to trade in and out. A passive attitude by reserve managers therefore seemed largely inevitable. Other than covering SDR-denominated liabilities to the Fund, why and how should SDR holdings be more actively managed? And active management of the SDR was not necessarily a measure of its success. Indeed, for some countries there were important administrative advantages in not having to worry about reserves on a day-to-day basis.

Although the general tenor of the survey was not encouraging, care would be needed in isolating the problem, Mr. Comotto remarked. The tendency for holders to use the SDR as their first line of defense could not, as in the past, be automatically ascribed to a poor yield as the SDR interest rate had been improved significantly over recent years. A large part of any remaining tendencies to liquidate SDRs first in a crisis could be explained by the problems of liquidity and usability cited by most survey respondents, which might encourage holders to cover themselves in a crisis by precautionary encashment.

The most appropriate course of action was therefore to continue with the gradual improvement of the liquidity and the usability of the SDR, Mr. Comotto considered. Proposals requiring amendment of the Articles were clearly out of the question, but there were many more feasible improvements open, a number of which the staff had already described. The success of those steps would be measured by the degree to which administrative intervention could be replaced by voluntary transfers: transactions by agreement superseding designation. While designation ensured the ultimate liquidity of the SDR, the degree of liquidity and usability that it provided was not really sufficient and was inherently limited. In addition, designation was inherently undesirable because it was a further source of uncertainty for reserve managers in creditor countries. Obviously, however, designation would have to be maintained as a safety net.

The Fund should not undertake active measures, such as market making or providing a liquidity guarantee to authorized holders in order to improve the liquidity and usability of the SDR, Mr. Comotto noted. Such operations should be unnecessary, given the availability of standing arrangements to buy and sell SDRs. At a minimum, such proposals would need to be more fully elaborated, and, in particular, the staff would have to assess their likely costs. Was there in fact a sufficient volume of currently repressed transactions to justify such an effort? His authorities were opposed to force-feeding markets. Perhaps the staff could delineate the potential market: given that the SDR was an exclusively official reserve asset, its potential must be limited to the volume of interofficial reserve asset transfers, such as central bank swap arrangements. Quantifying those flows was difficult, but some consideration needed to be given to the question before any ambitious schemes of enhancement were tackled, and before more staff resources and Board time were devoted to the SDR.

A more appropriate way for the Fund to nurture the SDR would be for it to adopt some of the technical proposals that had been made in the paper to improve liquidity and usability, Mr. Comotto said. In particular, the possible measures to reduce the transaction costs of using SDRs seemed valuable. He saw no difficulty in allowing transactions by agreement and prescribed operations to be undertaken even for same-day value, given that that would require the agreement of both parties. The possibility of allowing the same for designation, when both parties agreed, should at least be investigated. Such flexibility would have usefully extended the period available for consideration of the purchase request that the Board had approved at the previous meeting.

The proposal for a single authorization of transactions by agreement and prescribed operations seemed a useful way to save Board time, Mr. Comotto remarked. If there were worries that certain transactions and operations might be contrary to the Articles, then the staff might set out the requirements of the Articles for the Board, identifying the kinds of transactions and operations that would cause problems. The suggestion originally made by the staff in 1982--to reduce reporting requirements for transactions by agreement and prescribed operations--presented no problems, particularly if the Fund was able to seek nonoperational data retroactively, if only periodically. While he agreed with Mr. Grosche that existing requirements did not appear a significant problem in themselves, they might have had a disproportionate effect on perceptions of the SDR in the busy foreign exchange departments of central banks. However, it seemed imprudent to relax the reporting requirements for designation.

He remained unconvinced by proposals to increase confidentiality, Mr. Comotto continued. Certainly, the use of the SDR in exchange market intervention would require confidentiality; for the moment, if there was a real demand, the Board could consider the arguments for restricting the publication of SDR information, for example, in IFS.

On promoting the SDR, there had been considerable success with respect to helping certain members' reserve management, Mr. Comotto noted. Use of the IMF Institute seemed appropriate, but perhaps program and Article IV missions were best placed to encourage the use of the SDR when such encouragement would be helpful. Given the very high volume of delayed routine payments to the Fund, the scope for improving reserve management vis-à-vis Fund obligations seemed fairly large.

The proposal to widen the list of authorized holders of SDRs seemed acceptable, Mr. Comotto said, but he wondered which official institutions remained to be recruited. The inclusion of private entities might however be premature at that stage, but staff examination of the issue would be helpful.

While he was curious about the promised paper on exchange market intervention in SDRs, he too was concerned about attempts, at least for the time being, to convert the SDR into a means of general payment, Mr. Comotto remarked. Nonetheless, the monetary transfer function of the SDR among official institutions should be improved, and it seemed quite appropriate that the SDR should provide an "inside circuit" for interofficial monetary transfers. Greater use of the SDR in that way might help to enhance its attractiveness. Higher turnover should not itself undermine the proper role of the SDR: reserve assets did not have to be left in the deep freeze. In fact, constraints on the transfer of a reserve asset would impair its quality as a precautionary or investment instrument. Financial instruments were not adopted as reserve assets just because of their stability and safety; their most definitive characteristics were liquidity and usability. Thus, a cash deposit could qualify as a reserve asset, but an investment might not. If there was a problem in ensuring that, over the longer term, SDRs were used appropriately as a monetary asset, the Fund would again have to reassess the SDR's relative attractiveness as an investment.

An extension of the survey--at least in its present form--did not seem warranted, Mr. Comotto noted. The survey had been useful to check what had been widely suspected, but there seemed no reason to think that widening the survey would reveal anything new. With regard to the possibility of expanding the survey to include reserve currency countries, he was surprised that the positions held by those countries appeared unclear. A better approach might be to analyze in detail the SDR transactions and operations in a number of representative countries over the past few years, using more than just aggregate statistical analysis. That would be a good way of using all the information on SDR transfers which it had been considered so necessary to collect. It might also be appropriate to provide, perhaps only for information, some analysis of general reserve management practices. A number of assumptions seemed to have been made about reserve management that were not necessarily true in practice: for example, there was at least prima facie evidence that exchange risk was not as important a consideration in reserve management as had been assumed. Moreover, if the Board was seeking to determine whether the SDR had a role in reserve portfolios, it might be helpful to have a picture of the range of other assets kept as reserves. Those suggestions were, however, subject to the constraints on staff resources.

Mr. Al-Assaf made the following statement:

The results of this limited survey are not unexpected. They confirm that the SDR is, in the view of most central bank managers, an unattractive reserve asset. What then can be done to enhance the role and attractiveness of the SDR? Although the allocation of additional SDRs, in and of itself, will obviously increase their supply, it will not necessarily generate demand for holding them by the monetary authorities unless and until some of the basic characteristics of SDRs are changed. While I am not advocating a fundamental change in present procedures, I can see merit in improving two areas.

First, it would be desirable to reduce transaction costs associated with the transfers of SDRs. For example, the Fund should consider reducing the time needed for the arrangement of transactions by agreement. Along the same lines, the time required for transactions by designation could also be shortened.

Second, I agree with those respondents who feel that confidentiality considerations are important factors in the discretionary use of the SDR. Here again, I think the Fund should give serious consideration to the suggestion that disclosure be kept to a minimum.

With respect to the staff's suggestion on widening the SDR market, present procedures clearly preclude member countries from playing a profitable market-making role. At the same time, I am not sure that the Fund should engage in market-making activities in the SDR. A wider market for the SDR should be generated by further enhancing its attractiveness, rather than by artificially creating a market for it, while the enlargement of the number of authorized holders by including private holders merits further consideration. However, there is a considerable cost to the Fund in managing SDR transactions, and such a cost is likely to be significantly higher if the number and the scope of transactions is allowed to expand significantly; such a step would require an amendment to the Articles, and it is not yet clear if there is a genuine demand for the SDR from private sector institutions.

The idea of encouraging countries with liabilities to the Fund to hold part of their reserves in SDRs is interesting, and worth further consideration. Such a reserve management strategy would clearly cover risk exposures, as SDR holdings would match SDR-denominated liabilities; it would also make repayments to the Fund easy and would avoid the transaction costs often associated with the involvement of financial intermediaries, and those holdings will still earn market-related yields. For all these reasons, I strongly support the idea of encouraging countries with obligations to the Fund to adopt a reserve management practice that would involve the covering of their liabilities to the Fund by SDRs. Such a strategy should have the added advantage of minimizing the problems associated with late payments, and is likely to reduce the incidence of arrears.

Mr. Wijnholds made the following statement:

Mr. Grosche's lucid statement has made my task easier. I generally agree with his points, including his statement that "the SDR has to remain a purely monetary instrument." The staff study is indeed helpful, as it empirically proves a number of points that have been assumed in our past discussions on the role of the SDR. The main results from the questionnaire appear plausible, and a more elaborate survey does not at this time seem warranted.

More generally, the attitude of monetary authorities is also influenced by the rather uneven distribution of the outstanding SDRs, as well as by the relatively small amount of SDRs compared to other reserve assets. Many countries apparently regard the SDR as a cheap source of more or less permanent credit, and most SDRs are held by only a few creditor countries. These beliefs undermine the SDR's character as a reserve to hold. Those creditor countries may therefore have come to regard the SDR less favorably, reducing their appetite for this asset. The SDR allocation must therefore be based on a long-term global need, and not on financing purposes, however worthwhile, such as enlarging the structural adjustment facility.

On the specific proposals contained in Section IV of the staff paper, my views are the same as those of Mr. Grosche. I want to underline three issues, however.

First, the SDR's liquidity could be enhanced by the Fund entering into two-way arrangements--particularly with larger countries--and I was glad to see that there are now two such arrangements. My authorities are not unwilling to enter into such an agreement, provided that sufficient other countries--in a strong external position--do the same. Mr. Grosche is, however, right to indicate the possible erosion of the designation process that such a development might cause, and this possibility will bear further examination if two-way arrangements become more widespread. The staff's suggestion that the IMF become a buyer of last resort for SDRs is however unfortunate, as there is a real risk that SDRs will be dumped in the IMF, especially given the tendency to spend SDRs rather than to hold them.

Second, I share some of the staff's optimism that the SDR has the potential to become a more important reserve asset, even in its current form, than is indicated in the responses to the questionnaire. I would place particular emphasis on using the SDR to cover the risks associated with SDR liabilities. Further elaboration and clarification of the role that the SDR could play in countries' reserve management is therefore indeed useful, and the staff could consider ways to do this.

Finally, avenues to increase the SDR's usability could be explored, particularly by simplifying the present procedures governing SDR transactions, within the limits that Mr. Grosche has indicated, without changing the Articles of Agreement. A more fundamental approach to making the SDR a competitively attractive reserve asset would, however, have to entail the direct usability of the SDR in foreign exchange interventions and the existence of an array of SDR instruments of varying maturities and corresponding interest rates. Such a development would of course imply a substantial change in the character of the SDR, and is for the time being not a realistic option.

Mr. Fayyad said that the paper before the Board was a useful first step in the effort aimed at identifying means by which the role of the SDR in reserve management and in the international monetary system in general could be enhanced. In that regard, he found the mechanisms identified by the staff in Section IV to be particularly useful, and he therefore looked forward to further consideration and analysis of those mechanisms. He also looked forward to a serious consideration of a meaningful SDR allocation, as a new allocation would help to ease the burden of members trying to maintain a reasonable level of reserves while avoiding the kind of growth-impeding import compression and payments restrictions experienced in recent years.

Mr. Morales said that he welcomed the staff study, especially since it involved a reserve management questionnaire which provided direct and valuable information on perceptions and attitudes toward the SDR in member countries.

The survey clearly suggested that member countries did not assign a high priority to use of SDRs, and that they viewed the SDR as an asset used mostly for transactions with the Fund, Mr. Morales noted. Additionally, while it was seen as a safe and stable asset, its lack of liquidity and its limited usability were the main reasons cited by member countries to explain their view that the SDR was an unattractive reserve asset.

The SDR should have an important role in the portfolio management of Fund countries, Mr. Morales considered. As that was clearly not the case, all possible ways to increase the SDR's attractiveness should be further explored; its characteristics should be changed even if that implied the possibility of amendments to the Articles of Agreement.

His chair's firm view was that SDR allocations should be promptly resumed, Mr. Morales concluded. An allocation would certainly help to increase the presence of the SDR as a reserve asset.

Mr. Engert said that he associated himself with Mr. Grosche's views.

The Deputy Treasurer said that some question had been raised as to whether the expansion of two-way arrangements might undermine the designation process. Two-way arrangements would, if they were extended along the lines suggested by Mr. Prader, be a useful development of the SDR system and reduce the need to rely on the quarterly designation process, by providing for voluntary redistribution of SDRs by and between members. The designation process would of course remain as a safety net to ensure the liquidity of the SDR scheme.

The possibility of using a single prescription or authorization to cover all operations between participants and other holders was by far the most important means of simplifying procedures and, hence, improving the usability of the SDR, the Deputy Treasurer considered. The list of prescriptions--and of other holders--had already grown from 2 originally to 23 and was expected to grow further. However, any movement toward simplification by means of a single prescription authorizing operations between participants was conditional on the Board's agreement that the equal value principle should not apply to those transactions; members could then agree on the price at which they would make the transaction. Repealing the equal value rule in such a case would, however, require an 85 percent majority, which did not currently appear to exist.

Staff would re-examine the three-day value date for transactions carefully, in light of the support for a shorter delay, the Deputy Treasurer continued. While such a change would not affect some transactions--for example, those involved in implementing the purchase by Argentina discussed earlier in the meeting, where the amount of SDRs being sold could be handled on a single same day basis only through the cooperation of the United States as only U.S. dollars were involved--there would always have to be some advance notice in terms of values. After all, the foreign exchange markets operated on a two-day spot basis. The problem in reducing transaction times to two days was that time zones and market hours meant that two days in the United States would mean in practice only one day in Europe. In fact, the three-day basis had been adopted only because certain European members--in particular some of the major members of the European Communities--had felt that it was difficult to shift sometimes large amounts of dollars in only one day. A move to a two-day value date would, also, raise difficulties for the General Resources Account, especially for repurchases by countries a long way outside the Eastern Standard Time zone--for instance, in Asia. The staff would look at those problems and might be able to come back to the Board with more flexible proposals--perhaps for operations on a two-day basis with the consent of the members involved, or between participants that regularly agreed to operate on a two-day basis, while formally retaining the three-day value.

The parallel drawn between the need requirement for designated transactions, which Mrs. Ploix had suggested should be abrogated, and the abrogation of the need requirement in the use of the reserve tranche was somewhat misleading, the Deputy Treasurer said. In the General Resources Account, and to a lesser extent in the designation plan, the overwhelming benefit of any doubt was given to the use of the reserve tranche; de facto, that meant that there was no close check on the need requirement. The requirement of need was, however, checked in the SDR Department, in particular because members undertook not to change the composition of their reserves through SDR transactions.

One of the advantages of the survey--and a reason for its possible extension--was its usefulness as a means of discovering the possible preferences of members, the Deputy Treasurer considered. The staff had been quite surprised by some detailed answers, and by the widespread lack of information concerning SDR-related actions that were prohibited and also those that were allowed. The staff had not known whether there was a market for certain types of transactions in the SDR, and it had wished to offer various possibilities to members--such as those presented in the staff paper--or to find out if members were already aware of the possibilities, the Deputy Treasurer continued. Rather than pushing a specific type of transaction on member countries, the staff would prefer to accommodate existing demand as revealed by similar surveys.

The Fund was already legally entitled to make markets and act as "purchaser of last resort" if necessary, the Deputy Treasurer noted. The relevant provisions of the Articles that allow the Fund to buy SDRs could be invoked through Executive Board decision, if the Board so wished.

The World Bank was entitled under the Articles of Agreement to hold and receive SDRs, and could ask members to undertake transactions in SDRs with members of the World Bank and other development banks, all of which institutions were official holders of SDRs, the Deputy Treasurer explained. The World Bank was a rather important element in some Fund transactions, particularly in terms of some operations relating to the use of resources of the Special Disbursement Account. The World Bank could, if it so wished, expand its operations in SDRs, as a matter of policy. The World Bank's disbursements were in a unit of account based on a currency pooling arrangement rather than the SDR, and a move toward the more direct use of SDRs as a unit of account would be a major policy change for the World Bank.

Closer links with the commercial banks would not cause difficulties in the general operation of the SDR Account, the Deputy Treasurer explained. The commercial banks made no direct use of the SDR because they could not be made authorized holders. Private market transactions in SDRs involving commercial banks would require amendment of the Articles of Agreement.

The staff representative from the Treasurer's Department said that responses to the questionnaire with respect to the SDR's yield displayed no clear tendency in the relationship between attitudes toward yield and the respondent's position in the Fund. The staff had expected to find that members with relatively low SDR holdings and high use of Fund credit would regard the interest rate on the SDR as too high, and that members holding SDRs above their net cumulative allocations might find it too low; but there had been no clear tendency in that regard. While that outcome might have reflected the specific question posed, the absence of a pattern was still somewhat surprising.

Mr. Grosche said that a number of questions remained open in his mind, on one basic issue in particular. If the SDR was not sufficiently liquid and usable, the request for higher allocations to make the SDR more attractive ran contrary to experience. He found it difficult to understand why higher supply should result in higher quality, or in economic terms, in higher prices. Usually it was the other way around. He therefore had some sympathy with Mr. Templeman's comment that a higher yield would be more effective than changes in a number of other technical features in making the SDR more attractive. However, several of those technical changes seemed both useful and in need of further study. The current yield of the SDR was satisfactory, given its character as a reserve asset, and he would certainly go along with further allocations if the global need was established--without necessarily having or precluding any improvement in the quality of the SDR as a reserve instrument.

Nevertheless, neither the Board nor the staff should devote high priority to studies of the technical aspects of the SDR, Mr. Grosche concluded. The Board's work load was heavy, and a further survey should not be conducted--at least not one similar to that which formed the basis for the staff paper before the Board.

The Deputy Treasurer said that the survey had not itself linked allocations and attractiveness of the asset. Clearly, for many countries--and not only the deficit countries--the SDR was an asset of minimal significance, and SDR holdings were therefore not actively managed.

The Acting Chairman made the following summing up:

Rather than repeating Directors' generally well-known positions regarding the role of the SDR and the issue of SDR allocations, I will concentrate on the remarks made today concerning members' attitudes regarding the characteristics of the SDR

Directors were in broad agreement that safety and stability are among the most attractive characteristics of the SDR, and make it a useful instrument to hold for precautionary and investment purposes. They noted in particular that the basket method of evaluation significantly contributes to the stability of the SDR. These features of the SDR appear to make it attractive for members to cover their SDR-denominated liabilities to the Fund by acquiring SDRs or SDR-denominated assets in advance of payments to be made to the Fund. Such a practice was regarded by some Directors as a useful management technique that would reduce the risk and uncertainty associated with exchange rate changes between reserve currencies and the SDR.

Many Directors noted that liquidity and usability have a particular bearing on the role of the SDR for transaction purposes. Speakers expressed reservations about the liquidity and usability of the asset, based on the fact that the SDR cannot be used directly in some types of financial transactions, including those with private institutions. There is a perception that the need for the Fund to act as an agent to effect many types of transactions involving the use of SDRs among members may be inhibitive for some holders of the asset. It is difficult to judge the extent of this inhibition, but it was stressed that we should make every effort to improve, within the boundaries set by the Articles of Agreement, the process by which SDRs can be transacted among participants and also with the Fund. Taken in this light, I believe that many Directors generally agreed with several of the suggestions of the staff to simplify the procedures regarding the use of SDRs. Let me mention the following:

First, many Directors encouraged a move toward faster settlement times; speeding up settlements to two days would more closely match market convention. This could not be done without difficulties due to differences in time zones and fiscal considerations, but the staff will explore this matter with individual members.

Second, voluntary market-making arrangements were encouraged by a number of Directors. Countries that have entered into two-way agreements to transact in SDRs, along with those entering buying arrangements, were commended for enhancing the liquidity of the SDR. The staff will continue to explore with members the possibility of expanding such arrangements.

Third, although some Directors expressed support for the Fund itself playing a market-making role, this avenue was not widely endorsed.

Fourth, a number of Directors supported the simplification of regulations relating to operations in SDRs, but there was insufficient support to replace the many decisions authorizing specific operations in SDRs with a single Board decision that would allow all participants and other holders to engage in any transaction or operation by mutual agreement, subject only to the specific limitations imposed by the Articles. There was also insufficient support for eliminating the application of the equal value principle to operations in SDRs.

Fifth, although a number of Directors expressed interest, there was insufficient support for the more far-reaching changes mentioned in the staff paper, such as extending the types of authorized holders, or creating a link between the official SDR and "private" SDRs.

Finally, the innovative survey of monetary authorities' attitudes to the SDR as a reserve asset was well received. While there was some support for further survey work, particularly focused on the major reserve currency countries, most of these countries did not feel that an extension of the survey would yield new insights from those already achieved and there was insufficient support to extend the survey in general. There was approval for using the facilities of the Fund, including the IMF Institute, and other means to encourage governments to understand the features of the SDR that make it an attractive asset to hold in reserves, and it was understood that the staff could be in contact with members as regards their conduct of operations in SDRs. If more governments could find it possible to help to enhance the liquidity and usability of the SDR, as a number of governments already do, then the role of the SDR in reserve management would be increased.

## 2. OFFICE SPACE - JOINT LIBRARY

Mr. Kafka said that, as he understood it, a plan was being discussed by management and staff to transfer the joint library from its present quarters to the International Square building. While that move might be unavoidable, it would certainly inconvenience Board members and the staff, as the library was probably the best of its kind and had always been heavily used by Fund personnel.

Such decisions should not be taken without effective input from Executive Directors, Mr. Kafka considered. He therefore hoped that before any final decision was made, Directors would be informed and their opinions sought in a practical way. That had been the procedure followed when the library had been moved on previous occasions. He was particularly concerned about the plan to move the library because the recent decision to shorten library hours on weekdays and to close it altogether on weekends had not been brought to the attention of Executive Directors.

The Acting Chairman said that alternative ways of using the space in International Square were under consideration, and a final decision had not been taken. Some very difficult choices on office space would have to be made. After much study of the problem, the staff was moving toward the view that the unit in the headquarters building that could be moved with the least disruption was the library. He appreciated the interest shown in the matter and noted that, in becoming further involved, the Board would have to be aware of the choices and their relative costs and advantages. Ultimately, of course, the problems inherent in using outside rented space would best be solved through the expansion of the headquarters building.

The Director of the Administration Department remarked that the staff's current thinking was that if the library were to be moved to the International Square building, a reference and reading center could be established in the main building, with a reference librarian, basic reference sources, reading materials, and a computer link to the data base in the Joint Library, so that reference inquiries could be dealt with immediately in the main building. In addition, a dedicated messenger service would bring library materials to and from the two buildings.

The Fund accounted for approximately 30 percent of library usage, compared with 70 percent by World Bank personnel, computed on the basis of requests to reference librarians and the use of the open areas of the library, the Director continued. Relatively few people visited the library in person to explore the stacks while searching for material.

Mr. Kafka's point concerning extended library hours was also under active consideration as a part of the plans to move the library to the International Square building, the Director commented. Staff members might prefer to visit the library early in the morning or later in the evening, rather than during the heart of the working day.

The staff would provide an explanation of the library plan in more detail, including the reasoning that had led to it and its implications; in fact, management had only been provisionally informed of the direction in which the plans were tending, the Director of the Administration Department concluded. Plans were now reaching the stage at which it would be appropriate to seek views of Executive Directors.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/87/101 (7/10/87) and EBM/87/102 (7/10/87).

3. SAUDI ARABIAN MONETARY AGENCY (SAMA) - BORROWING AGREEMENTS

The Executive Board authorizes the Managing Director to take such action as is necessary to amend Annexes A and B of the Borrowing Agreement between the Saudi Arabian Monetary Agency and the Fund effective May 7, 1981, and Annexes II-A and II-B of the Supplementary Agreement between the Saudi Arabian Monetary Agency and the Fund effective April 30, 1984, as set out in paragraph 5 of EBS/87/150 (7/6/87).

Decision No. 8643-(87/102), adopted
July 10, 1987

APPROVED: January 4, 1988

LEO VAN HOUTVEN
Secretary