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EB/CQuota/89/2

January 25, 1989

To: Members of the Committee of the Whole on Review of Quotas

From: The Acting Secretary

Subject: Ninth General Review of Quotas - Payment for the Increased Subscription

There is attached for consideration by the Committee of the Whole a paper on payment for an increase in quotas in connection with the Ninth General Review of Quotas. Concluding observations appear on pages 12-14.

Mr. Roncesvalles (ext. 8338) or Mr. Tweedie (ext. 7811) is available to answer technical or factual questions relating to this paper prior to the Committee's discussion scheduled for Friday, February 10, 1989.

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INTERNATIONAL MONETARY FUND

Ninth General Review of Quotas - Payment for the Increased Subscription

Prepared by the Treasurer's Department

(In Consultation with Legal Department)

Approved by David Williams

January 24, 1989

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I. Introduction

In the paper on "Ninth General Review of Quotas - Considerations Relating to the Increase in Quotas" (EB/CQuota/88/1, 2/17/88), the staff outlined the considerations relating to the size of the reserve asset payment and the media in which such payment might be made in connection with increased quotas in the Fund. 1/ In that paper, the staff concluded:

> It would seem reasonable to require a reserve asset payment amounting to 25 percent of the increase in quotas. Given the need to maximize the effectiveness of an increase in quotas, a reserve asset payment in SDRs would improve the liquidity position of the Fund more than a payment in usable currencies and would also allow for greater use of SDRs in the Fund's operations and transactions. If a reserve asset payment payable in SDRs were agreed upon, arrangements would need to be put in place to (i) enable members with insufficient SDRs to acquire them in transactions by agreement with other members and (ii) enable members with low reserves and insufficient holdings of SDRs to borrow SDRs to make the reserve asset payment to the Fund and to repay, on the same day, the same amount of SDRs by drawing on the reserve tranche which had been enlarged as a result of the payment in reserve assets. In addition the Fund would need to adopt a policy as regards the sale of SDRs acquired by the General Resources Account in part payment for the increase in quotas.

This matter was discussed at the Committee of the Whole Meeting 88/4, March 14, 1988 and in his summing up the Chairman noted that "Many Directors agreed that 25 percent of the increase in quotas should be paid in SDRs or in currencies acceptable to the Fund, with a certain preference for SDRs, and that appropriate arrangements would be worked out by the staff in due course to arrange for the sale of SDRs to those members with insufficient SDR holdings and for members with low reserves in general" (Buff Statement 88/56, 3/21/88, revised 4/6/88).

At the discussion of the Committee of the Whole in September 1988 (CW/Quota/88/8 and CW/Quota/88/9), the issue of the mode of payment for the increased subscription was again raised, including a suggestion by one Director that consideration might be given to the contribution that an allocation of SDRs might make in financing an increase in quotas. The Chairman referred to this issue at the Committee of the Whole Meeting (CW/Quota/88/11, 11/18/88) in connection with the proposed work program for the Ninth General Review and noted that "it was a completely open question, but it would be appropriate to discuss it at that time" (first half of February) (Buff Statement 88/237, 11/30/88, corrected 12/1/88).

1/ See, especially Section IV of EB/CQuota/88/1, pp. 21-23.

This paper elaborates in greater detail a number of issues relating to the reserve asset payment that have been raised in earlier discussions of the Committee. The paper briefly outlines main issues relating to (i) the financing of the local currency subscription (Section II); (ii) the size of the reserve asset payment and the media in which payment may be made (Section III); (iii) the consequences of a reserve asset payment in SDRs and their mitigation for members with insufficient SDRs or low reserves in general (Section IV); (iv) the relationship between the reserve asset payment for an increase in quotas and SDR allocations (Section V); and Section VI provides some concluding remarks.

II. Financing the Local Currency Portion of Fund Subscriptions

The local currency portion of a member's position in the Fund (including its subscription payments) is held by the Fund's depository (central bank) in the member country, normally in the form of non-negotiable non-interest bearing notes, similar types of obligations, or in cash. These assets are available to the Fund at call and are used to finance the Fund's day-to-day operations and transactions in accordance with its policies on the use of its resources. When a member pays its subscription or draws on the Fund, the member pays to the Fund in its own currency an amount equivalent to a given portion of the subscription or of the drawing (denominated in SDRs) and deposits the counterpart in the Fund's No. 1 and Securities Account. When sold by the Fund, the local currency is normally converted into a freely usable currency (usually U.S. dollars), or into U.S. dollars if a member requests conversion of another freely usable currency sold by the Fund. The "cost" of the local currency paid to the Fund is effectively the cost involved in transforming the sale of the currency by the Fund into a reserve tranche position if the sale involves the conversion of the local currency into a freely usable currency. As this involves the exchange of one reserve asset for another, there is no reduction in reserve availability, but over the long term there may be a cost (benefit) if the interest rate and exchange rate change on the reserve tranche position exceeds (or is less than) the rate of remuneration and change in the SDR value of the local currency. If there is no conversion of the local currency sold by the Fund, the net cost to the member is the interest cost, if any, paid on financing the currency provided to the Fund, e.g., through increasing the domestic borrowing requirement minus remuneration and the change in the SDR value of the currency.

The payment of a member's local currency subscription and the local currency counterpart payments of drawings made on the Fund, do not usually result in increased budgetary outlays by a member. 1/ While the specific internal arrangements regarding the financing of members' operations and transactions with the Fund differ amongst the membership-- sometimes the central bank is responsible for meeting the member's financial commitments with the Fund and sometimes the Treasury or Ministry of Finance--in general the financial impact on the member of its financial operations with the Fund falls on its external financial reserves and not on changes in domestic currency expenditures, except for the reserve currency centers. The legislative issue in most members regarding an increase in quotas is thus likely to be more one of Parliamentary authorization or approval of the quota increase than financial appropriation. 2/

III. Reserve Asset Payment

Article III, Section 3(a) makes clear that a payment in SDRs amounting to 25 percent of the increased subscription is to be regarded as the normal rule, and no decision to prescribe such a payment is needed by the Board of Governors. Other amounts and forms of payment require a decision of the Board of Governors by a 70 percent majority of the total voting power. All members of the Fund are participants in the SDR Department. Those members that would not have sufficient SDRs to pay the reserve asset subscription in SDR at the time of payment would thus need to acquire them.

As noted in EB/CQuota/88/1, in the Sixth General Review, members (not all of whom were participants in the SDR Department at that time)

1/ The staff conducted a survey in 1980/81 of over 70 countries (including the United States) as regards their accounting for Fund positions, all of which confirmed that an increase in Fund quotas had no consequential effects on the Government's accounts and was not a budget item, nor did it result in borrowing in the market. For the position of the United States see footnote 2/ below.

2/ The United States, in connection with an increase in the U.S. quota in the IMF under the Eighth General Review, required budget authorization and appropriation for the full amount of the increase in quota. The local currency payment was made with non-interest bearing letters of credit, which are a contingent liability, while the reserve asset payment was made in SDRs or foreign currency with an equal offsetting receipt representing an increase in the U.S. reserve position in the Fund. As a consequence, payment of the subscription and transactions thereunder did not affect net budget outlays, or directly affected the budget deficit, except insofar as they led to changes in interest expenditures resulting from consequent changes in public debt outstanding. See, for example, "National Advisory Council on International Monetary and Financial Policies: Special Report to the President and to the Congress on the Proposed Increase in the Resources of the International Monetary Fund," March 1983, Appendix C.

were given the option to pay 25 percent of the quota increase in SDRs or in currencies of other members specified by the Fund, subject to their concurrence, or in the member's own currency. However, almost all (95 percent) of the subscription payments were made in members' own currency. Under the Seventh Review (1980), the payment of 25 percent of the quota increase in SDRs was mandatory for participants in the SDR Department, and for non-participants the reserve asset payment was made in currencies of other members, specified by the Fund, with their concurrence. It will be recalled that allocations of SDRs, totalling SDR 12.1 billion, were made in 1979-81 inclusive. In the Eighth Review, members were required to pay 25 percent of the quota increase in SDRs or in currencies of other members specified, with their concurrence, by the Fund, or in any combination of SDRs and such currencies; of the total reserve asset payments, 88 percent were made in SDRs.

The payment of a reserve asset in connection with an increase in Fund quotas is, from the point of view of the member, an exchange of assets: the member acquires a reserve tranche position on which it receives remuneration, if the member had a remunerated reserve tranche position prior to the quota increase. The payment of the reserve asset is also likely to create a remunerated position, depending on the norm for remuneration, equivalent to or smaller than the size of the reserve asset payment. In light of the Executive Board decision which excludes the Fund's holdings of currency acquired by the Fund from transactions in the credit tranches, the EFF, EAR, and the special facilities for the purposes of defining a "reserve tranche purchase"--i.e., holdings "float" above the reserve tranche--the payment of a reserve asset is effectively an exchange of assets whether the member is a creditor or debtor of the Fund. A member that has a balance of payment need can make a reserve tranche purchase without challenge.

In brief, from the point of view of the member, a reserve asset payment equivalent to 25 percent of an increase in quotas does not result in a net drain on a member's reserves, though the member could incur some interest costs in acquiring a reserve tranche position, especially if it would need to borrow resources to pay the Fund. On balance, it would therefore seem reasonable that members make a reserve asset payment equivalent to 25 percent of the increase in quotas because such a payment is effectively only an exchange of assets.

A major aim of a review of quotas is to endow the Fund with usable resources, and the liquidity effects of a reserve asset payment made in SDRs are greater than a payment in usable currencies. The maximization of the liquidity effects of an increase in quotas makes it desirable to call not only for a reserve asset payment equivalent to 25 percent of the increase in quotas, but, because of the superior liquidity effects of an SDR payment, that the reserve asset payment be made in SDRs. While SDRs can always be used to replenish the Fund's currency holdings and can be sold by the Fund to members making purchases, the usability of currencies in the Fund fluctuate with changes in members' balance of payments and reserve positions. Furthermore, payments made entirely in members' own currency have the smallest liquidity effects because a relatively large proportion of such payments--probably in excess of 35 percent of the increase in quotas--would not be in usable assets. 1/

IV. Consequences of Reserve Asset Payment Made in SDRs

A reserve asset payment in SDRs would provide operational and administrative advantages for the Fund and its members and it would also help promote the SDR. However, a reserve asset payment in SDRs would result in a substantial shift of SDRs to the Fund and a correspondingly lower share of SDRs in members' reserves, though it would seem preferable for members, rather than the Fund, to hold the bulk of allocated SDRs. Furthermore, such a payment would, under the present distribution of SDR holdings among members, seem to result in a substantial redistribution of SDR holdings among members themselves in order to ensure that members hold sufficient amounts of SDRs to pay the Fund. These aspects are discussed in the following paragraphs.

1. Present distribution of SDRs - As can be seen from Table 1, approximately 80 percent of total SDRs outside the Fund are held by 12 members each with quotas exceeding SDR 2 billion; another 14 percent is held by 25 members each with quotas in the range of SDR 500 million to SDR 2 billion. The remainder of the membership (114 members) each with quotas of less than SDR 500 million accounts for only 5 percent of total SDRs. In terms of country groupings, 87 percent of total SDRs held by the membership are held by 20 industrial countries; the major oil-exporting countries hold another 5 percent so that the remainder (8 percent of the total) is held by 119 other developing countries. At the end of 1988, 17 members did not hold any SDRs and another 67 members' SDR holdings were less than 1 percent of their quotas. In all, SDR holdings for 103 members accounted for 10 percent or less of their quotas.

Table 2 shows illustratively the amount of SDRs that would be needed to finance a reserve asset payment in connection with illustrative increases in quotas ranging from SDR 125 billion to SDR 180 billion with the quota increases being allocated according to Method A. As can be seen, present holdings of SDRs are very small in relation to the size of the quota increase for most countries, even those with relatively large quotas and comparatively high levels of SDRs. Because of the size and concentrated distribution of SDR holdings, a reserve asset payment in SDRs would exhaust the SDR holdings of many members and require many members to acquire SDRs for

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1/ The different liquidity impact in part arises also because a member with balance of payments need may decide not to exercise its right to draw its reserve tranche.

Table 1. Present Quotas and SDR Holdings of Members

(In millions of SDRs)

	Number of Countries	Quotas (Amount)	Percent of Total	SDR Holdings (Amount)	Percent of Total
A. Classification by quota range					
Above 2,000	12	56,218.4	62.5	16,355.8	81.1
From 1,000 to 2,000	8	10,090.5	11.2	1,355.7	6.7
From 500 to 1,000	17	10,907.8	12.1	1,557.2	7.7
From 100 to 500	37	9,595.2	10.7	530.3	2.6
From 25 to 100	52	2,976.0	3.3	334.1	1.7
Up to 25	25	199.7	0.2	24.0	0.1
Total	151	89,987.6	100.0	20,157.1	100.0
B. Classification by groups					
Industrial countries	20	56,089.0	62.3	17,540.8	87.0
Oil-exporting countries	12	9,751.8	10.8	1,074.3	5.3
Non-oil: ESAF countries	61	8,773.0	9.7	637.9	3.2
Non-oil: Other countries	58	15,373.8	17.1	904.1	4.5
Total	151	89,987.6	100.0	20,157.1	100.0
C. Classification by SDR holdings in relation to quotas					
No SDRs	17	2,018.2	2.2	0.0	0.0
Less than 1 percent	84	18,358.1	20.4	23.7	0.1
Less than 5 percent	95	22,183.7	24.7	158.5	0.8
Less than 10 percent	103	22,901.5	25.4	210.4	1.0
Less than 25 percent	126	49,206.9	54.7	5,054.5	25.1
Above 25 percent	25	40,780.7	45.3	15,102.6	74.9
Total	151	89,987.6	100.0	20,157.1	100.0

Table 2. SDR Holdings in Relation to Illustrative Quota Increases 1/

(In millions of SDRs)

	End-1988 SDR Holdings (Amount)	Number of Countries 2/	Quota Increase (Amount)	25 Percent of the Increase (Amount)	SDR Holdings as Percent of Quota Increases
I. Fund of SDR 125 billion					
A. Classification by range of quota increases					
Above 2000	11,703.8	4	13,661.6	3,415.4	85.7
From 1000 to 2000	3,151.0	4	5,680.7	1,420.2	55.5
From 500 to 1000	2,206.6	7	4,655.9	1,164.0	47.4
From 100 to 500	2,704.1	36	8,736.1	2,184.0	31.0
From 25 to 100	166.2	34	1,632.6	408.2	10.2
Up to 25	226.1	65	670.3	167.6	33.7
B. Classification by groups					
Industrial countries	17,540.9	20	22,477.7	5,619.4	78.0
Major oil-exporters	1,074.4	12	4,385.1	1,096.3	24.5
ESAF-eligible countries 3/	131.9	59	1,106.0	276.5	11.9
Other non-oil countries	1,410.6	59	7,068.4	1,767.1	20.0
Total	20,157.7	150	35,037.3	8,759.3	57.5
II. Fund of SDR 150 billion					
A. Classification by range of quota increases					
Above 2000	13,837.3	7	31,201.0	7,800.3	44.3
From 1000 to 2000	2,518.6	5	7,192.5	1,798.1	35.0
From 500 to 1000	2,034.0	14	9,556.7	2,389.2	21.3
From 100 to 500	1,442.4	31	8,929.7	2,232.4	16.2
From 25 to 100	250.5	46	2,630.5	657.6	9.5
Up to 25	74.8	47	526.7	131.7	14.2
B. Classification by groups					
Industrial countries	17,540.9	20	38,516.5	9,629.1	45.5
Major oil-exporters	1,074.4	12	7,513.5	1,878.4	14.3
ESAF-eligible countries 3/	131.9	59	1,895.5	473.9	7.0
Other non-oil countries	1,410.6	59	12,111.7	3,027.9	11.6
Total	20,157.7	150	60,037.1	15,009.3	33.6
III. Fund of SDR 180 billion					
A. Classification by range of quota increases					
Above 2000	15,849.3	10	54,122.1	13,530.5	29.3
From 1000 to 2000	1,860.1	8	10,940.8	2,735.2	17.0
From 500 to 1000	1,637.8	18	13,224.7	3,306.2	12.4
From 100 to 500	562.5	38	9,168.1	2,292.0	6.1
From 25 to 100	217.9	47	2,335.4	583.9	9.3
Up to 25	30.1	29	246.2	61.5	12.2
B. Classification by groups					
Industrial countries	17,540.9	20	57,762.4	14,440.6	30.4
Major oil-exporters	1,074.4	12	11,268.2	2,817.0	9.5
ESAF-eligible countries 3/	131.9	59	2,842.3	710.6	4.6
Other non-oil countries	1,410.6	59	18,164.4	4,541.1	7.8
Total	20,157.7	150	90,037.3	22,509.3	22.4

1/ Based on Method A with the quota increase equally apportioned between equiproportional and selective components.
2/ Excluding Democratic Kampuchea, which does not participate in the quota review because of the absence of data to determine its calculated quota.
3/ Excluding two countries with above-average quotas (India and China).

making a reserve asset payment. For example, total SDRs in existence amount to SDR 21.4 billion while the reserve asset payment would amount to approximately SDR 15 billion if the Fund were increased to SDR 150 billion. If the present distribution of SDR holdings would continue in the future, and in the absence of an allocation of SDRs, it seems clear that a reserve asset payment in SDRs in connection with an increase in quotas could result in a large number of members needing to acquire SDRs either from the Fund or from other members. Arrangements would be needed to enable all members to make payments in SDRs.

2. <u>Sale of SDRs by the Fund</u> - A decision by the Fund to sell its relatively modest holdings of SDRs against usable currency to members wishing to make their reserve asset payments would be the equivalent of the reserve asset payment being made in usable currency in the first place. The Fund could, however, give emphasis in executing the operational budget to make transfers in SDRs to members making purchases at around the time that payments for quota increases may be needed, and these members could, if necessary, retain the SDRs required for quota payments. Similarly, emphasis could be given in advising members to make repurchases in currency rather than in SDRs, whenever feasible, though they would retain the right to make repurchases in SDRs if they so wished, provided, of course, that the GRA itself held a sufficient amount of SDRs to meet its obligations.

Over the longer term, however, and in view of the prospectively large proportion of total SDRs that may come to be held by the General Resources Account, the Fund would need to adopt a policy that would redistribute the SDRs back to members to help maintain the viability of the SDR as a reserve asset held and, when needed, used by members. It will be recalled that following the receipt of SDRs in connection with the reserve asset payment under the Eighth General Review, the Executive Board decided that over a period of approximately four years the Fund would sell effectively all the SDRs received in payment from the increase in quotas. This was achieved in 1988, and the GRA holdings of SDRs is now limited to within a range of SDR 750 million to SDR 1,250 million. 1/ A similar course of action would in all likelihood be needed in the event that a reserve asset payment in SDRs was to be made in connection with the Ninth General Review.

3. <u>Sale or loan of SDRs to other members</u> - In view of the substantial redistribution of members' SDR holdings that would be needed if a reserve asset payment in SDRs were agreed upon, it would seem essential for the Fund to make arrangements to ensure that all members had sufficient SDRs to pay the Fund. A similar situation arose at the time of the Eighth General Review in 1983, though on a considerably smaller scale than might be indicated in connection with the Ninth General

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1/ Decision No. 8574-(87/64) S, 4/24/87. See also "Review of the Level of the Fund's SDR Holdings," SM/87/70 (4/3/87).

Review because the volume of SDRs has not been increased since that time. On that occasion, the Fund put in place a large number of arrangements with members to enable other members with insufficient SDRs to acquire them in transactions by agreement. It would be possible to duplicate such arrangements in connection with the Ninth Review, if needed, though there can be no guarantee that members would enter into such arrangements or in sufficient volume to effect the size of transactions that might be needed.

It will also be recalled in connection with the Eighth General Review, that arrangements were put in place that enabled members experiencing difficulties in making their reserve asset payment because they did not hold sufficient official foreign assets (SDRs and foreign exchange) to borrow the amount of SDRs needed to pay the Fund and repay promptly the reserve assets they had borrowed to make the 25 percent reserve asset payment by drawing on their reserve tranche. A schematic presentation of the various technical steps involved is shown in the Appendix. Each of the steps mentioned under paragraph 2 in the Appendix were arranged for the same value date after the paying member had completed payment of the domestic currency portion of the quota payment and that the four steps were recorded in the order indicated, so that the new quota was in existence before the reserve tranche purchase was executed.

The SDRs borrowed in this connection were repaid to the original holder on the same day they were loaned to the member making the reserve asset payment, and there was no loss of interest to the lender nor any exchange risk involved. The member making the loan did not charge a fee or commission for its services and no payment of interest was necessary as all transactions were made on the same day.

While similar transactions could technically be carried out in currencies specified by the Fund and with the cooperation of the issuer of the currencies or of a central bank willing to assist, or if members arranged bridge financing with a commercial bank, operations involving currency could conceivably take more than one day to complete. As a consequence, exchange risks could arise for the parties concerned. Furthermore, borrowing from a commercial bank, even in connection with a same-day transaction, would involve transaction costs or fees for the borrowing member.

All such transactions carried out under the Eighth Review were made in SDRs. 1/ If the Executive Directors agreed that there would be a need for similar arrangements in connection with the Ninth General Review, it is recommended that such arrangements should again be confined only to SDR transactions, which, as mentioned above, do not

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1/ On that occasion, 39 members borrowed SDR 608 million from 11 other member countries.

involve any exchange risks since the timing of each of the steps in the arrangement can be arranged being within the control of the Fund.

V. SDR Allocation

At CW/Quota/88/8 and 9 (September 1 and 2, 1988), an Executive Director raised for consideration the issue of an allocation of SDRs in association with an increase in quota in order to facilitate the financing of an increase in quotas and, by the same token, to increase the role of the Fund as the center of the system. It will be recalled that in 1978, in connection with an allocation of SDRs in the third basic period (1978-81), the Managing Director presented to the Executive Board a package of financial measures that included allocations in the range of SDR 4 to 6 billion a year for three years and a general quota increase (Seventh General Review), of which 25 percent was payable in SDRs. At its meeting on September 24, 1978, the Interim Committee reached a consensus on allocations of SDR 4 billion a year in 1979, 1980, and 1981, conditional on agreement being reached on equiproportional quota increases. 1/ The Managing Director, in his proposal to make allocations of SDR 4 billion a year for each of three years noted "in specifying these amounts [of allocations], I have also in mind the agreement that has been reached that special drawing rights will be used in partial payment for the quota increases that are to take place under the Seventh General Review of Quotas."

In deciding to make an allocation of SDRs, a finding of a long-term global need to supplement existing reserve assets is required under the Articles. Article XVIII requires that the allocation of SDRs be made "in such manner as will" (i) promote the attainment of the Fund's purposes and (ii) be consistent with the objective of avoiding economic stagnation and deflation as well as excess demand and inflation in the world economy. An allocation of SDRs would also be consistent with the objective of making the SDR the principal reserve asset in the international monetary system.

There are a number of reasons why the need for SDRs to pay a possibly substantial reserve asset payment in SDRs does not necessarily imply that the needed SDRs cannot be met from the existing total of SDRs:

First, the Board of Governors can decide that the reserve asset payment should be made in other media than SDRs, or could be waived altogether, though an SDR payment maximizes the liquidity effect of an increase in quotas. An increase in quotas is not, therefore, dependent on an allocation of SDRs; rather the relationship is that an SDR allocation could be viewed as partly conditional on the same

1/ See paragraph 5 of Board of Governors' Resolution 34-3, adopted December 11, 1978.

considerations that occasion a general quota increase, such as the need for an increase in international liquidity. Furthermore, an SDR allocation would of itself help effect the payment for an increase in quotas and thereby help meet the need for increased conditional liquidity. In this connection, it is of interest to note that the part of an allocation of SDRs that is to be used for the payment of reserve assets in SDRs results in an increase in international liquidity in the form of enlarged reserve tranche positions and not in SDRs, which would be held by the Fund. As reserve tranches can be drawn upon only on a representation of balance of payments need, the SDRs used to make payments to the Fund become in a small way usable conditionally, because the SDRs are converted into Fund-related assets. 1/

Secondly, and as explained above, the payment of a reserve asset does not lead to a loss of reserves, but rather to a redistribution of reserves because a reserve asset payment results in the substitution of one reserve asset--a reserve tranche position--for another (SDR), though the total level of liquidity would have been increased as a result of the decision to allocate SDRs.

Thirdly, arrangements can be put in place, as described above, that could reduce the difficulties for members that hold insufficient SDRs to make the required reserve asset payment or whose reserve holdings in general (including SDRs) are insufficient to pay SDRs to the Fund in connection with the increase in quotas. However, in view of the relatively small amount of SDRs in existence and their relatively uneven distribution, there is no assurance that the arrangements followed under the Eighth Review could fully accommodate a reserve asset payment in SDRs that would be large in relation to the outstanding total of SDRs. Furthermore, the rearrangement of SDR holdings among members could be substantial, consequent upon them being paid to the Fund in connection with a reserve asset payment. Consequently, an allocation of SDRs would greatly reduce the need for such arrangements and would thus facilitate the payment of a reserve asset in connection with an increase in quotas.

As regards the more qualitative aspects of an SDR allocation, the payment of SDRs in connection with an increase in quotas helps promote the attainment of the Fund's purposes in that it maximizes the liquidity effects of an increase in quotas, and hence the liquidity of the Fund, and thereby improves the ability of the Fund to make

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1/ The effect of such a transformation of SDRs is, however, not comparable with other post allocation adjustment schemes previously discussed in view of the liquidity of the reserve tranches and the ability to acquire SDRs through such drawings; see "Further Consideration of Issues Relating to Post Allocation Adjustment in the Distribution of SDRs" (forthcoming).

conditional liquidity available in the world economy; secondly, it is an important addition to the uses of SDRs made by members and also gives the SDR a more important place in the Fund's operations, i.e., it promotes the use of the SDR and, thereby, enhances its role in the international monetary system. The payment of part of the quota increase in SDRs thus has a bearing, as in 1978, on the amount of SDRs to be allocated at a particular time.

In short, a reserve asset payment in SDRs would help promote the attainment of the purposes of the Fund and to make the SDR the principal reserve asset in the system. The payment of a reserve asset in SDRs, as provided by the Articles, can be taken into account as an element in the finding of a need to allocate SDRs. A reserve asset payment in SDRs adds to the use of SDRs and in that particular respect bears on the amounts of SDRs to be allocated. It also effectively changes the form of part of the increase in liquidity resulting from an SDR allocation into a Fund-related asset with a consequential, though relatively minor change in the usability of the asset. Furthermore, the use of part of an SDR allocation to enable members to pay their reserve asset subscription would be more efficient than the measures adopted in connection with the Eighth Review and which might well be needed on the occasion of the Ninth General Review. In general, an SDR allocation would help meet the payment of the reserve asset without a major redistribution of SDRs and transformation of existing official reserves into reserve tranche positions.

VI. Concluding Observations

This paper has elaborated on a number of issues touched upon in earlier meetings of the Committee of the Whole which bear on the payment for an increase in quotas. The main conclusions of the paper may be summarized as follows:

1. The payment of the local currency portion of an increase in quotas does not usually involve a budgetary outlay by the member. The financial impact of the Fund's transactions with a member involving the purchase of its currency normally falls on a member's foreign exchange reserves or its domestic borrowing requirement; in either case, there are corresponding changes in the member's reserve tranche position and the transaction can be regarded as an exchange of assets.

2. The Articles of Agreement provide as a normal rule for a reserve asset payment amounting to 25 percent of an increase in quotas to be paid in SDRs. Other amounts and media for payments require a decision by the Board of Governors by a 70 percent majority of the total voting power.

3. The payment of a reserve asset does not involve a loss of reserves because it is an exchange of assets. A member acquires in exchange for the payment an equivalent amount of a reserve tranche position which, depending on its norm for remuneration, may be partly or fully remunerated.

4. An SDR payment maximizes the liquidity effect of an increase in quotas because SDRs can be sold by the Fund for usable currency or used directly in financing purchases by members. Payments in members' own currency have the smallest liquidity effect because only a portion of such currencies are usable by the Fund.

5. The total of SDRs in existence (SDR 21.4 billion) is small in relation to possible reserve asset payments in SDRs, and their distribution is heavily concentrated in a relatively few large industrial countries. A reserve asset payment in SDRs would thus lead to a major redistribution of SDRs and a transformation of existing official reserves.

6. Arrangements would be needed if it were decided to make a reserve asset payment in SDRs in connection with the Ninth General Review, so as to enable members with insufficient SDRs to acquire needed SDRs to pay to the Fund.

7. Sales of SDRs by the Fund against usable currencies would be tantamount to the reserve asset payment being made in usable currency. For those members with insufficient SDR holdings, the Fund could assist them, with the cooperation of other members, to acquire SDRs from other members in transactions by agreement or by the Fund providing them with SDRs if they made purchases from the Fund. For those members with insufficient reserves in general (including low or zero SDR holdings), the Fund could arrange, as on the occasion of the Eighth General Review, for them to borrow SDRs from other members and to repay such loans on the same day with the proceeds of a drawing on the reserve tranche that would be established as a result of the payment for the increased quotas. There is no assurance that such arrangements would work as well as under the Eighth Review because the amount of SDRs needed for the reserve asset payment in connection with the Ninth General Review might be considerably larger in relation to the total of SDRs outstanding than in 1982.

8. As regards the issue of an allocation of SDRs in association with an increase in quota, it was concluded that the payment of a reserve asset in SDRs, as provided by the Articles, can be taken into account as an element in the finding of a need to allocate SDRs. A reserve asset payment in SDRs helps promote the attainment of the purposes of the Fund and to make the SDR the principal reserve asset in the system. A reserve asset payment in SDRs adds to the use of SDRs, converts it to a Fund-related asset, and obviates the need for special arrangements

and therefore constitutes an efficient means of payment for an increase in quotas. To the extent that the amount of SDRs needed to make a reserve asset payment cannot be accommodated from the existing stock of SDRs, the existence of such a need could be taken into account in determining the amount of an SDR allocation.

Borrowing of SDRs for Asset Payment for Quota Increases and Simultaneous Reserve Tranche Purchase and Repayment of Borrowing

1. A member (Member X), which is willing to cooperate and has the authority to do so, would authorize the Fund to debit its SDR Account, as and when required, and credit the amount of the asset payment as a loan in SDRs to other members making their reserve asset payments for the quota increases on the understanding that

(i) the borrowing member does not have sufficient SDR holdings or foreign exchange available with which to make the reserve asset payment;

(ii) the borrowing member would make an immediate reserve tranche purchase in the amount of the asset payment, and

(iii) that the SDRs received in the purchase would be credited back to Member X on the same value date as its SDR Holdings Account had been debited for the SDR loan.

2. A member (Member Y) making its quota payment that needed to borrow SDRs for the asset portion would instruct the Fund as follows, to be carried out after that member had confirmed payment in full of 75 per cent of the quota increase in its own currency.

(i) Indicate that it will need to borrow, because it has insufficient reserves with which to make the asset payment, from another participant as arranged by the Fund an amount of SDRs to make reserve asset payment amounting to 25 per cent of the increase in quotas to which it consented and that these SDRs should be credited to its SDR Account;

(ii) Authorize the Fund, after the crediting of the SDRs, to debit its SDR Account in settlement of the reserve asset payment;

(iii) Request, for value the same day, a reserve tranche purchase; the text would include the required representation by Member Y of a balance of payments need;

(iv) Instruct the Fund, regarding use of the SDRs obtained through the reserve tranche purchase, to pay the SDRs obtained in the reserve tranche purchase in repayment of the borrowing.

3. As the result of the above, the Fund would have the authority from the members concerned to execute the various transactions and operations on the same value date, which would be after the Fund had received confirmation from the borrowing member that the local currency portion of its quota increase had been paid in full. As the Fund would make the arrangements between members, it would be fully informed of the details of the SDR loans as required under Decision No. 6001.