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SM/86/154

June 27, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Proposals for Post-Allocation Adjustment in the Distribution of SDRs

Attached for consideration by the Executive Directors is a paper on proposals for post-allocation adjustment in the distribution of SDRs, which is proposed to be brought to the agenda for discussion on Wednesday, July 23.

Mr. Mathieson (ext. 7662), Mr. Isard (ext. 6640), Mr. Clark (ext. 7800), or Mr. Decarli (ext. 6525) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Proposals for Post-Allocation Adjustment in the Distribution of SDRs

Prepared by the Research Department and the Treasurer's Department

(In consultation with the Legal Department)

Approved by Wm. C. Hood and Walter O. Habermeier

June 24, 1986

I. Introduction

Recent discussions of the role of the SDR in the international monetary system have raised the issue of whether an allocation of SDRs based on Fund quotas appropriately reflects the distribution of countries' reserve needs in the context of existing international monetary arrangements. Structural changes in the international monetary system in the 1970s and 1980s, in particular the increased role of private financial markets as a major source of official reserves, have resulted in a distribution of international reserves among countries that depends to a considerable extent on countries' access to these markets. As a result, it has been argued that an assessment of the long-term global need to supplement international reserves requires consideration of how the supplementary reserves would be distributed among countries with different degrees of access to financial markets.

In particular, concern has been expressed about an allocation of SDRs based on Fund quotas providing additional reserves to countries whose reserves are already adequate or ample as well as to those with relatively large unsatisfied reserve needs. Apprehensions have also been voiced that an SDR allocation sufficient to satisfy the reserve needs of certain groups of countries might create inflationary pressures and weaken adjustment efforts. In response to these concerns, there have been proposals for altering the distribution of SDRs that would result from an allocation based on Fund quotas.

This paper focuses on three proposals that have been presented to the Executive Board by Mr. de Groote (the Belgian proposal), Mr. de Maulde (the French proposal), and Mr. Sengupta regarding supplementary arrangements that could accompany SDR allocations so as to improve the distribution of reserves and to strengthen the linkages between SDR allocation and adjustment efforts. 1/ The three proposals are shaped by the common objective of making available to countries with relatively strong reserve needs a part or all of the SDRs received by countries that have no need or a lesser need for additional reserves at the time of an allocation. To allay concerns that an SDR allocation would undermine adjustment efforts, the proposals link the redistribution of an SDR allocation either to temporary lending subject to a form of conditionality (Belgian and French proposals) or to a reconstitution or repayment requirement (Sengupta proposal).

Although the three proposals would either temporarily or permanently modify the distribution of SDRs implied by allocations in proportion to quotas, it needs to be emphasized that the decision on the allocation of SDRs would continue to be governed by the criteria set out in Article XVIII, Section 1(a) of the Articles of Agreement: 2/

> In all its decisions with respect to the allocation and cancellation of special drawing rights, the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world.

The proposals stress that the concept of a global need for reserves must encompass concerns about the distribution of reserves among countries. A redistribution of allocated SDRs has been viewed as a means of reducing the real costs and potential deflationary effects of accumulating reserves through current account surpluses for countries with limited access to international financial markets.

1/ Mr. de Groote's proposal was discussed in his statements at the Executive Board on SDR allocation issued on August 5, 1983 (83/115), March 20, 1984 (84/46), and August 31, 1984. Mr. de Maulde's proposal was discussed in his statement on SDR allocation issued on August 30, 1984 (84/143). Mr. Sengupta's proposal was discussed in his statement on the Implication of Changes in the International Monetary System for the Role of the SDR issued on February 7, 1986 (86/20). In addition, Mr. Sengupta has provided the staff with an informal aide memoire describing in greater detail alternative arrangements that could be considered to give effect to his proposal. These documents or pertinent excerpts are reproduced in the Annex.

2/ The existence of post-allocation redistribution arrangements would have to be carefully considered in the assessment of a long-term global need. The specific characteristics of the arrangement, and in particular the temporary or permanent nature of the transfer of SDRs, would have to be taken into account.

The Fund cannot make it a condition of an allocation that members enter into a commitment to participate in the arrangements envisioned in these proposals. However, countries could voluntarily agree to participate either because of their particular concern for prospective recipients or because of a general concern for the smooth operation of the international monetary system. Moreover, individual participants could withhold support for an allocation unless and until a prespecified number of prospective participants had entered into a voluntary commitment of a specified type.

The three proposals are described and their effects compared in the remaining three sections of the paper. In Section II, there is consideration of the objectives and main features of each proposal; the nature of the transfer of SDRs; the incidence of SDR interest charges and earnings that would arise; and issues related to the use of SDRs and repayment or reconstitution requirements. Section III examines the effects of implementing these proposals by considering three issues. First, since these proposals seek to improve the performance of the international monetary system by redistributing allocated SDRs, there is consideration of the potential effects of combining an SDR allocation with arrangements to redistribute SDRs on the level, composition, and distribution of reserves. This discussion includes an examination of whether such arrangements would help reduce the potential deflationary effect on the international economy of having countries with relatively weak reserve positions and limited access to private financial markets accumulate reserves through current account surpluses. Second, the effects of the combination of an SDR allocation and arrangements to redistribute SDRs on inflation and adjustment efforts are considered. Third, reference is made to certain legal aspects of the proposals and to the reserve asset characteristics of the SDR. A full examination of the legal issues is not attempted in this paper, as the description of the proposals is made in general terms, without full specification of particular characteristics. Section IV examines the role of the Fund in the implementation of these arrangements, and Section V provides some concluding comments.

II. Comparative Description of the Proposals

While the Belgian, French, and Sengupta proposals have the common objective of making available all or part of the newly allocated SDRs received by countries with strong reserve positions to countries with weak reserve positions, they have suggested different arrangements for achieving this redistribution. These arrangements differ in terms of the mechanisms for transfer, the duration of the transfer, and the conditions governing the use of the transferred SDRs as well as the role of the Fund they envisage. To facilitate a comparison of these arrangements, the following subsections describe the main features of each proposal and then examine certain aspects of these arrangements in more detail.

Main features

The Belgian proposal was introduced in 1983 and 1984 in the discussion of SDR allocation in the fourth basic period and was also considered in 1984 by the G-10 Deputies during the preparation of their report on the functioning of the international monetary system. Some distributional aspects of the proposal were recently examined in a staff paper on the contribution of the SDR to economic stability. 1/ In addition, the Fund's Legal Department examined whether the arrangements envisioned under the Belgian proposal would be consistent with the Articles of Agreement. 2/

Under this proposal, members with strong reserve positions could make available to the Fund all or part of their newly allocated SDRs. The resulting increase in SDR holdings would be used to extend credit to countries that are undertaking Fund-supported adjustment programs. Since the Fund is not authorized to borrow SDRs, the proposal provides for an arrangement under which the Fund would borrow currency from each creditor participant in the arrangement in an amount equivalent to the SDRs that the participant agreed to make available, and it would simultaneously use the borrowed currency to purchase those SDRs from the participant. 3/ At the end of a given period, the arrangement regarding the Fund's borrowing could be reviewed and a decision made either to continue it or to return the SDRs to their original owners. The interest rate paid by the Fund on its borrowing of currency and charged by the Fund on its lending of SDRs 4/ would be the SDR interest rate. Therefore, the interest received by the Fund on its holdings and lending of SDRs would match the interest payments on its borrowing of currency, while the interest cost incurred by the sellers of SDRs (as a result of their holdings being lower than they would otherwise have been) would be fully compensated by the interest payments received from the Fund.

The French proposal was introduced in 1984 during the discussion of an SDR allocation in the fourth basic period as a way to avoid the complex parliamentary agreements that the Belgian proposal might require because of its character as an IMF funding operation. Under the French proposal, industrial countries and possibly some oil producing countries, would lend part of their newly allocated SDRs directly to certain

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1/ "The Potential Contribution of the SDR to Economic Stability," SM/86/17, January 29, 1986.

2/ "Proposal of the Belgian Deputies of the G-10 for a Conditional Use of SDR Allocation," EBS/84/191.

3/ Each loan would have to be made in the currency of another member because the Fund can purchase SDRs from a member only in exchange for the currency of another member.

4/ For convenience in the exposition, the extension of credit by the Fund to members is referred to as a loan in this paper, although technically it is a purchase of SDRs or currency by the member from the Fund.

developing countries. This arrangement would have the following features: (1) prior to an allocation, the transferring countries would commit themselves to lend to other countries all or some fraction of the SDRs to be received in the allocation; (2) developing countries' access to these SDRs would be linked to an appraisal, by the Fund's Executive Board, of their economic policies, their need for reserves, and the prospect that these SDRs would effectively strengthen their reserves; (3) this conditionality would be applied only to the SDRs lent by the transferor countries and not to SDRs directly allocated to developing countries; (4) the interest rate on SDR loans would be the SDR interest rate; (5) loans by participating lending countries would be in proportion to their allocations; and (6) there would be a reimbursement period, which would stretch over a medium-term period after a grace interval and would be uniform for all loans.

According to the Sengupta proposal, which was offered for consideration in Executive Board Meetings on the role of the SDR in January and February of 1986, 1/ SDRs allocated to countries that have a lesser need for additional reserves at the time of allocation would be made available to developing countries that wanted to rebuild their reserves. The transfer of SDRs would not be subject to conditionality, and it would be of such a nature that the developing countries could consider those SDRs as a permanent addition to their reserves. The precise nature of the arrangement was not specified in Mr. Sengupta's February statement but it was indicated that the developing countries should either be enabled to retain those SDRs permanently in their reserves or have access to them through an "overdraft facility" that they could use in case of need. 2/ The member using SDRs would be required to replenish or recon stitute its overdraft facility at the end of a prespecified fixed time period (around three years) or a time period that could take into account the state of the international economy. The arrangements for transferring SDRs among members would be designed to ensure that no net interest cost would accrue to either transferors or recipients as a result of the transfer of SDRs, but SDR charges would be paid for the use of these SDRs.

Nature of the transfer of SDRs

As already discussed, the three proposals involve a transfer of SDRs from countries with strong reserve positions at the time of an allocation to countries with weak reserve positions. In the Belgian proposal, the transfer would take place by the Fund borrowing currencies, acquiring SDRs from some members, and lending them to others in a manner consistent with the Fund's policies on the use of its resources. In the French proposal, the transfer would take the form of a loan of SDRs between members. In the Sengupta proposal, the transfer could

1/ EBM/86/18, January 31, 1986 and EBM/86/37, February 26, 1986.

2/ Buff statement 86/20 (2/7/86), p. 5. (Annex, pp. 33-35). See also Mr. Sengupta's aide memoire of May 28, 1986 (Annex, pp. 36-39).

take place in a number of ways. The following two basic alternatives, however, would appear to be consistent with the proposal: 1/ (1) certain countries could make available to others a permanent SDR overdraft facility by "earmarking" part of their SDR holdings or keeping them in blocked accounts, on which the recipient countries could draw by borrowing SDRs when needed; or (2) certain countries could at the outset transfer SDRs to other countries, which could keep them in "overdraft accounts" (held in their own books or with other holders of SDRs) that could be drawn upon when needed; the transfers could (but need not) take the form of transfers of ownership through donation and are treated as such in this paper to distinguish them from the "earmarking" alternative.

An important aspect of the arrangements would be the manner in which the transferors and the recipients of the SDRs are to be selected. In general, a variety of methods could be used to select the transferors and recipients in such an arrangement, although not all the ones mentioned below would be applicable to each of the proposals. All three

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1/ In order to give effect to the substance of his proposal, Mr. Sengupta has put forward three suggestions, elaborated in an informal aide memoire (reproduced in the Annex, pp. 36-39) to this paper, for achieving the transfer of SDRs. The first requires each transferor to relinquish its right to receive an allocation and envisions the transfer of these unallocated SDRs to developing countries. While members can decide under Article XVIII, Section 2(e) not to receive their shares in an SDR allocation provided they did not vote in favor of it, this procedure could not result in a transfer or reallocation of SDRs to other members. Moreover, if Governors casting more than 15 percent of the total voting power did not vote in favor of the allocation, the allocation could not take place. The second suggestion relies on developed countries pledging not to use the SDRs allocated to them and holding them in blocked accounts, while the Fund would provide developing countries with entitlements to overdraft facilities equivalent to the blocked SDRs. While the Fund has no legal basis for conferring such overdraft entitlements to members, the substance of this feature of the arrangement could be accomplished by agreement among participating transferors and recipients. The third suggestion envisages that SDRs would be transferred to developing countries and held in an unconditional SDR overdraft account. Although under the Articles such an account could not be established within the Fund, which can hold SDRs only in its General Resources Account, such an account or accounts could be held in the books of the recipients of SDRs or on their behalf by willing participants in the SDR Department or by prescribed holders of SDRs. Under either the second or third suggestions, the Fund could provide its services as an agent under Article V, Section 2(b) in assisting the operation of such arrangements if they are deemed to be consistent with the purposes of the Fund. These latter two variants of Mr. Sengupta's proposal would be consistent with the mechanisms discussed in this paper.

proposals would require selection of a group of potential transferors, and the French and Sengupta proposals may also require selection of a group of potential recipients as well as specification of criteria for distribution among recipients (e.g., Fund quotas). Under some arrangements, the selection of participants could be left to members on a bilateral basis, in which case separate agreements could be expected to develop among countries with close ties. Alternatively, prospective transferors and recipients could be selected in a multilateral setting in accordance with certain economic criteria, which could include, in addition to the level of reserves, such other factors as balance of payments position and income per capita. Prospective transferors would presumably have a choice of participating in any specific arrangement. A prospective recipient would also have the choice of participating or not. A minimum number of participants and a commitment of some minimum aggregate amount of SDRs would presumably be prerequisites for the implementation of any given arrangement.

The transfer of SDRs under the proposed arrangements could not entail a transfer of the obligations of members that accompany the allocation of SDRs. In particular, the obligations to pay charges, to pay assessments, and to accept SDRs, as well as those that may arise from the termination of participation in or the liquidation of the Special Drawing Rights Department, are defined in the Articles of Agreement in relation to the net cumulative allocation 1/ of each participant, and those obligations would therefore not change with the transfer of SDRs under the proposed arrangements.

Distribution of SDR interest charges and earnings

In each of the three proposals, it is intended that the initial transfer (or earmarking) of SDRs would not lead to net interest costs for transferors or recipients of the transferred SDRs, but that the use of the transferred SDRs would be subject to the payment of SDR charges. Exact compensation to the transferor for the excess of charges over interest appears to be an explicit feature of the three proposals as formulated by their proponents. However, if it were considered desirable, the compensation could be larger or smaller. 2/ To achieve the intended neutrality in the financial cost of the transfer, or to permit some financial compensation for the transferor if desired, account must be taken of Article XX of the Articles of Agreement, which governs interest and charges on SDRs. This article provides that "[i]nterest at the same rate for all holders shall be paid by the Fund to each holder on the amount of its holdings of special drawing rights," and "[c]harges at the same rate for all participants shall be paid to

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1/ Cumulative allocation less any cancellation of SDRs.
2/ Also, the operation of the proposed arrangements would generate costs for the Fund, which would depend on the degree of Fund involvement. Consideration would have to be given to appropriate provision for covering these costs.

the Fund by each participant on the amount of its net cumulative allocation of special drawing rights ..." To compensate the transferor exactly for the excess of charges over interest that it would experience as a result of the transfer, the transferor would have to receive interest payments at the SDR interest rate for the amount of the transfer; additional compensation would require that the transferor receive a higher interest rate than the SDR interest rate. These payments would have to be made by the recipient of the transferred SDRs. In the Belgian proposal, the Fund would pay the SDR interest rate to borrow currency from the transferor and, on the other side of the operation, the Fund would charge the same interest rate to the borrower of SDRs. 1/ If SDRs were borrowed by recipient countries from other countries, as under the French proposal or one version of the Sengupta proposal, payments would be made from borrowers of SDRs to lenders of SDRs. If the ownership of SDRs were transferred to recipient countries, as might be the case in another version of the Sengupta proposal, the obligation of the recipient to pay interest to the transferor for the amount of the transfer could take the form of a legally-binding condition to which the initial transfer of ownership would be subject. The precise mechanism for the payment of interest would depend on the particular form of the arrangement. However, irrespective of the nature of the agreement between the transferor and the recipient, the obligation to pay SDR charges would remain with the transferor, which would bear the risk should the recipient fail to pay interest.

While the initial transfer of SDRs under any of these proposals would not result in net interest costs or receipts accruing to transferors or recipients, the subsequent use of these SDRs by recipients would generate net interest payments by them. They would continue to pay charges on SDRs allocated or transferred to them but they would cease to receive interest on any SDRs that are no longer held by them.

Conditionality, reconstitution requirements, and repayment periods

Access to transferred SDRs would be subject to some form of Fund conditionality under both the Belgian and the French proposals, but it would not be subject to conditions under the Sengupta proposal. 2/ Under the Belgian proposal, the Fund would buy all SDRs available for transfer at the time of the allocation, and it would lend them to countries over time in support of their adjustment efforts. 3/ In the

1/ For the amount of SDRs bought by the Fund but not yet used in its lending operations, the Fund would receive the same amount of interest as a holder of SDRs as it would pay as a borrower of currency.

2/ Under any of the proposals, certain general conditions could be made part of the arrangement.

3/ The Belgian proposal was formulated along these lines, but it could also be arranged for the Fund to borrow currency and acquire SDRs only in amounts needed for lending from time to time.

French proposal, the transfer of SDRs would require an appraisal by the Executive Board "of the [recipient] countries' need for reserves, their economic policies, and the prospect that the SDRs being lent would effectively strengthen their reserves." 1/ By contrast, the Sengupta proposal envisaged no conditionality associated with access to the transferred SDRs. In particular, the availability of transferred SDRs would not be tied to the existence of an adjustment program supported by the Fund. In all three proposals, once the recipients have obtained access to the transferred SDRs, they would be able to use them in the same way as all other SDRs they might hold (see Article XIX of the Articles of Agreement). In particular, there would be the expectation that a participant would not use its SDRs to obtain an equivalent amount of currency in a transaction by designation unless it had a balance of payments need.

The transferred SDRs would be intended to constitute an addition to recipients' gross reserves. However, they could be used temporarily when needed to finance a balance of payments deficit. If transferred SDRs were used with designation, they would flow toward countries with strong balance of payments and reserve positions which would tend to include the original transferors as a group unless the pattern of payments imbalances had changed substantially between the time when the arrangement became effective and when the SDRs were used. This tendency would be reinforced by the fact that the transfer itself would reduce a transferor's holdings of SDRs without changing its net cumulative allocation, thus increasing the amounts of SDRs that the member could be assigned to receive in the designation plan. 2/ In the three proposals, the use of SDRs is intended to be temporary, and transfers of SDRs in the direction opposite to the ones just described would occur when the user repaid SDR loans or reconstituted its holdings as required in the proposals.

The conditions concerning the duration of the arrangement were specified in the Belgian proposal and in the Sengupta proposal, but not in the French proposal. In the Belgian proposal, the feature of transferring SDRs was envisaged only as a temporary addition to the arrangements accompanying an SDR allocation based on Fund quotas: "... at the end of the borrowing period the Fund should review the situation and could decide either to maintain the conditional use of the SDRs or to convert the SDRs into unconditional liquidity by unwinding the borrowing

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1/ Note by Mr. de Maulde on Allocation of SDRs, EBM/84/130, August 31, 1984 (Annex, pp. 30-32).

2/ To the extent that the use of SDRs took place in transactions by agreement, SDRs might tend to flow initially to participants that had financial obligations payable to the Fund in SDRs. The Fund would eventually receive these SDRs and, assuming its policy on SDR holdings did not change because of these arrangements, it would use them in its operations.

arrangement." 1/ However, it might be assumed that unwinding would normally be phased in time with members' repurchases of Fund credit. The French proposal would also appear to have a temporary character, as no possibility of relending of SDRs is suggested after the repayment period. By contrast, in the Sengupta proposal the redistribution or earmarking of SDRs is not intended to be reversed, and unused portions of the transferred SDRs are intended to be considered as additions to the reserves of the recipient countries. 2/

The terms for repayment of the borrowed SDRs were not described in full detail in the proposals. The French proposal suggested a grace period and a repayment period that would stretch over the medium term. The Belgian proposal did not indicate particular repurchase terms, although one might infer that those generally applicable to the use of resources borrowed by the Fund would apply. The Sengupta proposal suggested that repayment of SDRs drawn from the overdraft facility be made over a three-year period or that some form of reconstitution be required, perhaps by specifying that the account must be fully constituted for some proportion of the time (i.e., for 365 days of a four-year period). The same desired effect of allowing only for temporary use of permanently earmarked or transferred SDRs could be obtained with an obligation to repay borrowed SDRs in one version of the Sengupta proposal or with a requirement to reconstitute holdings in the other version. These reconstitution or repayment arrangements could take a variety of forms and would be intended to ensure that recipients hold the transferred SDRs (or not use the earmarked SDRs) at least some of the time. They would relate only to the SDRs transferred under the proposal and would be established through agreements among members outside the Articles of Agreement. In any case, under permanent arrangements, the issue would have to be considered of how repeated annual allocations would affect the intended repayment or reconstitution of SDR holdings. The Fund could administer these arrangements as an agent if they were deemed to be consistent with the purposes of the Fund.

1/ Statement of Mr. de Groote in EBM/84/45, March 26, 1984 (Annex, pp. 23-26).

2/ In normal financial practice, overdraft facilities, credit lines, and swap facilities are ordinarily available only for a limited period and are not considered as part of the reserves of the prospective borrowers. The permanence of the earmarking or transfer under the Sengupta proposal is intended to give reserve character to the transferred funds, even if the arrangement does not involve a transfer of ownership. Under some variants of the Sengupta proposal, it might be possible to include provision for creditors to make use of earmarked or transferred SDRs in special circumstances of reserve need. However, such provisions would raise questions about the permanence of the earmarking or transfer and therefore about the availability of the SDRs to intended recipients, and would need to be considered carefully from this point of view.

Regarding the more general rules for reconstitution in the Articles of Agreement, those established in Schedule G, Section 1(a) (abrogated in 1981) sought to have each member partially rebuild its holdings in relation to its net cumulative allocation. If new reconstitution provisions were to be introduced in the future and to coexist with an arrangement to redistribute SDRs, the two arrangements would have to be carefully harmonized.

III. Assessment of the Effects of the Proposed Arrangements

The effects of the Belgian, French, and Sengupta proposals on the performance of the international monetary system would depend on how their implementation might alter the terms and conditions under which reserves are supplied to countries in different circumstances. Particular interest attaches to the extent to which the implementation of any of the three proposals would enable countries with relatively weak reserve positions and limited access to private financial markets to accumulate reserves without having to resort to deflationary policies designed to improve their current account positions. In this discussion, the Belgian, French, and Sengupta proposals are compared in terms of their potential effects on the reserve system. Then, there follows a consideration of the effects of implementing the proposed redistribution arrangements on inflation and adjustment efforts. The discussion concludes by examining certain questions related to the implementation of the proposals and the implications of these arrangements for the reserve asset characteristics of the SDR.

The size of the transfers of SDRs that would be associated with the combination of a modest SDR allocation and arrangements to redistribute SDRs would naturally be a key factor in determining the scale of the effects of these proposals on the international economy. The scale of the transferred SDRs would depend on the set of countries agreeing to make the transfer and the proportion of allocated SDRs that would be transferred. Moreover, the size of the countries that would have access to these transferred SDRs would determine the potential relative contribution of this transfer to reserve accumulation. For example, an allocation of SDR 5 billion would provide the industrial countries with SDR 3.15 billion and the developing countries with SDR 1.85 billion of allocated SDRs. Such allocations would represent 1.4 percent and 1 percent of the non-gold reserves of the industrial and developing countries at the end of 1985, respectively. If the industrial countries were to agree to transfer all of their allocated SDRs (SDR 3.15 billion), this transfer would be the equivalent of 1.8 percent of the reserves of all developing countries at the end of 1985, 2.5 percent of those of the capital-importing developing countries, and 7.9 percent of those of the capital-importing developing countries with debt-servicing problems. 1/

Effects on international reserves and liquidity

The potential effects of implementing these proposals would reflect the sharp differences between the terms and conditions under which different countries can acquire and maintain their holdings of reserves in the present international monetary system. Countries with dependable access to international financial markets manage their reserve holdings flexibly through borrowing in international capital markets. For such countries, the net cost of acquiring reserves through these markets is relatively low, equaling the difference between the loan interest rate and the yield obtained on reserve assets. Countries with limited access to international financial markets, 2/ however, would be unable to acquire reserves without adjusting current account positions--reducing deficits or increasing surpluses--relative to the prospective net inflow of official or private equity capital.

The consequences of the proposed arrangements for international reserves and liquidity depend on any effects they may have on the sources of reserve growth and the willingness of countries to hold the SDRs allocated or transferred to them. A modest allocation of SDRs supplemented by an arrangement to redistribute them would not be likely to affect significantly either the reliance of creditworthy countries on financial markets as a source of reserves or the terms and conditions under which those reserves are obtained. However, for countries with limited access to private financial markets, such a combination of SDR allocation and redistribution arrangements could represent an important alternative to generating reserves through current account surpluses or receipts of other nonbank private and official flows.

The effects of the combination of SDR allocation and redistribution arrangements on reserve holdings would depend on how the allocated and transferred SDRs were used by the recipients. If the recipient developing countries were to hold the transferred SDRs, the size of the current account surpluses needed to support reserve accumulation would be diminished and a potentially deflationary effect on the international economy would be reduced.

1/ This calculation, intended to illustrate roughly the possible scale of redistribution, is not applicable to the Belgian proposal. In that proposal beneficiaries would be chosen by applying the criteria for the use of Fund resources, and therefore beneficiaries would not necessarily belong only to a particular category of countries.

2/ This would include countries that are unable to obtain significant amounts of borrowed reserves (even at relatively high spreads) because of creditor concerns about their ability to service existing external debt.

Alternatively, the countries receiving the transferred SDRs might seek to convert them into foreign exchange reserves. 1/ As long as the total non-gold reserve holdings of these countries did not decline as a result of this exchange of SDRs for foreign exchange reserves, the potential deflationary effect on the international economy would also be avoided by enabling the countries needing to do so to rebuild reserves with smaller adjustments of current account positions (relative to prospective net inflows of official and private equity capital).

A quite different situation would prevail if recipient countries used transferred SDRs to purchase foreign goods and services and, as a result, their reserves were not increased. While the temporary use of these SDRs to meet transitory payment imbalances would be part of normal reserve management practices, a sustained use would be inconsistent with the objective of reserve accumulation. In seeking to avoid such a sustained use, the Belgian and French proposals would tie the redistribution of SDRs to adjustment programs reflecting some form of conditionality and repayment while the Sengupta proposal would establish a reconstitution or repayment requirement.

A willingness on the part of developing countries to hold the SDRs they received (or their equivalent in foreign exchange) might also facilitate the restoration of creditworthiness. To the extent that these countries were able to restore their access to private financial markets during the period of the transfer, their reserve holdings could also be maintained by borrowing from private markets even if they had to repay the transferred SDRs at the termination of a temporary redistribution arrangement. However, for those countries that had not successfully restored access to private financial markets, the repayments of the borrowed or transferred SDRs would reduce reserves.

The potential effects on international reserves and liquidity associated with each of the three proposals would differ as a result of the differences in the arrangements envisioned. For example, the set of countries that would have access to transferred SDRs could be quite different under the three proposals. Since the transferred SDRs would only be available to countries undertaking Fund-supported adjustment programs under the Belgian proposal, not all countries with limited access to private financial markets would necessarily have their reserve holdings supplemented under this arrangement. Moreover, any rebuilding of reserve holdings associated with the lending of SDRs as part of a Fund-supported adjustment program would provide only a temporary source of reserves, as these transferred SDRs would be available only for the duration of the Fund program.

1/ However, as already mentioned, in the Articles of Agreement there is the expectation that a participant will not use its SDRs to obtain an equivalent amount of currency in a transaction by designation unless it has balance of payments need.

Since the French and Sengupta proposals do not envision arrangements that would distribute transferred SDRs through Fund lending in support of adjustment programs, the implementation of these proposals might initially affect a potentially larger number of countries than would implementation of the Belgian proposal. While the set of countries that would be eligible to receive transferred SDRs under the French and Sengupta proposals would be determined on the basis of some yet unspecified criteria, the criteria could be such that countries not undertaking Fund programs could qualify to receive the transferred SDR.

The ability of countries to make temporary or sustained use of the SDRs transferred to them under the French and Sengupta proposals would also differ. The French proposal envisions a temporary transfer of SDRs that would be repaid when the arrangements were terminated. Moreover, the French proposal links the availability of the transferred SDRs to an appraisal of the Fund's Executive Board of each country's economic policies, its needs for reserves, and the prospect that these SDRs would effectively strengthen their reserves. Sustained use of transferred SDRs would thereby be limited in the French proposal both by the appraisal of the Fund's Executive Board regarding the likelihood that these SDRs would be added to reserve holdings and by the limited duration of the transfer arrangements. In contrast, the Sengupta proposal could involve a permanent transfer or earmarking of SDRs, and, while use of these SDRs would not be subject to conditions, sustained use would be restricted by a requirement of reconstitution or repayment.

In considering the size of an SDR allocation, account would need to be taken of whether the allocation would be accompanied by a redistribution arrangement. In some circumstances, the combination of SDR allocation and certain redistribution arrangements could result in an increase in reserves that would exceed the increase resulting from the allocation alone. For example, if SDRs were lent by certain members to other members, or currencies were lent by certain members to the Fund so that it could acquire SDRs, the resulting claims of the lenders on the borrowers or on the Fund could be included in the lenders' reserve holdings provided these claims were sufficiently liquid. As a result, there initially could be an increase in reserves reflecting both the SDR allocation and the liquid claims arising out of the redistribution of SDRs.

For those versions of the proposals that involve lending of SDRs (or lending of currencies), consideration would have to be given to the liquidity of lenders' claims on either the Fund or other borrowers. If the Fund were to borrow on its own account (as in the Belgian proposal), the liquidity of the claims of the lenders on the Fund would need to be ensured by the Fund in a manner to be agreed. If the Fund were to act as a monitor in an arrangement in which SDRs were lent among members, the liquidity of the lenders' claims on recipients of the transferred SDRs might be ensured by other means, for example, through provision for a lender to transfer its claims to other lenders.

Effects on inflation and adjustment

The implementation of any of the three proposals for redistributing SDRs could also have effects on the general performance of the international monetary system, especially in regard to inflation and adjustment. One concern raised by some observers has been that SDR allocations would be inflationary and weaken adjustment. A key issue is whether combining an SDR allocation designed to meet the long-term global need for reserves with arrangements to redistribute SDRs would make such an allocation inflationary. As has been examined in the various papers prepared for Executive Board discussions of SDR allocation in the fourth basic period, the inflationary effect of such an allocation is related both to the extent to which the allocated SDRs are held rather than used by recipients and to any change in countries' macroeconomic policies induced by the receipt of SDRs. If all countries added the allocated SDRs to their reserves and if the industrial countries were generally to achieve their announced monetary targets, then SDR allocations would not likely be inflationary or create expectations of higher inflation. Even if the allocated SDRs received by the developing countries were to be spent on goods imported from the industrial countries, the potential inflationary effect would depend principally on whether the industrial countries allowed their monetary bases to expand in line with their receipt of SDRs. 1/ In addition, inflationary effects could also arise in developing countries if the SDRs allocated to them were exchanged by the government for domestic credit at the central bank. However, even if modest SDR allocations were fully monetized in either country group, the potential effect on monetary bases, and therefore on inflation, would be small.

In addition to voicing concerns about the inflationary potential of SDR allocations, with or without arrangements to redistribute SDRs, some have expressed the view that allocations would weaken adjustment efforts. One issue is therefore whether the arrangements for redistributing SDRs would allay their concerns. The Belgian and French proposals seek to address this issue by tying the redistribution of SDRs to a form of conditionality and to a repayment requirement. The Sengupta proposal would rely on a repayment or reconstitution requirement. These measures would be in addition to the already existing incentives to maintain adjustment efforts that have been provided by the fact that the availability of new bank money and the willingness of creditors to undertake rescheduling depends on continued progress in adjustment.

1/ For an allocation of SDR 10 billion, a transfer of developing country SDRs to the industrial countries would be equivalent to about 1/2 of 1 percent of the monetary base of the industrial countries at the end of 1985.

Issues relating to the implementation of the proposals

Discussions of the Belgian, French, and Sengupta proposals have raised a number of issues regarding the consistency of these proposals with the Articles of Agreement, the legal complexities involved in implementing the proposed arrangements, and the implications of adopting any of these proposals for the reserve asset characteristics of the SDR. Regarding the legal form of the arrangements, the Belgian proposal has been examined by the Fund's Legal Department, 1/ which concluded that it could be structured so as to be consistent with the Fund's Articles of Agreement, provided that (1) there exists in the judgment of the Fund a long-term global need to supplement existing reserve assets; and (2) participants not agreeing to channel SDRs to the Fund would receive their share of allocated SDRs and be free to use it. The Legal Department also concluded that the proposal would not result in the creation of a type of "conditional SDR," as the characteristics of the asset would remain unchanged. The principal novel features of the proposal would be the linkage of a decision to allocate SDRs to the adoption of the proposed arrangement and the use by the Fund of borrowed currency to acquire SDRs from the lenders for the purposes of the Fund's transactions through the General Resources Account. Other appropriate arrangements would have to be found for implementing the other proposals. 2/

Even if the proposals could be structured in a manner consistent with the Articles, concerns have been raised about the need to obtain parliamentary approval for any lending of currencies to the Fund (as is envisaged in the Belgian proposal) or any lending or donation of SDRs to other countries. In part, the French proposal was designed to minimize the need for parliamentary approval by substituting lending of SDRs to countries for the lending of currencies to the Fund. It has been pointed out, however, that in some countries parliamentary approval would be required for either type of lending, except possibly for lending to countries under special short-term arrangements. These concerns would also be relevant with respect to the authorization for transfers to a permanent SDR overdraft account or the establishment of blocked SDR accounts under the Sengupta proposal. In addition, some

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1/ "Proposal of the Belgian Deputies of the G-10 for a Conditional Use of SDR Allocation," EBS/84/191.

2/ For the implementation of the French and the Sengupta proposals, operations in SDRs would be made either under existing prescriptions or under new prescriptions pursuant to Article XIX, Section 2(c) of the Articles of Agreement. In this context, the lending of SDRs has been authorized by Executive Board Decision No. 6001-(79/1)S (12/28/78), and the donation of SDRs has been authorized by Executive Board Decision No. 6437-(80/37)S (3/5/80).

have argued that the negotiation of the agreements concerning the terms and conditions under which the transfer of SDRs would take place could be very complicated and involve an extended period of time.

Concerns have also been raised about the adoption of any of these proposals for the reserve-asset characteristics of the SDR. Some G-10 Deputies noted that the proposals whereby SDRs would be used to finance Fund adjustment programs "...could also blur the distinction between the SDR and conditional IMF credit..." 1/ In addition, the G-24 Deputies opposed the concept of "conditional SDRs" and argued that "only an unconditional SDR allocation could provide the required reserve strength..." 2/ To be sure, the characteristics of the SDR as an asset would not be affected by the implementation of the Belgian and French proposals: the valuation of the SDR, its interest rate, and the conditions for its use would not be changed. The Sengupta proposal was partly designed to retain the unconditional character of the SDR. However, some have argued that reinstituting some version of a reconstitution requirement under these arrangements would also reduce the owned-reserve characteristics of the SDR.

IV. Implications for the Role of the Fund

The three proposals discussed in this paper have envisaged various degrees of Fund involvement in arrangements designed to facilitate the transfer of SDRs among member countries. Two related questions merit consideration. First, what activities would the Fund undertake under these proposals? Second, how would these activities affect the general role of the Fund and its relationship with members?

As discussed above, the activities of the Fund envisioned under these proposals could differ markedly. One possibility is that the Fund would serve as a general monitor to oversee and record transactions among participants; this would appear to be an element in variants of the French or the Sengupta proposal. Alternatively, the Fund could borrow currencies on its own account, acquire SDRs, and lend them under the general policies governing the use of its resources or under special policies established for this purpose; such activities would be a part of the Belgian proposal. Another level of Fund involvement could be arranged under the provisions of Article V, Section 2(b) of the Articles of Agreement, which provides that "[i]f requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund." 3/ Such activities would appear to be elements

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1/ Report of the G-10 Deputies, "The Functioning of the International Monetary System," EBD/85/154, para. 75.

2/ Report of the G-24 Deputies on "The Functioning and Improvement of the International Monetary System," EBD/85/228, para. 105.

3/ Article V, Section 2(b) also provides that "[o]perations involved in both the French and the Sengupta proposals. In both cases, the Fund would render services to some member countries ready to lend or donate SDRs to other members under certain agreed rules.

In comparing the role of the Fund in implementing the three proposals, it is useful to distinguish between arrangements involving the redistribution of SDRs through Fund lending in support of adjustment programs (as in the Belgian proposal) and other arrangements that do not involve the Fund as an intermediary (as in the French and Sengupta proposals). As already indicated, the Belgian proposal would initially involve a transfer of SDRs at the time of an allocation from countries that do not need additional reserves to the General Resources Account of the Fund, with the Fund borrowing currencies from members in order to purchase the newly allocated SDRs. These purchases would increase the liquid resources of the Fund and would enhance the SDR basis of Fund operations. The increase in the Fund's liquid resources financed by borrowing currencies on its own account from member countries would reduce its need for other sources of financing, including quota increases. In connection with the new borrowing and the use of the resources obtained, issues to be resolved would include: (1) whether the current guidelines for borrowing by the Fund would have to be revised; 1/ (2) how the various measures of Fund liquidity would be affected; and (3) whether and how the lending of the resources obtained under the proposal would affect the Fund's access policies. 2/

One possibility regarding the coordination of lending under the Belgian proposal with lending under enlarged access policy would be for the resources obtained by the Fund through an SDR allocation to be totally integrated with other resources of the General Department. In such a case, it would appear that the conditionality for the use of the additional resources should be the same as generally in effect.

In contrast to the Belgian proposal, in which the redistribution of SDRs would reflect the pattern of Fund-supported adjustment programs, the French and Sengupta proposals would involve the Fund serving to monitor the transfer and to provide various services. Although the transfer and use of SDRs under the French and Sengupta proposals could be monitored under a variety of potential bilateral or multilateral arrangements, the role of the Fund in the administration of the SDR Department implies that the Fund could conveniently serve as a central monitor of such transactions. Moreover, such a role is implied in the French proposal by the requirement that an evaluation be made by the

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3/ (Cont'd from p. 17) in the performance of such financial services shall not be on account of the Fund. Services under this subsection shall not impose any obligation on a member without its consent."

1/ These guidelines establish that quota subscriptions are and should remain the basic source of the Fund's financing.

2/ A particular issue to be addressed is that access to the Fund's general resources must be uniform for all members.

Executive Board of recipient countries' reserve needs. The role of the Fund as a provider of services both in the French and the Sengupta proposals could be arranged under the provisions of Article V, Section 2(b) of the Articles of Agreement, provided these services are consistent with the purposes of the Fund.

Although the arrangements under the French and Sengupta proposals do not involve the Fund lending on its own account, they could have implications for the Fund's policies on the sources and uses of its resources. The arrangements would constitute a new source of financing for recipients, which the Fund would have to take into account in assessing the need for use of Fund resources and determining the parameters of Fund programs.

V. Concluding Comments

This paper has examined three proposals for arrangements that are intended to alter the distribution of newly allocated SDRs so as to increase the proportion of these SDRs going to countries with relatively large reserves needs. The proponents argue that such arrangements could, to varying degrees, strengthen the linkages between SDR allocations and adjustment efforts and reduce or eliminate any potential inflationary impact of SDR allocations. If these arrangements were combined with SDR allocations that meet a long-term global need for reserves, countries with little access to international financial markets would be able to rebuild their reserve holdings without having to adopt restrictive policies designed to improve current account positions relative to prospective net inflows of official and private equity capital.

While the proposals share these common objectives, they differ in important respects relating to their permanence, the conditions for use of transferred SDRs, the mechanisms for transfer, and the role of the Fund in the prospective arrangements. In particular, the Belgian and French proposals envisage the temporary utilization of transferred SDRs in connection with members' adjustment programs agreed with the Fund (Belgium) or appraised by the Fund (France). The proposal advanced by Mr. Sengupta envisages a permanent reallocation of the availability of SDRs to recipients. It attaches no policy conditions to the actual use of the SDRs that are made available, but does envisage a repayment or "reconstitution" requirement to ensure that such use is temporary, implying that policies would be implemented by recipients if necessary to make repayment or to reconstitute holdings.

From the point of view of the role of the Fund, all of the proposals would involve an increase in the amount of reserves available or potentially available to certain members. The increased availability of reserves would need to be taken into account by the Fund in assessing members' financing requirements and determining access to the Fund's resources and, under the Belgian proposal, would directly affect the

Fund's capacity to provide financing. The Fund's involvement would be relatively modest under the arrangement advanced by Mr. Sengupta in that, although the Fund might administer the transfer of SDRs among participants, it would not be asked to advise on recipients' economic policies in connection with the arrangement and its resources would not be engaged. The French proposal would envisage for the Fund the more substantive role of providing policy appraisals, but would not engage Fund resources and the transactions would take place among participating members without Fund intermediation. The Belgian proposal is of a substantially different character, envisaging both the requirement of a Fund adjustment program and the direct involvement of the Fund as a financial intermediary, utilizing resources deriving from the proposed arrangement. In that sense, the Belgian proposal should be viewed not only as an arrangement for the redistribution of SDRs but also as a technique for the funding of the Fund, and would need to be assessed in that light as well.

Statements by Mr. de Groote, Mr. de Maulde, and Mr. Sengupta
Relating to Proposals for Redistributing Allocated SDRs

Excerpts from the Statement by Mr. de Groote
on SDR Allocations
Executive Board Meeting 83/115
August 1, 1983 1/

The suggestion I have already made, several times, to this Board in favor of a conditional use of SDR allocations is not necessarily a replacement for the traditional allocation whose size is now based on the attempted evaluation of the overall need for owned reserves. Conditional use could either supplement or substitute for the traditional exercise, according to the Board's judgment. In essence, as you well know, this approach would consist in making the use of the allocated SDRs dependent on a Fund program. Deficit countries which were implementing such programs would have access to the conditional allocation in two ways: first, by qualifying to use their own share of the conditional allocation in the framework of a Fund-supported program, and secondly, by obtaining SDRs lent to the Fund by countries in surplus, out of their conditional allocations. Some kind of designation plan would obviously be needed to ensure the movement of SDRs from the allocations of surplus countries to the financing of Fund-supported programs. However, no amendment of the Articles would be required to permit implementation of such a scheme. At the outset, it would suffice to obtain the formal commitment of the members that they would use their conditional allocations only when in deficit and under conditions approved as part of a Fund program; and that, when in surplus, they would be ready and willing to lend their conditional allocation according to a periodically revised designation plan. It will be necessary to settle some technical issues, involving the precise moment when the SDRs are considered as being lent to the Fund and, therefore, the burden of the interest rate payment. As far as I can see from a preliminary examination of these problems, and from exploratory talks with some of my colleagues, none of these technical questions raises any fundamental obstacle. The real problem is to know whether we wish to devise a new approach to the use of the SDR and then find the appropriate techniques, or whether we wish to use the existing techniques as an obstacle to further progress.

The approach I have suggested, albeit in a very sketchy manner, would have the important advantage of not requiring an a priori demonstration of the desirability of a precise amount of global allocation: the total amount of the conditional allocation would be very broadly indicated by reference to general conditions. The particulars of each individual case would indicate how much of the pool of conditional SDRs would be activated. This manner of proceeding would greatly allay the doubts and fears of those who have always been dissatisfied with the mechanical aspects of SDR allocations.

1/ Buff statement issued on August 5, 1983 (83/115).

I do not believe that in the present circumstances the notion of a conditional SDR allocation can receive sufficient study, before the convening of the Interim Committee, to become an effective proposal. I do hope, however, that my colleagues will show enough interest in this approach to mention it, as a matter deserving further reflection, in the communiqué. Meanwhile, I would be most happy to have a further exchange of views in this Board, after the recess, in order to refine the delineation of the idea, assuming that there is any interest in it, and to bring out the essential differences between this proposal and a quota increase.

Mr. de Groote's Statement at
Executive Board Meeting 84/45
March 26, 1984 1/

While there seems at present to be ample justification for an allocation of SDRs, support for an allocation is not yet sufficiently widespread to permit a positive decision. The proposal for the conditional use of SDRs attempts to strengthen the chances for approval of an allocation by answering the principal objections standing in the way of broader support, in allowing an SDR allocation to make a better contribution to the adjustment process. The fundamental purpose of the proposal is to establish an effective link between SDR allocations and the adjustment process, without attempting to define specific options as to what group of countries would cede their allocations for conditional use or how much of an allocation would be set aside for such use. Those options will have to be further defined in the light of latter discussions of the scheme.

The proposal for the conditional use of newly allocated SDRs aims essentially to preserve the ability to create international liquidity through the IMF in the form of SDRs by adapting the use of these resources to the present need for adjustment, without modifying in any way the system of SDR allocation as defined at present by the Articles of Agreement. This adaptation would remove the two major objections to the resumption of SDR allocations, namely, that unconditional use of the allocated SDRs would delay the adjustment process by placing deficit countries in a position to spend their newly acquired reserves, and that the allocation, would grant unconditional reserves to countries that do not need them. The proposal would establish a clear link between the need for better adjustment and the use of an SDR allocation.

The envisaged scheme would not change the present system of allocating SDRs: the conditions outlined in the Articles of Agreement for justifying an allocation of SDRs and for determining its size and distribution among the members would all operate according to the existing rules. Only a supplementary arrangement would be worked out, to ensure that the utilization of the SDRs thus allocated would be aligned with the need for more adjustment.

This proposal does not imply that all allocations of SDRs should necessarily be implemented according to the proposed scheme: new allocations could indeed be made along the traditional lines when the global liquidity need would be more pressing then the need for adjustment; alternatively, an allocation could be made partly along traditional lines and partly according to the new scheme, as warranted by current circumstances. In agreeing to an SDR allocation under the present proposal, members would therefore have to accept the condition that the final use of a part or all

1/ Buff statement issued on March 20, 1984 (84/46).

of the SDRs allocated would be governed by additional provisions designed to make sure that these resources become usable only in conjunction with an adjustment program.

The scope of this agreement would vary according to whether all or only some of the participants would place all or a part of their allocation at the disposal of the Fund, which could then onlend these additional resources to countries submitting to adjustment programs. The range of options could extend from the extreme case where all members would lend the totality of their allocation to the Fund for conditional use, to the other extreme under which only a group of countries would lend a part of their allocation for conditional use, while another group would freely use its allocations. Obviously, all these options have different implications for the distribution of the newly created international liquidity and for the associated adjustment efforts.

Whatever the option chosen for the part of the allocation that would be subjected to conditional use, the most acceptable technique from the legal standpoint would be for the Fund to borrow the currency of each member in amounts equal to the amount of SDRs allocated to it, and to purchase SDRs from each country in exchange for that country's own currency.

The proposal for a conditional use of SDR allocations satisfies several important objectives:

(a) The SDR allocation reserved for conditional use would be directly linked with the adjustment process. Such allocation would introduce an additional incentive for corrective action and provide resources that would make the adjustment process more effective, rather than permit adjustment efforts to be deferred if deficit countries were spending these resources.

Moreover, the SDR allocation reserved for conditional use would not in and of itself lead to a general increase in immediately usable reserves, since these additional reserves would be lent to the Fund. Only the extension of Fund credit financed by these SDRs would lead to an increase in the volume of effectively usable SDRs, and any such increase would automatically be canceled by the repayment of this credit to the Fund. There would thus be a strict parallelism between financing and adjustment.

(b) The newly allocated SDRs for conditional use would be channeled to those countries that have a real need for reserves to support their adjustment efforts instead of providing liquidity to countries that do not need it, as with the present system of allocation. This would optimize the use of SDRs, since the SDRs allocated to countries that do not need the supplementary reserves would be onlent to the Fund, which would pass them through to the deficit countries; the amounts to be allocated could therefore be less sizable than is currently the case.

(c) The goal of making the SDR the principal reserve asset would be reinforced as available SDR reserves are increased, thereby contributing to a better composition of international reserves. Indeed, a basic objective of the international monetary system is to achieve a reserve composition in which the role of the SDR is maintained and even strengthened so as to control international liquidity better.

(d) Whether or not the Fund's liquidity will be improved depends on whether or not additional drawing possibilities are created. If the newly created SDRs are entirely used to finance drawings additional to those under the present policy of enlarged access, the Fund's liquidity position will not improve; if, on the other hand, these resources are used to finance existing drawing possibilities, the Fund's liquidity will be considerably strengthened.

Several aspects of the foregoing deserve further comment:

(a) The proposal is no panacea for replenishing the Fund's resources, compared with the concluding of new borrowing arrangements. The procedure needed to allocate SDRs and to lend the allocated SDRs to the Fund may well be as cumbersome as those involved in negotiating borrowing arrangements with creditor countries.

(b) There would be no permanent adaptation of the system of SDR allocation. As the arrangement would take the form of a borrowing operation of the Fund, the conditional use of the SDRs would not necessarily be permanent: indeed at the end of the borrowing period the Fund should review the situation and could decide either to maintain the conditional use of the SDRs or to convert the SDRs into unconditional liquidity by unwinding the borrowing arrangement.

(c) The proposed procedure is to be viewed as a temporary expedient, tailored to the present specific needs for adjustment. It would establish a long overdue link between SDR allocation and the adjustment process. Ideally, the aims of the scheme could have been achieved if allocations had been decided on in connection with quota increases and if the SDRs then allocated had been used to subscribe to part of the quota increase. Since this option was not exercised at the time of the most recent quota increase, other formulas must now be considered to permit an SDR allocation and to ensure its conditional use.

(d) The proposed legal framework for linking an SDR allocation with the adjustment process--indirect lending of the SDRs to countries with adjustment programs--does not require any amendment of the Articles of Agreement. It also deals effectively with the Fund's limitation that it cannot borrow SDRs but only currencies.

(e) Technically, this allocation method would avoid the problem of creating two kinds of SDRs. The characteristics of the SDRs created under the scheme would be the same as those of SDRs created by traditional allocations; a single acceptance limit would apply without distinction based on the uses to which the allocated SDRs are put. The SDR account would remain in equilibrium: the SDRs would be lent to the Fund at the moment of allocation using the legal technique suggested in the sixth paragraph. The Fund would receive interest on its borrowed SDR holdings, and that interest would accrue to the lenders and fully compensate their interest charges as a result of their SDR holdings being lower than their cumulative allocations. The credit financed by these SDRs would also bear interest at a rate equal to that on the SDR, and that interest would accrue to the original lender.

The proposal to lend allocated SDRs to the Fund to ensure their conditional use is not the only way to achieve a better integration of the system of SDR allocation in the adjustment process. Other proposals have been made, such as the reintroduction of the reconstitution obligation for SDRs and the obtaining of a commitment from members not to use their newly allocated SDRs.

The reconstitution requirement has a built-in incentive for adjustment since members would be required to earn foreign exchange to repurchase SDRs spent. The requirement would, however, make the SDR a qualitively less attractive reserve instrument, compared with other reserve assets. It is, moreover, a cumbersome procedure, as members must constantly check their SDR holdings to ensure that their average holdings are in compliance with the reconstitution requirement.

A pledge not to use the SDRs allocated at a certain moment would require establishing a distinction between those holdings that are freely usable and those that are subject to conditional use.

Both formulas, while achieving similar results, would nonetheless be less effective than the present proposal, which would preserve the character of the SDR and improve the efficiency of the reserve asset.

While being amendable to further developments in linking the SDR Department and the General Department of the Fund, the proposal retains the present system of SDR allocation with only a minor modification concerning the possible use of the SDRs created. This modification is deemed necessary to obtain agreement on the continuation of SDR allocations, without which the SDR may well soon join the talent, the farthing, the solidus, and the cowrie shell in the museum of monetary curiosa.

Excerpts from Statement by Mr. de Groote on
Allocation of SDRs in the Fourth Basic Period
Executive Board Meeting 94/131
August 31, 1984

Mentioning, as I just did, the possibility of using an allocation for reinforcing the Fund's role in the adjustment process prompts me to make a few remarks on Mr. de Maulde's note on this subject.

Mr. de Maulde's objectives seem to me to deserve a strong support. Directing the allocation where there is a need for additional liquidity, in the framework of a Fund appraisal of the economic policies of the member countries, is a proposal that has much in common with the one I submitted to you earlier. Mr. de Maulde sees, however, an important difference between both proposals in that his scheme would "probably" avoid the need for parliamentary approval since it only involves lending to member countries, a possibility already allowed for in the Articles. The real question here is to know which countries Mr. de Maulde has in mind. It is correct that in the five countries of my Constituency, lending of SDRs under Mr. de Maulde's scheme would be possible without parliamentary approval. But did he not have another country in mind? It was my understanding, when I started reflecting on a more effective use of a new allocation, that the Exchange Stabilization Fund that receives, in the U.S., the allocation, can lend its SDRs to the monetary authorities of another country for short-term swap operations, up to a maximum of three months. It would be difficult to qualify as short-term operation a continuous renewal of such swaps. Irrespective of the legal requirements on the matter, I would be surprised if a responsible government would decide not to ask for an approval of a scheme that, if not formally at least in substance, represents exactly the case for which an approval is required. Anyway, this is not a question to be answered by me. Both Mr. de Maulde's and my proposal being identical from the viewpoint of a needed parliamentary approval, I had felt it preferable, with the same objective in mind as Mr. de Maulde, to opt for a more straightforward and transparent solution, one also that would introduce a possibility for change in the role of the SDR and of the Fund itself. In that respect, Mr. de Maulde's proposal attempts to add an attractive feature to the allocation system as it stands today, under the assumption that an agreement could first be reached on such allocation; the suggestion that I submitted to you earlier can also be considered in cases where there is no agreement on a traditional type of allocation, but where there is a clear global need for additional reserves, evidenced by the inadequacy of Fund resources for financing acceptable adjustment programs. Under Mr. de Maulde's proposal, conditionality is an attractive extra feature of a decision that has to be justified on its own; under my proposal, conditionality is the raison d'etre of the envisaged allocation.

There are a few more differences between the French and the Belgian proposals on which I would like to draw your attention.

Mr. de Maulde indicates that under his scheme LDCs would have to accept conditional SDRs, but only for those lent back by industrial countries and he implies that this is a difference with my proposal; LDCs, in other words, would keep their allocation. This eventuality was explicitly envisaged in my statement of March 20, in which I left open different options in that respect. Allow me, Mr. Chairman, to quote from this statement:

"The scope of this agreement would vary according to whether all or only some of the participants would place all or a part of their allocation at the disposal of the Fund, which could then onlend these additional resources to countries submitting to adjustment programs. The range of options could extend from the extreme case where all members would lend the totality of their allocation to the Fund for conditional use, to the other extreme under which only a group of countries would lend a part of their allocation for conditional use, while another group would freely use its allocations. Obviously all these options have different implications for the distribution of the newly created international liquidity and for the associated adjustment efforts."

Although I thus left all options open for further consideration by my colleagues, it was, all along, my personal view that the best solutions would be as indicated and suggested by Mr. de Maulde, to have only industrial and oil producing countries lend their allocation to the Fund.

Mr. de Maulde's proposal essentially aims at ensuring that an allocation, hopefully in his view a large one, would be used for enabling LDCs build up reserves. Can this aim not be achieved by limiting the proposal to a reintroduction of the reconstitution obligation? If reserve rebuilding, rather than assisting the Fund in its role in promoting an adjustment, is what we are after, this is the obvious solution.

Mr. de Maulde feels that his system has the comparative advantage of simplicity. I do not discover much simplicity in the necessity for all lending members to register, in their accounts, for every drawing for which the loans are used, thus frequently, amounts that can be minimal and fractional. It is true that machines have by now rendered Habermeier's army to some extent obsolete. Still, on the other side of the transaction, I am not too sure that Central Banks would welcome the complexity of keeping track with, for instance, the share of Luxembourg in a drawing by the Maldives. I would have thought that one of the most obvious merits of my proposal consists in leaving entirely unchanged the present system and, specially, the present accounting procedures for drawings and the present rules for repurchase obligations.

Finally, let me observe that the Fund judgment underlying the use of the allocation available for lending refers, in Mr. de Maulde's proposal, to an appraisal of an individual country's needs for reserves. I am not too certain that it is possible to develop criteria for evaluating, on a case by case basis, such needs. Allowing the Fund to use part of the totality of the allocation for financing drawings as usual does not request the adoption of any new type of criterion for the use of Fund resources.

Let me say in ending, Mr. Chairman, that my remarks on Mr. de Maulde's very stimulating proposal should not be interpreted as expressing a disagreement on the objectives that it pursues. I am specially heartened in realizing that the preoccupation of better adapting the use of an allocation to present needs is gaining ground around this table.

I was heartened also by an interesting opinion, submitted by Mr. Nicoletopoulos at the request of the Chairman of the Deputies of the G-10, on the Belgian proposal. Mr. Nicoletopoulos was kind enough to show me a first draft of his text. My initial reaction was that there was not much need to have it circulated now, in order to avoid creating a confusion between the decision we have to take on a traditional allocation, a decision that should intervene at the occasion of the Annual Meetings, and a proposal that rather has its place in a general discussion of the reform of the Fund. If, however, now that we have before us an alternative proposal, my colleagues would find it useful to have, Mr. Nicoletopoulos' opinion, I would be glad to have it circulated here and to the G-10. I would, anyway, prefer to avoid transmitting to the G-10 a document that would not, at the same time, be circulated here. This is the practice I have followed up to now.

Note by Mr. de Maulde on Allocation of SDRs
Executive Board Meeting 84/130
August 31, 1984 1/

Over the past two years, the French Government has been supporting and advocating the resumption of SDR allocations. The view it held, and is still holding is that such an allocation is--in the present world economic circumstances--amply justified by the global need to supplement existing reserves. However it is clear that, although a vast majority of member countries share this view, there are still important member countries which are not yet fully convinced that there is a case for an allocation.

In order to help the emergence of a consensus, this note offers a few comments and suggestions on possible ways to meet the concerns of all IMF members.

1. Clearly, the easiest option would still be a straightforward allocation of a modest amount (SDR 20 billion, with 10 billion being allocated at the beginning of 1985, and 10 other billion at the beginning of 1986).

But it would have a very marginal effect on the reserves of heavily indebted countries. As an example, and assuming that the amounts allocated are not used for other purposes, the non-oil developing countries of the Western hemisphere would receive 1.46 billion. Such an amount would represent only 5.8 percent of the reduction in the non-gold reserves of these countries between the end of 1981 and the end of 1983. Taking gold into account, this percentage would even be lower.

In light of this, it would seem appropriate either to ensure that a larger share of allocations goes to indebted countries (2), or to agree on a larger allocation (3). These two options could also be combined to some extent.

2. Various possibilities offered by the Articles of Agreement might be explored to enlarge the share of indebted countries in an SDR allocation.

(a) There is first the possibility of allocating SDRs on the basis of quotas prevailing at a date other than the date of decision. Such a basis could be for instance quotas prevailing before the last review. But the improvement would then be negligible.

(b) The Belgian solution, or any similar one, is compatible with the Articles of Agreement, and basically attractive in as much as it could be focused--through the Fund--on priority needs, and allow control over allocated SDRs. But it may run into practical difficulties in the

1/ Buff statement issued on August 30, 1984 (84/143).

short term, in as much as it would entail a new funding operation of the IMF, and therefore require complex parliamentary agreements in some countries.

(c) A more fruitful possibility would draw form Article 19, section 2C, which allows for members to lend SDRs to other members. The scheme would only require a 70 percent majority to be set up, and could run along the following lines:

- industrial countries, and possibly some oil-producing countries, would commit themselves to lend SDRs, up to a given proportion of their new allocation, to developing countries;

- the interest rate would be that of the SDR;

- the drawings by LDC's would be linked to an appraisal, by the IMF Executive Board, of the countries' need for reserves, their economic policies, and the prospect that the SDRs being lent would effectively strengthen their reserves;

- in order to avoid complex discussions, the drawings on participating industrial countries would be uniform in relation to their share in the overall allocation;

- for the sake of simplicity also, the reimbursement period starting from each drawing should be uniform. Given the purpose of the scheme--the consolidation of reserves--the reimbursement should be over the medium term and provide for a grace period.

Such a scheme would be fairly well balanced: LDCs would have to accept conditional SDRs. But this would only apply to those lent back by industrial countries. It would also probably avoid the need for parliamentary approval since it would involve lending to countries, which is already allowed for by the Articles of Agreement.

In practice, the committment could involve 50 percent of the SDRs allocated to participating countries. Assuming the participation of all industrial countries in the scheme, and an overall allocation of SDR 20 billion, this would increase by a maximum of SDR 6.28 billion the amount which could be made available to LDCs. As an illustration, assuming all non-oil developing countries meet eligibility requirements and are the only ones to benefit from an SDR lending, the amount of SDRs made available to them would increase by 120 percent.

3. Such schemes may look somewhat complex to some. The second alternative could therefore be a larger allocation, in the order of SDR 30 billion (20 for 1985 and 10 for 1986).

In that case, it would be necessary to ensure that such a large allocation be used to build up reserves rather than to increase imports and consumption. The need to prevent too large drawings on designated currencies should also be borne in mind.

Such potential problems could be dealt with through a reactivation of the "reconstitution obligation", which has the great advantage of being a simple and technically well-known device.

If an amount of SDR 30 billion were allocated, as much as 30 percent to 50 percent of the allocation might then be initially frozen through the reconstitution obligation. This would help to meet the concerns expressed by some about the monetary risks of a large allocation.

Excerpts from Statement by Mr. Sengupta on
Implications of Changes in the International Monetary
System for the Role of the SDR
Executive Board Meeting 86/18
January 31, 1986 1/

7. The subject of distribution brings me to the important concept of "link" which developing countries had raised several times in the past. When we are attempting a thoroughgoing review of the role of the SDR, it will be necessary for us to examine this aspect in detail once again. Mr. Polack is right that with a rising cost of the SDR the old argument for link related to seignorage over the reserve assets is no longer that compelling. But still there are other arguments, especially those related to the distribution of liquidity commensurate with reserve needs, which should be examined. It is unfortunate that Mr. Polak thought that this might be a possible disincentive for SDR allocation. To us, it should be the reverse--especially because we believe this can be used as an effective instrument of international effort to help developing countries in the process of adjustment. After all, development assistance has been accepted by everybody as a desired international objective. The Report of the Committee of Twenty, whose deliberations I am afraid did not incorporate all the arguments in favor of "link" or consider all the various possibilities, however placed its emphasis on the right point. I quote:

"A link would contribute to the smooth functioning of the adjustment process, since, by enabling developing countries to run larger current account deficits, it would tend to relieve the tensions involved in the pursuit by developed countries of the current account surpluses that many of them prefer."

8. Even if the element of long-term resource transfer involved in the "link" proposal does not find general acceptance, there is a case for appropriate distribution of international liquidity to meet the reserve requirements of developing countries. This is justifiable purely on grounds of improving the efficiency of the system, as you will note from the quotation I have given above from the IMF Annual Report of 1966. There are many different ways in which the distribution of the SDRs could be made more efficient. At present, the SDRs are allocated to each country on the basis of its quota and this distribution does not take into account the needs of individual countries. The purpose of some of the earlier proposals made by Mr. de Groote and Mr. de Maulde was aimed at correcting this situation. Even when their proposals were discussed, we had stated that the allocations should be unconditional, as required under the Articles, and that we cannot support any conditional use of SDRs. Therefore, methods should be found which retain the SDR's

1/ Buff Statement issued on February 7, 1986 (86/20).

unconditional character, yet enable the Fund to change the distribution mechanism in such a way as to take into account particular needs of the world economy at the time of the allocation.

9. The immediate example one has is the present debt situation in many market borrower countries and the untenable reserve situation in most African and Asian economies which need an immediate substantial allocation. There could be several ways in which an efficient redistribution of allocated SDRs could be thought of and I would like to suggest an alternative to Mr. de Groote's and Mr. de Maulde's proposals, which retains the non-conditional as well as the reserve asset character of the SDR but being distributed more appropriately. For example, the SDRs allocated to countries that do not need them at the time of allocation, such as the industrial countries, could be reallocated to the needy developing countries. These developing countries should be allowed to retain the transferred additional SDRs permanently as an overdraft facility but use these SDRs, only if necessary, for a limited period, maybe three years or so--which may be fixed with reference to the world conditions or cycles of BOP adjustment--and after which they would be required to pay back the additional SDRs used by them. So long as these SDRs are not used but are kept as reserves, they do not pay any interest on them. * When they use the additional SDRs, the interest paid on them could accrue ** to the countries which originally provided the reallocated SDRs. The repayment would be like rebuilding their SDR holdings but not exactly in the same manner as that of the old reconstitution method. It would be more like unconditional lending for three years or so, if countries use them for meeting their reserve needs. Otherwise they would be held just as reserves in the form of an overdraft facility. A scheme on these lines could have several positive features.

First, it will ensure that for a given overall allocation, the needs of the more needy members are better met through the redistribution mechanism;

Second, it enables countries, especially those in serious debt problems, both low-income and major debtors, to augment their reserves immediately and enables them to undertake the adjustment measures needed for viability with greater flexibility and confidence;

Third, it will ensure that for the sake of reducing the immediate balance of payments gap, countries do not undertake measures that restrict growth such as a drastic reduction in imports and cutting down investment;

Fourth, in view of the fact that the additional SDRs are available only for a limited period of time, it encourages the country concerned to put in place quickly viable policies to achieve the needed adjustment within that period;

* Correction: "additional SDR," has been corrected to read "additional SDRs,"
** Correction: "rallocated SDRs." has been corrected to read "reallocated SDRs."

Fifth, it enables the Fund to play its role usefully as a provider of international liquidity for the purposes of stability of the international economy and in line with the provisions of the Articles of Agreement on SDR allocation; and

Sixth, it improves the role of the SDR and makes it a more useful tool for the promotion of international economic stability and growth.

To sum up, in addition to the points raised by Mr. Polak in his excellent presentation this morning, the staff and we in the Board could reflect on some of the following areas which I had covered a little earlier.

First, it appears necessary that we examine the statement that countries become creditworthy by following prudent adjustment policies and study as to how free market forces have responded to the needs of the countries which have undertaken strenuous adjustment measures in the past few years. What are all the perceptions that go into a banker's mind in determining whether a country is creditworthy or not? I think some deeper analysis in this area would be useful;

Second, the G-10 report also indicates that for developing countries which, despite adjustment efforts, lack sufficient access to capital markets, should be provided with official finance. When we discuss this aspect of the role of the SDR in the provision of international liquidity, it would be necessary to examine the mechanism suggested by the G-10 to generate such official finance and if it would be flexible and would be able to meet the liquidity needs of all such countries in an unconditional way;

Third, it is necessary also to examine how far the proposal of the G-24 relating to the link has relevance especially in relation to the developing countries; and

Fourth, we should also look into schemes on the lines I had outlined above as an example, which would have the necessary flexibility to meet the liquidity needs of countries in a difficult situation but at the same time put a timeframe for them to undertake voluntary adjustment. A scheme of that type could meet some of the important concerns, not only of those who are opposing an SDR allocation at this moment, but also those of the developing countries which do not wish to give up the unconditional character of SDRs, as that would be against the Articles of Agreement.

Proposal Relating to Allocation of SDRs
Linked to the Reserve Needs of
Developing Countries
May 28, 1986
(Aide Memoire Provided by
Mr. Sengupta to the Staff) 1/

My buff statement of February [7], 1986 outlined a proposal for allocating SDRs to the developing countries linked to the reserve needs of members. Since then we have discussed that question from different angles both in the Fund and outside. I have on several occasions elaborated on the details of the proposal with members of the staff. As these issues are now being examined by the staff for a Board paper, I thought it might be worthwhile to spell out the characteristics of the proposal, as I see it, to help the staff study them from all different angles.

The idea behind this proposal is to make available to the countries with greater reserve needs, additional SDRs over and above their usual allocation, to be held normally as reserve assets, which could however be used, if necessary, to meet short-term contingencies of payments deficits. In order that these additional SDRs closely approximate the characteristics of owned reserves and functioning as surrogate reserves, from the points of view of the recipient countries, as well as their creditors, the access to the use of such reserves by the recipient countries should be permanent and unconditional. The arrangement of this allocation should be so devised as to ensure that these additional SDRs would normally be held and not spent, but there should be no bar to their use when the need arises, provided the amounts spent are replenished or reconstituted within a given time. Except for this temporary nature of their use, these additional SDRs should be available to the recipient countries to be used like any other reserve assets. In other words, the access to these surrogate reserves through the "overdraft" mechanism suggested by me should enable the countries to substitute them, if it is desired, for other normal reserve assets.

The mechanism under these arrangements could work out as follows:

First, SDRs should be allocated as usual, to all countries according to their quotas.

Second, the developed countries, which have no reserve shortage, should agree to a voluntary withdrawal from the use of the newly allocated SDRs. (Flexibility can be introduced here, allowing some countries in special need to revoke their withdrawal pledge after consulting the IMF, because all SDRs are not expected to be used at any particular time.) This withdrawal can take a number of alternative forms depending upon the legal requirements of the Fund procedures, as follows:

1/ This aide-memoire was provided on an informal basis to facilitate discussion and does not necessarily reflect official views.

a. The developed countries after agreeing to the overall allocation of SDRs, may not exercise their right to receive their share of SDRs, so that the Fund could allocate the SDRs thus given up by the developed countries to the developing countries in proportion to their quotas as "special SDRs" in an overdraft account to be operated according to specified rules. If SDRs are not allocated to begin with to the developed countries, the effective surrender of SDRs by them would not entail any payment of additional charges. So long as the allocated special SDRs into the overdraft account are not used by the recipient developing countries, there would be no net payment of charges or interest on them either.

b. The developed countries need not surrender the SDRs allocated to them but pledge that they would not use them but hold them in a blocked account (except under special circumstances by arrangement with the Fund) in which case also there will be no net payment of interest or charges. The developing countries on the other hand would receive from the Fund additional "entitlements" or "claims" to overdraft facilities for amounts, in proportion to their quotas, but which would add up to the sum of SDRs allocated to the developed countries. These overdraft facilities could be used unconditionally, as and when needed by the recipient countries, provided that the SDRs used from this facility are replenished in a given time period. When a country uses these facilities or activates the overdraft account, it will receive SDRs from the Fund and will start paying charges on them from the date of such receipts. The Fund would provide the developing countries such SDRs by withdrawing them from one or a number of developed countries according to a scheme similar to the present designation plan. The developed countries would release these SDRs from their blocked SDRs earlier allocated to them. They will, however, receive these SDRs back, from the developing countries through the Fund, in exchange for their currencies. On SDR account, therefore, there will be no net change in the holding of SDRs of the developed countries and therefore no net payment of charges or interest. However, the developed countries will receive interest on the currencies released by them for use by the developing country which activates its overdraft account. The interest thus received by the developed countries would be equal to the charges paid by that developing country to the overdraft account.

c. The developed countries could transfer the newly allocated SDRs to the developing countries, right away after the first allocation according to an arrangement worked out by the Fund, under which the transferred amount of SDRs to the developing countries would be kept in an overdraft account in proportion to the quotas of the developing countries. This would be like the developed countries lending SDRs directly to the developing countries, except that it will be like permanent lending, and there should be an agreement that the recipient countries would pay interest (at SDR rate) to the developed countries on the entire amounts transferred. The developed countries in transferring the SDRs to the developing countries would reduce their SDR holdings and pay charges to the Fund equal to the amount they will receive back from the developing countries as per the rule of the transfer. The developing countries would hold additional SDRs and therefore will get interest from the Fund which they would pay to the developed countries according to the same rules of the transfer. Therefore, so long as the SDRs are not actually used, there will be no net payment of interest or charges either by the developed or by the developing countries. If after this a developing country wishes to use its SDRs by activating its overdraft account, it will reduce its SDR holdings and therefore will pay charges. The developed countries following the designation plan as specified, in the alternative (b) above, would release currencies against SDRs accepted by them; their holdings of SDRs will increase, and therefore they will receive interest equal to the amount of charges paid by the developing countries for using the overdraft amount.

Third, the access to the overdraft facility for the developing countries should be permanent and unconditional in the sense that the arrangements for the redistribution of the surplus SDRs of the developed countries should be such that the developing countries can use these SDRs unconditionally whenever they need. This would effectively imply that the developed countries would give up their right to use these SDRs. This would not necessarily involve giving up the ownership except that the transfer would take the form of a permanent lending facility. In fact when a developing recipient country repays the amounts used by them from the overdraft facility, the principals can be paid back to the developed countries. However, the developing countries must retain the right of using them again as necessary.

Fourth, the developing countries would have a permanent access to the overdraft facility, up to amounts in proportion to their quotas (with the upper limit that all such amounts add up to the total SDRs allocated to but not intended to be used by the surplus developed countries), but they can borrow SDRs from this facility only for a limited period. I suggested as an example that this period could be three years but there is nothing sacrosanct about it.

In my buff statement, I have elaborated on the merits of this proposal and I do not have to repeat them here. It has been pointed out to me that a permanent overdraft facility which can be used repeatedly can be converted into a permanent resource transfer, by drawing from the facility, then repaying it after three years and by drawing again from that immediately after the date of payment. I do not think this to be an important point because in an arrangement of international cooperation, if the facility is not meant for permanent use but for holding the amounts normally as reserves, recipient countries should be expected to adhere to the rules and use the additional SDRs as appropriate reserve assets. However to provide for some safeguards, one could think of some reconstitution plans. The rules for reconstitution were abrogated in 1981 so that the SDR would function fully, freely and unconditionally as a reserve asset. This indeed should be so. But some reconstitution could be thought of in respect of the special SDRs held in the overdraft account. In case this course of action is precluded on legal grounds, some alternative mechanisms, may have to be worked out. The main idea is to see that the recipient countries hold the SDRs in the overdraft account as reserves as long as possible. In this context, one suggestion is that the amount of SDRs used from the overdraft account for three years should not be available to the user again for at least one year thereafter. This, however, may be unnecessarily restrictive, because the country concerned may have a genuine need for using the additional SDRs in the fourth year. A better alternative would be to stipulate that special SDRs in the overdraft account could be used for any number of times, provided 100 percent of the special SDRs are held as reserves, in all for 365 days, which need not be consecutive but could be discrete, during any period of four years. In other words, for any 365 days in the total period of four years, the overdraft account of the recipient developing country should record 100 percent holding of the allocated special SDRs. Variations of this principle can be thought of but is important that the country has full access to the amount at any point of time, provided the country is willing to replenish or reconstitute the amount according to the rules.