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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/125

3:00 p.m., July 30, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	K. Yao, Temporary
	D. C. Templeman, Temporary
J. de Groote	
	T. Alhaimus
	M. Sugita
	B. Goos
Huang F.	
J. E. Ismael	Jaafar A.
A. Kafka	
	S. King, Temporary
H. Lundstrom	
	L. Leonard
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
	S. de Forges
J. J. Polak	
	A. V. Romuáldez
	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
	N. Kyriazidis

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: A. D. Ouattara, Director. Legal Department: F. Gianviti, Director; R. H. Munzberg, J. M. Ogoola. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; M. P. Dooley, D. Folkerts-Landau, P. Isard, D. J. Mathieson. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; D. Berthet, P. B. Clark, W. L. Coats, Jr., E. DeCarli, S. I. Fawzi, T. Heidorn. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: W.-R. Bengs, S. Ganjarerndee, J. Hospedales, K. Murakami, I. Puro, R. Valladares, A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, B. Bogdanovic, F. Di Mauro, W. N. Engert, G. Ercel, V. Govindarajan, G. K. Hodges, A. H. Mustafa, W. K. Parmena, M. Rasyid, D. Saha, C. A. Salinas, L. Tornetta, H. van der Burg.

1. SDRS - PROPOSALS FOR POST-ALLOCATION ADJUSTMENT IN DISTRIBUTION

The Executive Directors considered a staff paper on proposals made by Executive Directors on previous occasions for a post-allocation adjustment of the distribution of SDRs (SM/86/154, 6/24/86).

Mr. Nimatallah said that, in light of the growing problem of overdue financial obligations to the Fund, it would be useful for the staff to comment on the steps that would be taken under the various proposals in the event that redistributed SDRs were not returned to their original source. Would the Fund have any liability under the Belgian proposal?

The staff representative from the Treasurer's Department replied that a distinction should be made between the Belgian proposal and the other two proposals. The Belgian proposal would involve loans to the Fund and extension of credit by the Fund. Hence, the Fund would be at risk. Under the other two approaches, the risk would be on the countries that transferred the SDRs to other countries.

The Director of the Legal Department, responding to a question by Mr. de Groote, confirmed that there was some analogy between the GAB and the Belgian proposal. Under the GAB, transfers of resources involved a risk for the Fund.

Mr. de Groote made the following statement:

> The staff has given a fair and well-reasoned presentation of the different suggestions for a redistribution of SDR allocations. Most of the statements that I have made on this issue have been reflected in SM/86/154. Therefore, I can limit my intervention to a few remarks on the background against which some of the proposals were made.
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> The staff is correct in presenting the initial proposals as an answer to the major objection that was made in 1983 and 1984 to allocations, namely, that the industrial countries would not have an immediate need for additional reserves. The purpose of the proposals, in other words, was not at all to justify an SDR allocation, but rather to attempt to correct its distributional effects. Nevertheless, consideration of the proposals could substantially contribute to adapting the allocation process to present circumstances. It is indeed now generally recognized that the market mechanisms that underlie the supply of reserves do not as such guarantee that the level and distribution of reserves will necessarily correspond to countries' needs. The redistribution of an allocation might precisely be an answer to some of these shortcomings. Furthermore, once it is agreed that the allocations have to take place as a function of some recognized relationships, such as countries' imports, which seem to bear a stable relationship to the demand for reserves, the effective use of part of this allocation under Fund programs

would certainly, to that extent, offset the risk that the allocation would have the undesirable inflationary effects that some fear. Thus, there is an indirect but clear relation between the proposals and the justification for an allocation.

It might be somewhat artificial to try to distinguish the Belgian proposal from the French and Indian proposals on the basis that the Belgian proposal would meet countries' needs for credit while the other two proposals would directly meet the demand for reserves. Fund programs do assist countries in replenishing desirable levels of reserves and can explicitly refer to this objective, as is intended under the French proposal.

Two Executive Directors have asked me whether there is a contradiction between my proposal and Mr. Polak's suggestions with respect to a desirable relationship between members' SDR reserves and members' total non-gold reserves. There is, of course, no contradiction between these two proposals, because there is no direct relationship between them. Each one addresses different issues. However, the possibility for countries to maintain voluntarily an appropriate ratio between their SDR assets and their nongold reserves would be greatly improved if they were assisted in the implementation of Fund-supported programs by SDR loans, so that they could replenish their overall level of reserves.

Mr. de Forges made the following statement:

Since my authorities' views on this matter are well known and form a substantive part of the staff paper, I will limit myself to a few comments.

I wish to thank the staff for its comprehensive and valuable paper. It presents the arguments for and against a post-allocation adjustment in the distribution of SDRs in a remarkably clear fashion. Furthermore, the paper has the great advantage of refuting the usual objections to any new SDR allocation, especially if such an allocation is supplemented by the arrangements proposed by Mr. de Groote, Mr. Sengupta, or Mr. de Maulde.

Commenting on the impact of SDR allocations on international reserves and liquidity, the staff states on page 12 that "a modest allocation of SDRs supplemented by an arrangement to redistribute them would not be likely to affect significantly the relations of creditworthy countries with financial markets. 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."

As to the inflationary consequences of SDR allocations, the staff stated on page 15 that "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." Moreover, the staff concluded that "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."

In discussing the impact on adjustment, the staff stated on page 15 that "these (proposed) 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 depend on continued progress in adjustment."

The staff has highlighted the main advantages offered by such arrangements. These include the temporary and conditional character of the financing allocated in this manner, and the possibility of using SDR allocations to help to restore the creditworthiness of countries that have limited access to private financial markets.

Mr. de Maulde's proposal is a flexible one that is aimed at facilitating a necessary compromise. What is important is reaching the compromise; it is more important than the precise arrangement on which the compromise could be built. It was in that spirit that at the April 1984 meeting of the Interim Committee Mr. Camdessus, in discussing the so-called French proposal, said that "there is no need to repeat that a resumption of growth in world trade must be accompanied--if it is to be lasting and universal--by a general and sufficient expansion of official reserves. If we truly wish to see the expansion of trade to play its role, we must make the necessary financial accommodations. Do those who still hesitate to endorse an SDR allocation have other solutions to propose? If this is not the case, it appears to me that, at least, this allocation of SDRs must move ahead."

These questions are perhaps provocative, but they remain relevant. I do not expect to obtain answers to these questions today. Nonetheless, I hope to hear from Executive Directors whose authorities are steadfastly opposed to SDR allocations that arrangements along the lines of the three presented today would make allocations more palatable to them.

Mr. Sengupta made the following statement:

I believe that it has been fully established that there is a long-term global need to supplement international reserves. This has been demonstrated by the strains due to reserve shortages in the international monetary system, the deflationary pressure of the adjustment efforts of a large number of debtor countries, and the medium-term projections of imports and payments transactions and the reserve requirements to sustain those projected levels.

This global need also reflects the consequences of the highly lopsided distribution of reserves supplied by the existing system of international liquidity. With private financial markets emerging as the major source of official reserves, the distribution of international reserves depends primarily on countries' access to these markets. Whether or not such access can improve with appropriate policies, or whether some access and the resulting availability of funds are the prerequisites for adopting appropriate policies, or whether some reserves are necessary to earn confidence in a country's viability and creditworthiness, which determines its access to the financial markets, are all questions that are not analytically relevant to this discussion. The point is that the factors that determine a country's access to financial markets are not the factors that determine the country's need for reserves. Therefore, a system of distribution of reserves according to access to financial markets does not ensure distribution of reserves according to the need for reserves.

As a result, a majority of members having the overwhelming majority of the world's population has needs for reserves that are not satisfied by the existing system. This aspect of the global need supplements the systemic factors related to the conditions of the world economy that are taken into account in the assessments of the global need by the staff. The systemic factors of strains in the world economy are also in a sense a reflection of the lopsided distribution of reserves. Therefore, I believe that, while the global need establishes the case for a new allocation of SDRs, it also requires the institution of a scheme that improves the distribution of these SDRs. Even when SDRs are created, it is clear that the efficiency of a given volume of SDRs or reserves depends upon its appropriate distribution. The issue is more important now with the increasing shift to have the supply of reserves be determined by the market, which does not have a mechanism to ensure optimal distribution.

Of course, SDRs will be only a fraction of the total reserves, but the accumulation and regular allocation of SDRs according to proper distributional rules will allow an international official mechanism to correct the problems of international liquidity.

The proposal that I made is I hope a step in that direction. I have tried to ensure that any scheme for the allocation and redistribution of SDRs does not detract from the monetary or reserve asset character of SDRs, ensures that they will be held most of the time and will not be spent, and ensures that they will be seen by both the recipient countries and their creditors as reserves that are available without any bar on their use to meet any contingency.

The idea behind my 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 but which could be used, if necessary, to meet short-term contingencies of payments deficits. In order that these additional SDRs will have characteristics that are close to owned reserves and will function as surrogate reserves, from the viewpoint 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 such that it would ensure that the additional SDRs would normally be held and not spent, but there should be nothing standing in the way of their use when the need to use them arises, provided that the amounts spent are replenished or reconstituted within a given period. Except for the 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 that I have suggested should enable the countries to substitute them, if it is so desired, for other normal reserve assets.

It has been charged that the developing countries will not hold any SDRs that are made available to them but will promptly spend them. Why should they do so? The developing countries do hold reserves; in fact, their reserve holdings have increased even during periods of great hardship. The relationship between the level of nongold reserves and the volume of imports for capital-importing developing countries has been remarkably stable. If the countries concerned spend SDRs and hold other reserve assets, this shows no lack of demand for reserves to hold, but rather a relative preference for other reserve assets. The main factor affecting their portfolio decisions is not interest rates--the SDR interest rate is quite attractive--but the liquidity of the SDR and the increasing possibility of using SDRs as an intervention currency. This calls for working out mechanisms to increase the attractiveness of the SDR as a reserve asset and is not an argument for not augmenting the supply of reserves by an allocation of SDRs.

Under the scheme that I have proposed there will be some additional reason for holding the SDRs in the overdraft account, since as long as the overdraft account is not activated, the recipient countries would not have to pay anything and would have access to an amount of SDRs that could be spent any time to meet any contingency. This would be almost like having some owned reserves, which the countries would have acquired without the cost of generating a payments surplus and would be better than borrowed reserves, for which they have to incur the cost of borrowing. As long as the developing countries hold any reserves, they would be better off holding them in this cost-free overdraft account. These reallocated SDRs would be second best only to normally allocated SDRs, which were created--as was noted in the Report of the G-10 Deputies--to allow "nonreserve countries the possibility of acquiring reserves without having to obtain a balance of payments surplus," and as a result the SDR could alleviate somewhat the asymmetry of external constraints on national policies.

The introduction of a reconstitution provision would detract from the full reserve asset character of the SDR. That is why I have described it as a surrogate SDR. This issue was debated when the reconstitution provision was given up. I have suggested this reconstitution only for the additional reallocated SDRs to meet the objection that SDRs are normally spent as a means of resource transfer and are not held as a monetary asset. This presumption is not valid, and if there is a relative preference for other assets in the portfolio of reserve holdings, that should be corrected by improving the qualities of the SDR. However, to make doubly certain, I have suggested the introduction of the reconstitution mechanism but in a manner that does not detract from the character of the assets, so that they can be used freely whenever a contingency arises. The SDRs are supposed to be held entirely in the account for any 365 days, which need not be consecutive, in a four-year period. This gives the maximum flexibility in the use of SDRs without giving up the SDR's monetary character. I will not repeat my views on the Belgian proposal. There is one basic difference that is worth noting now, namely, that it is possible to use Mr. de Groote's proposal as a mechanism for borrowing funds from any other sources to build reserves. But the mechanism that I have been suggesting would make reallocated SDRs a reserve asset from the outset.

Mr. Polak made the following statement:

I agree with previous speakers that the paper provides a solid and systematic analysis of the three proposals for adjustment in the distribution of SDRs immediately after an allocation. Not all the aspects of these proposals have been fully clarified. In particular, some of the details of the plan proposed by

Mr. Sengupta remain somewhat vague. However, all three of the proposals are now sufficiently defined to permit an appraisal of their desirability.

Depending on how one looks at these various plans, one can find much that they have in common and important areas in which they are different. In my view--and apparently Mr. de Groote does not share this view--there is a marked difference between, on the one hand, the Belgian proposal, and, on the other, the French and Indian proposals. The Belgian proposal strikes me as being essentially a technique of using SDR allocations to augment the resources of the Fund. The main feature of the other two proposals seems to be that they provide a method by which countries that have easy access to reserves would help to meet the reserve needs of other members whose access to reserves was more limited, costly, or difficult.

Under the Belgian proposal, developed countries would lend allocated SDRs to the Fund which, in turn, could use those SDRs to make conditional loans to developing countries--or, presumably, to all members. This lending by the Fund would inevitably lead to conflicts about conditionality unless the additional resources were used by the Fund for transactions that are subject to the Fund's normal conditionality. In other words, it seems to be that the only possibility--and not what the staff referred to as one possibility--would be to have a total integration of the resources obtained by the Fund through an SDR allocation with the Fund's other resources, a point that was made on page 18 of the staff paper. If the use of other resources was indistinguishable from the normal use of resources, the Fund should continue to the extent possible to finance those transactions out of its own resources. This follows from the generally accepted rule that the Fund should finance itself primarily from quota contributions.

At the same time, when the Fund's own resources are insufficient to finance a degree of access that is considered necessary in particular circumstances, and the Fund must therefore borrow, I can see no good reason why such borrowing should be linked to SDR allocations, which would not simplify matters for the lenders and would introduce extraneous complications. Thus, in every respect I do not think that the Belgian proposal constitutes an attractive solution to the problems facing any significant group of members.

The French and Indian proposals are different in nature. Their objective is to have some or all of the developed countries, which have ready access to reserves, to lend all or part of their SDR allocations to some or all developing countries, most of which have considerable difficulty in acquiring the reserves that they need. The main difference between the two proposals is that the process of lending reserves under the French proposal would be conditional, on the basis of rules administered by the Fund, while lending under the Indian proposal would be subject to certain obligations to repay or to reconstitute. The purpose of those plans is clear and, at least at first sight, attractive.

However, I agree with the three points that Mr. Sengupta made about the nature of these plans. They are not link proposals; they are not proposals to use SDRs for development assistance. Rather, they are proposals under which some countries would help others by providing them, under certain safeguards, with reserves to hold; that is not to say that the reserves are never to be used to acquire goods and services, but rather that the reserves are to be used only in the case of need and will be rebuilt or reconstituted thereafter. I think that these three points were made by Mr. Sengupta in defense of his proposals, and I fundamentally agree with them.

What concerns me about these three proposals is not their broad aim but their implications for the SDR mechanism. These proposals appear to me to undermine the very logic of that mechanism. That presupposes that all countries have a need to increase their reserves over time and that SDR allocations meet that need in a manner that is beneficial to the international monetary system, even though it can be acknowledged that the developed countries could also meet their reserve needs without an allocation. If one were to design a system on the assumption that the lender countries did not need SDRs, assuming that allocations will be seen as being beneficial only to developing countries, this would only invite pressures to have allocations for the benefit of developing countries, thereby imposing on creditor countries a commitment to accept ever increasing claims on developing countries for the SDRs that they have lent them and, as Mr. Nimatallah said, at the risk of the lenders.

In sum, I do not think that it helps the SDR mechanism to devise mechanisms whose implicit aim is to find ways around provisions of the Articles that make allocations proportional to quotas. Incidentally, allocations in proportion to quotas lead to a distribution of SDRs between industrial and capital importing developing countries as groups that is not very different from that of the nongold reserves of these two groups. The quota system for allocation continues to be a reasonable way in which to allocate SDRs, which still constitute a beneficial component of the system of reserves. I am of course aware that a number of the larger countries have expressed reservations about the SDR system as it is currently defined in the Articles or about its usefulness in the present international monetary system. The best answer to these reservations is not to be found in drafting new and complicated variations on the present system but in the application of the system over a substantial period. To make the existing system more generally acceptable, it would be useful to reinforce it with some of the actions that were suggested by the Interim Committee at its April 1986 meeting.

Mr. Goos made the following statement:

I have serious reservations about the proposals discussed in the staff paper. The proposals are not helpful in promoting either the discussion of the role of the SDR in the present international monetary system or the idea of further SDR allocations. Accordingly, these proposals should not be pursued any further.

I wish to outline briefly my main concerns about the proposals. All three proposals have the fundamental shortcoming that they mix the issue of a global reserve need with considerations regarding the liquidity needs of individual countries or groups of countries. Correspondingly, as is mentioned on page 2 of the staff paper, "The proposals stress that the concept of a global need for reserves must encompass concerns about the distribution of reserves among countries." This chair has repeatedly contested the validity of that argument. In the real world, one can probably never observe an even distribution of reserves among countries. Hence, on the basis of this argument, one could always justify an SDR allocation in order to correct the situation. However, this would certainly lead to inappropriate results that would be comparable, for example, with the results of a central bank policy that the determination of the money supply should be guided by the liquidity problems of individual banks or local states. In my view, macroeconomic instruments like global liquidity creation through SDR allocations are completely inappropriate means to tackle structural or microeconomic problems such as individual liquidity shortages. My second main concern is that the proposals, although stopping short of establishing a direct link between SDR allocations and a transfer of real resources, might nevertheless pave the way for an introduction of such a link. In this regard, the reference on page 7 to per capita income as a possible criterion for the selection of prospective recipients is telling and indeed alarming. In this context, it is useful to recall that the Interim Committee's latest communiqué clearly states that "the SDR should not be a means of transferring resources."

The third point that I would like to make is that the proposals basically entail nothing more than the provision of additional temporary or permanent credits by industrial countries to the developing countries. To the extent that the potential donor countries are willing to provide such additional credits, they are certainly free to do so. In that event, there would be no need for special actions by the Fund. Moreover, to the extent that the proposed schemes would lead to compulsory credit extension, one probably cannot disregard the possibility of corresponding cuts in bilateral aid flows. Such a trade-off between SDR reallocations and cuts in bilateral aid might even occur if all participants were to enter into the proposed arrangements on a voluntary basis. Furthermore, if it were felt necessary to enlarge the Fund's lending capacity, as was suggested in the Belgian proposal, it would be more appropriate to consider that issue in the context of the regular reviews of the Fund's credit instruments, its access policy, conditionality, or quotas.

The proposals raise a number of questions concerning both their effectiveness and the need to provide the potential beneficiaries with additional liquidity. Moreover, there are considerable operational and legal problems, as the staff paper mentions, such as the need for parliamentary approval of the necessary SDR reallocation. For all those reasons and especially in the light of my fundamental reservations about the underlying concept of the proposed arrangement, I cannot support the proposals.

Mr. Zecchini made the following statement:

It is well known among Executive Directors that the fundamental criterion for an allocation of SDRs is the existence of a long-term global need to supplemental existing reserve assets. I am still committed to this criterion, and, therefore, I do not intend to approach today's discussion with a view to changing the global character of that criterion for assessing the reserve need.

It is clear that the current method of allocating SDRs cannot meet the present demand for reserves of many countries that have limited access to financial markets. For these countries, the only option that is now available in the face of an insufficient level of reserves and/or an external deficit is to accentuate the adjustment effort up to the point of generating a current account surplus the counterpart of which is an accumulation of owned reserves. In this context, I consider that the three proposals under examination are part of an attempt to offer these countries an alternative to an excessive deflation of their economies; the alternative would lead to a more orderly evolution of the adjustment process in the world economy. The pattern of resource allocation that will emerge will be less controlled by market forces and will be managed to a greater extent at the international level.

Although the three proposals share this common framework, they are designed to achieve different intermediate objectives. The French and the Belgian proposals do not involve any increase in the owned reserves of countries in need compared to the allocated SDRs; instead, the proposals provide a mere accretion of available financing. In contrast, the Indian proposal implies a permanent transfer of SDRs and, because of this, an expansion of the international reserve base on which a country can rely as a result of the addition of quasi-owned reserves. Furthermore, the first two proposals attempt to guide a country in the use of the additional resources in order to promote the longer-term viability of the economic situation of the country and consequently of the balance of payments positions in a worldwide context. The third proposal, instead, assumes that the country will make the best use of the new resources without the need for Fund intervention in the design and implementation of the economic program in order to make it consistent with the welfare of the world economy. In my opinion, it is unnecessary to delve into the many details of these proposals to reach a judgment on the advisability of these schemes. The main characteristics that I have mentioned are sufficient to reach a tentative conclusion.

I have difficulty in accepting the Indian scheme mainly for two reasons. First, it requires a permanent renunciation of some SDRs by the transferring country. Second, the assumption that the recipient country will use the resources in the best interest of both its economy and the balanced development of the world economy is too strong to be credible. Supplying additional resources through a redistribution of SDRs can be justified only if it is functional for the international management of adjustment, which necessarily involves some form of conditionality. Experience in the 1980s clearly shows the crucial importance of conditionality to this end. Conditionality is not an abuse of power by the creditor country, but rather a precondition that ensures consistency between the economic policies of the beneficiary country and the longer-term development of the overall world economy. Without conditionality the permanent transfers of SDRs would amount to introducing a link between the SDR and development aid. This link does not seem to me to be appropriate for a monetary asset like the SDR and could even be harmful to it at this very delicate moment of the SDR's existence.

I have some sympathy for the Belgian proposal. In essence, this proposal is now nothing more than a scheme for funding the Fund's loans, since it neither increases the supply of Fund financing to members at present, when the Fund's liquidity is quite comfortable, nor represents a constraint on extending more credit to actual or potential borrowers. Despite this characteristic, the Belgian proposal has two new and interesting implications. First, it enhances the use and the role of the SDR in lending operations. Second, it might permit the financing of the debtor at a rate lower than that applied on the resources borrowed by the Fund. However, it is not possible to reach a final conclusion whether or not to support such a scheme, since this has to be examined in the light of the policies that are going to be followed for enlarged access and on the increase in quotas. In this wider context, the appropriateness of the Belgian scheme can be better evaluated, since it is important that this scheme will not negatively affect the decisions on the other fronts.

At the same time, I do not see the Belgian scheme as being an instrument to overcome the opposition of those who believe that even a small SDR allocation will relax the adjustment effort. In fact, participation in this SDR transfer mechanism would be on a voluntary basis and would appear to be rather uncertain. Consequently, it is doubtful that it will inject a stronger dose of conditionality in connection with an allocation, since it is not certain whether the Belgian proposal can generate a critical mass to finance a substantial volume of programs.

The French proposal is different from the Belgian one in that it does not require a Fund program and, therefore, it cannot be considered a funding scheme for the Fund. The borrowing country would receive an addition to its gross reserves from other countries on terms that would be similar to borrowing in the marketplace, namely, on conditions that would be much milder in comparison with the standard conditions required by the Fund. This scheme might permit the financing of structural adjustment programs that have a medium-term perspective and do not put the credibility of the Fund at stake. However, I find it difficult to accept such a loose approach to conditionality, which could even crowd out or delay standard programs. It would be more appropriate to apply the type of conditionality envisaged under the structural adjustment facility to these loans.

In conclusion, I am not keen to introduce any of these proposals, because I do not see what crucial purpose they serve that could not be served by existing instruments. Nevertheless, I am ready to consider both the Belgian and French proposals under certain conditions. The Belgian proposal could be considered if it was part of a wider context in which it did not interfere with other mechanisms that are more fundamental and whose role should not be weakened. The French proposal also could be considered if the degree of conditionality were better defined and its impact on the policies of member countries were more effective.

Mr. Nebbia made the following statement:

I would like to start by commending the staff for a remarkable paper, which analyzes with precision the different mechanisms to implement the three proposals and their implications both for the system as a whole and for our institution.

The three proposals put forward by Mr. de Groote, Mr. de Maulde, and Mr. Sengupta represent efforts to find a viable solution for an allocation of SDRs. I believe that this list will not be complete if I failed to mention Mr. Polak's very useful buff statement in March 1986.

In the past, our position has been that allocations should not include elements of conditionality, and we would like to preserve this principle as much as possible; for this reason we are intellectually closer to Mr. Sengupta's proposal, but we approach today's discussion with an open mind.

The three proposals, as mentioned by the staff, involve a transfer of SDRs from countries with strong reserve positions at the time of an allocation to countries with weak reserve positions.

These proposals have some common features and obviously some elements that are particular to each of them.

The first distinction is that in Mr. de Groote's proposal the postallocation adjustment in the distribution of SDRs will have a multilateral character--"la raison d'être" of our institution--while the other two proposals imply the creation of bilateral arrangements of different degrees of complexity and the involvement of the Fund to keep account of them.

A second distinguishing feature is the degree of conditionality attached in each of them to the part of the allocation to be redistributed. Mr. de Groote's proposal features the highest conditionality directly associated with Fund programs, and Mr. Sengupta's proposal is the one with least conditionality, being compromised only by repayment or reconstitution.

The common feature of all three is that the share not to be reallocated will be free of conditionality, an aspect that, though welcome, may represent in my view a major obstacle to agreement on allocation.

At this stage I have to confess that, keeping in mind the concerns expressed by the major shareholders with respect to an allocation and our own concerns, I fail to see how any of the proposals can succeed to generate the necessary "political will" to get an agreement. Nevertheless, the need still exists; the present debt situation as well as the inability of many developing countries--both heavily and not so heavily indebted--to increase their level of reserves warrant an allocation.

I would like to make the following suggestion, which I have framed in the context of the Baker plan. I believe that an SDR allocation with certain characteristics can be regarded as the very sought after fourth leg of the plan.

This will be the contribution of the developed countries to the efforts of the three other parties that are intended to be involved in the new debt strategy.

First, the size of the allocation should be such that the share of the developed countries would be of the same order of magnitude as the contribution of the commercial banks to the plan.

Second, all countries will be given the following alternatives:

(a) They may keep the SDRs allocated; if they decide to do so, they will be subject to the provision of Paragraph 1(b) of Schedule G of the Articles, which could be made to ensure that members will pursue a balanced relationship between their SDR holdings and other reserve assets. This alternative is very much in line with Mr. Polak's suggestion in his buff statement of last March.

As long as the SDRs are kept as reserves, the holders will pay no charges; but in the event that they are utilized, the SDR interest rate will be applicable.

(b) Those countries that decide not to keep the SDRs allocated in whole or in part will transfer them to the Fund--in a manner consistent with the Articles--where they will be kept in a special account. It could be expected that an amount of the order of at least $16 billion over three years would be so available.

Third, keeping in mind that in the Baker proposal adjustment and growth are the two central elements, these resources will be used to finance contingency mechanisms, such as those contained in the Mexican program.

This will ensure the success of the adjustment effort, cushioning the effect of external shocks and providing for a real path to sustained growth in the medium term.

Fourth, for as long as the SDRs to be reallocated remain in the special account of the Fund or are assigned on a contingency basis, no net interest cost will be incurred by participants; but as soon as they are utilized, the country using them will have to pay a net charge.

In order to make the scheme more attractive to the developed countries it may be considered that the rate of interest to be paid be higher than the SDR interest rate but lower than the commercial rates prevailing in the market to preserve an element of concessionality. I would suggest that LIBOR minus a discount, on which agreement would have to be reached, could represent a reasonable approach.

To conclude, most of the favorable comments in the analysis made by the staff with respect to the effects of an allocation on inflation and adjustment as well as to those on international reserves and liquidity would, I believe, be applicable to my suggestion.

As to the implication for the role of the Fund, perhaps the staff would care to make some comments; but I am sure that our institution will reinforce its central role in dealing with the debt problem at this new stage, while it will strengthen its ability to create international liquidity.

Mr. de Groote remarked that he had not thought it necessary to integrate completely the resources that would be transferred under his scheme with the other resources of the Fund. As the staff explicitly suggested, the resources that would be "lent" by the industrial members to the Fund could be made available to members on conditions that were different from the conditions that were applied to the Fund's regular resources. The resources that would be available under the Belgian scheme could be used to meet a member's need for additional reserves or to support a contingency mechanism such as the one provided for in the present program for Mexico. The additional resources could even be used to finance ordinary operations, but not under the same conditionality that was normally applied. In that sense, the Belgian proposal was similar to Mr. Nebbia's proposal.

Mr. Zecchini said that he wondered whether the conditionality under the Belgian scheme would be applied in the context, or outside of, a Fund-supported program. Presumably the application of conditionality outside the program would bring the Belgian proposal closer to the French proposal.

Mr. de Groote replied that the conditionality would be applied in the context of a Fund program. However, the precise conditions in such cases would have to be formulated in line with the aims of the scheme. There was a fundamental difference between the French proposal and Mr. Nebbia's proposal: the French proposal would involve bilateral transactions between members that would not pass through the Fund; under Mr. Nebbia's proposal, the resources involved would be channeled back to the Fund, where they would be rechanneled through the Fund's regular operations.

Mr. Zecchini said that his interpretation of the French proposal was that any program that would be financed would not be formulated by a member in collaboration with the Fund. Instead, the program would be appraised by the Fund and would not involve the standard conditionality that was usually applied under Fund-supported programs. It was too soon to say whether the current program for Mexico represented a new chapter in the evolution of the Fund's conditionality.

Mr. Ismael made the following statement:

I welcome the attempt made by Mr. de Groote, Mr. de Maulde, and Mr. Sengupta to propose appropriate approaches that could overcome the obstacles to further progress in the allocation of SDRs. We have had many discussions on the subject of SDR allocations. Unfortunately, they have failed to produce any broad consensus in the Executive Board for an allocation. Three Executive Directors have made pragmatic suggestions to overcome the main obstacles that have been raised to a further allocation.

All three proposals have the common objective of making available to members with relatively strong reserve needs a part or all of the SDRs received by countries that have no need or have a lesser need for additional reserves at the time of an allocation. In addition to this common objective, the three proposals have many other common characteristics, such as the use of the existing SDR rate of interest in calculating the charges on the allocated SDRs. Of course, there are minor differences between the proposals, but these could be smoothed out through discussion. Therefore, I will not dwell on the specific details and will only comment instead on the major aspects of the three proposals.

I am not in a position to support the Belgian proposal. My main objection to this proposal has been mentioned many times, not only by this chair, but also by other Executive Directors: I could not accept the conditionality that would be imposed by the Fund on members wishing to use the allocated SDRs. By lumping the allocated SDRs together with other resources of the Fund, and by operating the allocated SDRs just like other Fund resources, there would be no difference whatsoever in the position of the needy countries with low reserves that have access to the allocated SDRs in order to improve their reserve position. Therefore, I see no additional advantage for these countries to adjust under this program when the same option that is provided under the Belgian proposal is already available to members.

The French proposal is definitely a far better one than the Belgian proposal in the eyes of the members of my constituency. By not transferring the newly allocated SDRs to the Fund, the French proposal, at one stroke, lowers the conditionality on the use of the resources and opens the eligibility to the use of the resources to many more members. However, conditionality would still remain, and not all the needy developing countries might benefit from the French proposal, as it gives the Executive Board the power to appraise the economic policies of applicant countries. Furthermore, the idea of a bilateral relationship in the transfer of the resources involved would be unacceptable. Of course, this idea is not an absolute requirement under the proposal, and I would be more amenable to accepting a multilateral transfer mechanism.

Mr. Sengupta's proposal, although not as comprehensive as the Belgian proposal, seems to be more in line with the original intention to make the use of SDRs unconditional. Mr. Sengupta's proposal would not impose any conditionality when the newly allocated SDRs are transferred to the needy developing countries with lower reserves in order to add those SDRs to the gross reserves of the needy members. This amounts almost to an automatic mechanism that at one stroke could boost the reserve position of the needy countries, thereby increasing their credit standing, which might enable them to gain access to the private financial markets. Consequently, the need for these countries to adopt deflationary policies in order to increase their reserves would be avoided.

Mr. Sengupta's proposal would involve conditionality only in the second stage of the transfer mechanism. This would be applied when use was made of the newly allocated SDRs. This is as it should be, as countries using the SDRs would have to reconstitute the SDRs when they are in the position to do so. I fully support the proposal made by Mr. Sengupta. However, as the staff has noted, there are a few variations of Mr. Sengupta's proposal from which the Executive Board can choose. In addition, there are still many unanswered questions that need to be answered before we can make further progress. For example, the question of what criteria to use to determine which countries are eligible to apply for the newly allocated SDRs transferred by the industrial countries is most pertinent and needs to be fully examined.

I fully agree with the analysis of the staff on the broader issues that might arise from an SDR allocation and redistribution, such as the effects on international reserves and liquidity, the effects on inflation and adjustment, and the issues relating to the implementation of the proposals. The differences between myself and the staff are minor ones. Indeed, the staff's analysis of these issues has been consistent, and those issues should not be raised again as an objection to an SDR allocation.

Mr. Yao made the following statement:

The issue under consideration is of great interest to my authorities. They see merits in the proposals to transfer allocated SDRs from countries with adequate reserves to countries that are in need of reserves at a time when many developing countries are reducing their financing gap through strenuous adjustment efforts, including severe cuts in productive investment outlays. Their interest stems from their view that the allocation of SDRs on the basis of quota should take into account the need for reserves of members. In this regard, the three proposals are steps in the right direction.

The staff's analysis of the three proposals is comprehensive. However, it was not clear to me from reading the staff paper whether the proposals are to be considered as mutually exclusive or are to be implemented simultaneously, provided that certain conditions are met. I would favor the latter approach, because it would appear to give more flexibility to all members. Indeed, while the Belgian proposal could increase the resources to countries with Fund programs, the French proposal could apply to countries that are under enhanced surveillance, and Mr. Sengupta's proposal could be used to provide bilateral assistance for temporary balance of payments financing. Obviously, participation in any arrangement would be voluntary. Despite their likely positive contribution to the reserve position of developing countries, the proposals do not address the main concern of those countries, namely, the inadequacy of the transfer of financial resources for development purposes.

I agree with the staff that under the proposals it would be necessary to provide some incentive to the transferors. However, in doing so care should be exercised in order not to exacerbate the financial difficulties of the heavily indebted countries.

Mr. Leonard made the following statement:

As the staff paper notes, one of the criticisms that has been made of the SDR is that allocations are indiscriminate in the sense that they do not adequately reflect the distribution of members' reserve needs. To the extent that the proposals before us address the distributional issue, they deserve consideration. However, I fear that whatever their merits on that score, the proposals might at a deeper level be at variance with the concept of the SDR.

Essentially I agree with much of what Mr. Polak said on this issue. The underlying justification for the SDR is that all the countries have a reserve need, that there can be a global need for additional liquidity, and that SDR allocations can meet that need in a manner that is beneficial to the international monetary system. Unfortunately, because it is hard to demonstrate that a long-term global need exists, it is also hard to give operational effect to the concept of the SDR. In a sense, the SDR is an instrument in search of a meaningful purpose. This probably contributes to the ambivalent, even apathetic, attitude of some members to the SDR.

The proposals before us are not consistent with the intent of the SDR in the sense to which I have referred; indeed, their explicit purpose is to address distributional issues. In addition, it is not clear that the use of the SDR in that way would have any special advantage on balance for the international monetary system. The problem of distribution can be better addressed, it would seem, in other ways. In particular, if it is felt that the problem requires the Fund to play an intermediary or insurance type of role, making up for exogenous shocks or excessive market reactions, ordinary conditional Fund operations would seem to be more direct and appropriate. Alternatively, if it argued that there is a need for a greater degree of resource transfer, the need might be met through changes in the terms of access to Fund resources or through explicit aid from other sources.

None of the proposals in the staff paper provides for additional "owned" reserves; all the proposals involved repayments or, under Mr. Sengupta's proposal, reconstitution, at least over the medium term. Thus, while gross reserves could be strengthened for a period, unless that period were used to make needed adjustments the improvement in the reserve position would not be lasting. Such a temporary strengthening of gross reserves is scarcely likely to change perceptions of the creditworthiness of the countries concerned unless it is also clear that these countries are addressing fundamental problems. Furthermore, if the added reserves were in fact used because of balance of payments difficulties, some countries might find it difficult to meet the repayment or reconstitution requirement. These are weaknesses that reduce the value of all the proposals that have been presented to the Executive Board.

Problems of conditionality arise with respect to two of the proposals. Mr. Sengupta's proposal in particular is silent on the issue, apart from a reconstitution requirement on SDR holdings, which was strongly criticized when it was proposed in the past. The French proposal contains an element of conditionality, although it is not clear how it would be applied and how effective it would be.

I also have difficulty with that part of the French proposal that calls for an assessment by the Fund of potential recipients' policies, which in turn would form the basis for a decision on eligibility. This provision would appear to imply that the Fund would have to establish explicitly the conditionality of loans that were not being funded by Fund resources, a situation that would hardly be consistent with the general attitude of the Executive Board in this area. In addition, there is also the possibility that the Fund's assessment could be used by transferors of SDRs, either bilaterally or multilaterally, in the same way as in enhanced surveillance, thereby leading to similar concerns about the role of the Fund. Moreover, if transfers were to take place under a multilateral arrangement, there would appear to be a need for some forum where transferors could come to some agreement on whether the Fund assessment justified a loan. There would also be questions about which countries should be potential recipients, the terms of loans, and whether there should be any limitations on their use. None of these questions are easy to answer, and it could take some time before satisfactory positions on them are reached and the schemes to which they relate could be pushed into operation.

As the staff notes, the Belgian proposal has to be viewed not only as an arrangement to redistribute SDRs, but also as a funding technique. Under this proposal there would clearly be much less concern about a weakening of adjustment efforts, as resources would be channeled through the Fund to countries with adjustment programs. However, in addition to the need for an agreement on an allocation of SDRs, other issues would have to be addressed and resolved, particularly the effect on access limits and provisions to ensure the liquidity of lenders' claims. Moreover, in a number of countries there are legal and other constraints on lending that could affect the willingness or the ability of countries to participate in this scheme. All of this would suggest that negotiations of agreements concerning the terms and conditions under which the transfers of SDRs would take place, even if agreement were reached in principle, could be complicated and lengthy.

As to the Belgian proposal's provision for a means of supplementing the Fund's borrowed resources, my Canadian authorities believe that a longer-term objective should be to reduce the Fund's reliance on borrowed resources, and that the concern about the future adequacy of Fund resources would be better met by moving ahead with a quota increase. Moreover, although the situation might well change, it appears that the Fund currently has adequate ordinary and borrowed resources. In addition, because of the difficult issues that it raises, it is not clear that the Belgian proposal would provide a more rapid means of adding to Fund resources, if this seemed to be necessary, than reaching agreement on a quota increase. Rather than rely on the proposal, which, apart from the points that I have already noted, is open to the criticism of blurring the distinction between SDR allocations and the Fund's conditional resources, my

Canadian authorities feel strongly that it would be much more appropriate to concentrate efforts on ensuring that the next quota increase is both adequate and timely.

Mr. Pérez made the following statement:

I appreciate the efforts that have been made by Mr. de Groote, Mr. de Maulde, Mr. Sengupta, and Mr. Nebbia to examine mechanisms and actions that might improve the functioning of the international monetary system and for the considerable time and thought that they have devoted to the role of the SDR in correcting some imperfections in the present system of reserve creation.

Although from a broad perspective the four proposals pursue the same objectives, their implementation has been conceived of in different contexts. The proposals by Mr. de Groote and Mr. Nebbia are aimed principally at enhancing the Fund's financial capacity in circumstances like those at present, in which the Fund lacks sufficient financing to meet effectively members' needs. This lack of financing has two well-known effects. First, program design becomes highly dependent upon the financial participation of commercial banks in some cases. Second, in a sense, the use of conditionality becomes not only a fair instrument to ensure its use of Fund resources, but also lends itself to being used as a rationing mechanism in order to match the supply of and demand for Fund resources. The proposals by Mr. de Maulde and Mr. Sengupta were made under the assumption that the Fund can afford to provide the financial support that is needed by members to address their external imbalances. Their proposals go further by establishing a mechanism that will provide additional reserves to members experiencing difficulties in gaining access to international financial markets in order to achieve an adequate reserve position. In my view, both of these approaches need not be mutually exclusive and are complementary.

I also think that the proposals by Mr. de Groote and Mr. Nebbia might contribute to the establishment of a mechanism to improve members' reserve distribution. Even with a conditional post-allocation system, the Fund could help members to overcome the shortcomings in distribution that might arise under the current system of reserve creation owing to countries' different degrees of access to international lending. To this end, Mr. de Groote's proposal would permit the Fund to extend credit to countries that, despite having appropriate economic policies in place, must run a balance of payments surplus to increase reserves because of their lack of substantial access to capital markets. If the policies of these countries were in fact adequate, and the inadequate creditworthiness resulted from a lack of information or from a collective error of private financial institutions, the Fund could provide these members with financial assistance that would not have to be subject to burdensome conditionality and might be less costly than credit from capital markets. In a sense, this might also constitute a signal to the financial community that might help in the restoration of a member's creditworthiness.

This brings to mind the question of conditionality, which is one of the key distinctive aspects of the three proposals. As I understand it, Mr. de Groote's proposal is aimed at attaining an across-the-board reduction of the Fund's conditionality. If endowed with adequate financial resources the Fund could avoid the use of conditionality as a rationing mechanism, thereby permitting the trade-off between adjustment and financing to take place on the basis of more adequate terms. One of the main features of Mr. Sengupta's proposal is that the transfer of SDRs under the reallocation mechanism would not be subject to conditionality. Although I agree with the principles behind Mr. Sengupta's proposal, I am not certain that it is feasible for several reasons. First, we must recognize that the proposed system is based on voluntary lending by members with a strong reserve position of all or part of newly allocated SDRs to countries experiencing difficulties in raising funds in the international financial market. The reluctance of some members not only to participate in any reallocation mechanism but also to go along with the simpler modest allocation of SDRs could be overcome by providing assurance that the transfer of financial resources would indeed improve the prospects for external viability and growth in recipient countries. Second, the process of reallocation will take place under the Fund's appraisal, which would show that the country concerned really required additional reserves and which would show the required amount of supplementary financing. That process would entail implicitly the use of the case-by-case approach. Once the Fund becomes involved in assessing a country's need for reserves, the second step is to make sure that the country will apply the additional financing to improving its growth prospects, which would prove to be a necessary step if we are to facilitate the availability of funds provided by members with a strong reserve position.

This brings me to a position that is closer to the French proposal in the sense that to ensure the availability of resources and their efficient use we need a certain level of conditionality; in my view, the conditionality that is applied to the use of resources in the first credit tranche under the compensatory financing facility would be appropriate. In order to participate in the reallocating mechanism a member would have to have an inadequate level of reserves and insufficient access to capital markets, and it must show that it will cooperate with the Fund in an effort to regain its creditworthiness. With this low level of conditionality, the expected effects on inflation and adjustment that are feared by some members could be minimized. As to the selection of participants, I would prefer an active role by the Fund instead of leaving it to members on a bilateral basis. A multilateral approach to this issue could better serve the purpose of ensuring a more evenhanded distribution of international liquidity.

Mr. Kafka made the following statement:

I welcome the proposals by Mr. de Groote, Mr. de Maulde, Mr. Sengupta, and Mr. Nebbia. Mr. Nebbia's proposal was made at the present meeting, and I will not comment on it until I have had an opportunity to examine it carefully.

The staff paper discusses three proposals for the redistribution of allocations. All of them are necessarily and at least formally voluntary, in line with the Articles. It is of course conceivable that a decision to allocate would be made only if sufficient pledges had been received to redistribute, making redistribution effectively compulsory. But I would regard that possibility for the foreseeable future as being small, since the beneficiaries of redistribution would presumably be interested in an allocation even in the absence of a redistribution. One could of course imagine a situation in which a dollar devaluation would persuade the other industrial countries, rather than the developing countries, successfully to encourage the United States to agree to an allocation, while the developing countries threatened to withhold their consent in the absence of a redistribution.

In addition, one could also argue that what really prevents and has prevented an allocation is not the belief of members with a blocking vote that there is no need for an allocation within the meaning of the Articles, but rather that the perception that recipients of the bulk of an allocation--the industrial countries--not only do not need one themselves, but also would, if they received it, abuse it, in comparison with the transferees under the three proposals, which could be prevented from abusing allocations as well as transfers. In that case, a redistribution scheme as a precondition for an allocation would make sense as it would if there were a need of the industrial countries--other than the United States--themselves.

Since a redistribution has to be voluntary, do we need a generalized mechanism for redistribution? Mr. Goos has suggested that we would not and that we could leave the redistribution to the decision of each member through transfers on the basis of consensus. The Fund cannot stop such transfers, except under the limited conditions of Article XX, Section 2(d). Any potential transferor could offer any potential transferee a transfer under conditions to be agreed between them. However, such transfers are possible now and do not occur. Hence, they are unlikely to occur in the future. After all, a redistribution can be made without an allocation. Conditionality and monitoring could, in the absence of a formal stand-by arrangement, be replaced by reliance on Article IV consultations under both the Belgian and French proposals, and by individual undertakings under Mr. Sengupta's scheme. Use of the transfers would be integrated with other loans where desired by performance criteria in stand-by arrangements. Another possibility would be to avoid choosing among the three schemes, or, indeed, between any of those schemes and no scheme. Could the Fund stand ready, at the request of any member, indifferently to operate the conditions of the Belgian proposal as well as to monitor those of the French scheme? Mr. Sengupta's proposal does not require either of those. I do not necessarily recommend this multiple choice method. I merely raise the question what would be the advantages or disadvantages of such a method. If we were prepared to permit the Fund to undertake these multiple tasks, I would think that at least much of the fear of creating a conditional SDR under the French proposal and particularly under the Belgian proposal would disappear and that the fear of in a sense demonetizing the SDR through reconstitution under Mr. Sengupta's proposal also would disappear. Not all the fear would vanish. A redistribution scheme that was sufficiently attractive could render conditional the use even of allocated SDRs by potential beneficiaries of redistribution under the Belgian scheme and possibly under the French scheme, although not under Mr. Sengupta's scheme.

Are there other concerns to which we must pay attention? Any such concerns must take into account the powerlessness of the Fund to prevent transfers by consensus of SDRs, unless they violate the provisions of Article XIX, Section 5 or Article XXII.

Mr. Huang made the following statement:

This is a good opportunity to discuss the issue of post-allocation adjustment in the distribution of SDRs. I greatly appreciate the constructive proposals that have been made by Belgium, France, and India. The proposals have a common general objective of strengthening the role of the SDR in the international monetary system and of meeting the reserve needs of members with weak reserve positions through the transfer of SDRs after an allocation. Although each proposal is based on a different approach, each one has its own merits.

Both the currency borrowing arrangements proposed by Belgium and the direct lending arrangements proposed by France are obviously trying to make a distinction between the use of allocated SDRs and the use of transferred SDRs by making the latter conditional--tied to either an adjustment program or to an appraisal of the economic policies of recipient countries. I wonder whether these proposals are consistent with the Articles. In addition, the undesirable effects of these arrangements would have to be avoided. The currency borrowing arrangement would involve a difficult funding process that would be subject to the approval of lender governments, a process that experience shows is a time-consuming one.

As the staff notes, direct lending arrangements on a bilateral basis would require a prior agreement on the transfer of SDRs between the transferors and the recipients, which would tend to reflect the close ties among certain countries rather than the actual need for reserves. In that event, the results would be contrary to the planned objective and to the role of the Fund with respect to SDRs.

I agree with the principles in Mr. Sengupta's "overdraft facility" proposal, especially the unconditional use of transferred SDRs subject to repayment and reconstitution. Since SDRs transferred through the so-called overdraft facility will be used by each individual country but will not be available to the developing countries as a group, the base for distribution, or the size of the drawing that eligible countries can make, should be determined at the time of the allocation. In that connection, Mr. Sengupta could probably provide some guidance.

Mr. Templeman made the following statement:

The Executive Board has had several occasions on which to discuss the possibility of a redistribution of new SDR allocations. The staff paper is a useful compendium of the specific proposals that have been made by the Executive Directors for Belgium, France, and India. I am pleased that the Executive Board has not become bogged down today in the discussion of technical details of these proposals. Rather, it seems to be more important that we should take a careful look at the fundamental issues that these proposals raise.

But, first, by way of clarification, let me say that the basic U.S. position on SDR allocations is rooted in an objective analysis of whether the relevant criteria in the Articles have been met. At the same time, this position reflects the recognition that fundamental changes in the international monetary system have significantly altered the rationale for the SDR and the need for a new SDR allocation.

In my view, the three proposals that are described in the staff paper are honest efforts to bridge differences of view in the Executive Board on an allocation. My authorities have given these proposals careful consideration, and they recognize the effort that has been made by Mr. Sengupta to preserve the monetary character of the SDR and by Mr. de Groote and Mr. de Maulde to try to ensure that SDR allocations would reinforce the adjustment effort. However, my authorities have also examined the proposals with particular attention to the three key issues that in their view are particularly important: whether the proposal for redistribution and use of SDRs would be consistent with the criteria for SDR allocations spelled out in the Articles; whether a conditional SDR allocation is necessary; and whether the proposals would be consistent with U.S. legislative requirements.

Under the Articles, an allocation of SDRs is designed to meet a global long-term need to supplement existing reserve assets. My authorities continue to view this as the basic criterion that must be met to justify an allocation. In our earlier discussions of the role of the SDR, it seemed clear that the increased size and flexibility of international financial markets had to a considerable extent made it less likely that there would emerge a global long-term need to supplement international reserves by means of an SDR allocation. This does not mean that a future allocation is impossible to conceive of, nor that the private markets have operated flawlessly. My authorities recognize that the markets have operated on occasion in a rather volatile fashion in one direction or another. But they do not view this as a systemic problem that is sufficient to justify an SDR allocation. In fact, they believe that for a very large number of members that manage their economies reasonably well, adequate external reserves can be secured from international capital markets. This does leave a problem for some relatively uncreditworthy countries. Indeed, the arguments for SDR allocations now seem to be increasingly focused on a perceived need to provide additional reserves to this limited group of countries, rather than to meet a truly global reserve need.

I have considerable sympathy with the authorities in highly indebted countries who feel the need to rebuild their international reserves as a part of their overall approach to solving their debt problems. In fact, this chair has supported the inclusion of a buildup in reserves in a number of Fund-supported programs and has accepted the corresponding implications for additional financing from the Fund or from other sources. Unfortunately, success has not always been achieved in reaching the desired reserve goals. I would welcome ideas from the staff or from the Executive Directors as to how the goal of strengthening reserves could be more effectively included in Fund-supported programs, within the limits of realistic financing availabilities.

Frankly speaking, my authorities continue to have problems with the argument that SDR allocations can be justified by the lack of access of some countries to international credit. As we have stated on earlier occasions, my authorities do not consider the distinction between creditworthy and uncreditworthy borrowers as representing an asymmetry or as constituting a systemic problem. Against that background, I take exception to the passages in the staff paper suggesting that the need to supplement reserves should take into account how these reserves should be distributed among countries with differing degrees of access to financial markets and that a redistribution of allocated SDRs should be viewed as a means of reducing real costs. In addition, I am still concerned that an allocation of unconditional SDRs could tend to delay the adjustment process.

Each of the three proposals in the staff paper calls for a final distribution of SDRs that is different from the one that is envisaged in the Articles and each would introduce some kind of conditions on their use. Proposals to make the use of allocated SDRs conditional raise some questions regarding the consistency of such an allocation with the Articles. Similarly, any proposal that would redistribute SDRs, other than in relation to quotas, in effect becomes a mechanism to transfer real resources to users. Since the inception of the SDR, my authorities have steadfastly opposed any such role for the SDR. Furthermore, the Interim Committee took this view in April 1986 when it stated in paragraph 7 of its communiqué that "the Committee stressed the monetary character of the SDR, which should not be a means of transferring resources...." We must bear in mind that efforts to weaken the monetary character of the SDR or to use it as a mechanism to transfer real resources might well undermine the willingness of some countries to hold SDRs as a reserve asset.

My authorities remain concerned about the danger that SDR allocations could tend to undercut economic adjustment efforts. Therefore, we stressed during our earlier discussion of the future role of the SDR the need to take into account the SDR's ability to contribute to sound economic policies in each member, to greater convergence in economic performance, and to more compatible economic policies among member countries. Mr. Sengupta's proposal does not address these basic concerns, since the use of the SDRs would remain unconditional with respect to economic policy commitments, and SDRs would be transferred on a permanent basis. In other words, Mr. Sengupta's proposal is tantamount to a modified form of an aid link. His proposal does encompass the possibility of repayment or reconstitution, and the Interim Committee has requested that the Executive Board should examine "different possibilities of obtaining a more balanced and stable proportion of SDRs in members' reserves." However, I will save my comments on this general question for the Executive Board's discussion that is scheduled for August 4, 1986.

My authorities believe that, in most circumstances, conditional credit is the most constructive kind. Both the Belgian and the French proposals do provide for some economic policy conditionality to be attached to any redistribution of SDR allocations. While this would take into account the danger that SDR allocations might impede economic adjustment, it also seems to imply that there is at present insufficient conditional credit available. In fact, the Belgian and French proposals can, in some ways, be viewed as a means of augmenting the Fund's financial resources that are available in support of adjustment programs. However, the General Resources of the Fund are specifically designed to provide conditional financing to countries in need of Fund financial support. Fund liquidity in the form of ordinary resources is quite ample at this time and will likely remain so for the foreseeable future. This source of financing, complemented by still available borrowed resources, should suffice to meet future needs, given current projections. Moreover, if the Fund's liquidity were to come under pressure, in our view the appropriate mechanism to remedy this situation would be through the quota system.

The staff paper recognizes the possibilities of problems for some members that might arise vis-à-vis their legislatures as a result of SDR proposals such as those outlined in the paper. This is an important consideration for my authorities. Traditionally, there has been strong opposition in the U.S. Congress to the extension of financing by the executive branch in ways that are seen as infringing upon the constitutional and other prerogatives of the Congress. In my authorities' view, all three of these proposals might very well require Congressional approval, which could be quite difficult to obtain.

I understand the desire of some Executive Directors to find ways in which to obtain the support of the necessary majority of the Executive Board for an SDR allocation. What seems to be lacking is a broader conceptual vision of how an SDR allocation would affect the SDR and what role the SDR ought to play in an international monetary system that has evolved substantially since the SDR was created. My authorities remain willing to reflect on our discussion today and to continue the broader discussion of the role of the SDR in the international monetary system, as requested by the Interim Committee.

Mr. Lundstrom made the following statement:

My authorities prefer the traditional type of SDR allocations, but they attach more importance to a moderate allocation actually being agreed than to its size and form. The overriding concern should be to bring about a resumption of allocations. I would therefore be prepared to consider more innovative proposals only if they seem likely to gain sufficient support and provided that they leave the fundamental role of the SDR and other Fund instruments essentially unchanged. Proposals that are found to be clearly unrealistic should be shelved so that they will not further complicate discussions on SDR allocations and the future of the SDR; having listened to previous speakers--not only to traditional opponents of allocations, but also and in particular to Mr. Polak--I am left with the impression that, unfortunately, all three proposals might fall under that category. I say "unfortunately" because I have considerable sympathy for the purposes of the proposals and because they represent very constructive efforts to break the present allocation deadlock.

It is against this general background that I will comment briefly on the three proposals. I look forward to studying carefully Mr. Nebbia's proposal and to commenting on it at a later stage.

Any SDR allocation must meet two requirements: it must not rekindle inflation, and it must not slacken adjustment efforts. The risk of inflation should be minimal, given the modest amounts that are in question. In terms of inflation, it is of course an advantage if arrangements could be found that would make it more likely that additional SDRs would lead to increases in reserves rather than to increases in imports. The three proposals address this problem in different ways. As for adjustment efforts, it is axiomatic that every external addition to reserves--for example, in the form of SDRs--in itself creates possibilities to maintain a correspondingly relaxed policy. There might be motivation for such an outcome in certain circumstances but not in others. The three proposals attempt to treat this problem by setting various conditions on the acquisition of SDRs.

Another aspect to be considered is how the proposals affect the normal resource requirements of the Fund. In my view, quotas should be the basis for the Fund's financing. Proposals for SDR allocations that might lead to an offsetting reduction in future quota increases should therefore be avoided. This problem could possibly be met by making arrangements for SDR allocations explicitly temporary.

Turning to the three proposals before us, my views may be summarized as follows.

First, a general consideration: the proposals should be resorted to only in the event a "normal" SDR allocation fails to receive sufficient support. A proposal should be further developed only if it stands a reasonable chance of generating the required qualified majority.

Second, under the conditions that I just mentioned, I am prepared to endorse further study of the Belgian proposal. One of its advantages is its ability to secure a certain amount of adjustment. Another advantage is its flexibility--in other words, the fact that allocated SDRs could be "withdrawn from the market"--should global liquidity be considered excessive. It has an important drawback, however, as it might be considered as a substitute for quota increases.

Third, the French proposal has the advantage of building on the existing possibilities of lending SDRs between members. Furthermore, it provides countries that do not require Fund-supported adjustment programs with an opportunity to strengthen their reserves. However, it is important that the Fund's appraisal of the borrowers' economic policies, which is a significant feature of the French proposal, should emphasize the need for the SDRs borrowed to increase resources and not only to permit a relaxation of adjustment efforts. In its present form--with a great number of separate loan agreements--the French proposal might appear to be administratively somewhat cumbersome. Some further elaboration of the French proposal would be required before I could take a final stand on it.

Fourth, Mr. Sengupta's proposal might be perceived as being related to previous SDR link proposals, on which my chair has maintained a negative view, since it presupposes that SDR allocations to developing countries as a group should be given the character of a "permanent overdraft facility." This might risk weakening the adjustment process or might at least give that impression. I am therefore worried that this proposal will not be a means of achieving a sufficient majority for SDR allocations.

Mr. King made the following statement:

I will start with a few general remarks before turning to the specific proposals before us today. This chair has made clear in previous discussions that we continue to see a role for the SDR as an owned reserve asset and as a unit of account and that we envisage a potential use for the SDR as a safety net. My authorities strongly agree with the view reflected in the latest Interim Committee communiqué that the SDR is not an instrument for transferring resources and must retain its monetary character. Finally, the issues of how to finance the Fund and the appropriate access limits under Fund facilities should not be confused with the separate question of whether or not renewed SDR allocations are justified by the evidence of the state of the supply of global reserves relative to the demand for those reserves.

One of the main objectives of the proposals before us today is to help countries with severe balance of payments problems to increase their reserve levels. As others have noted, the proposals are therefore attempts to deal with distributional rather than global problems. An inadequate level of reserves is undoubtedly a problem that faces a large number of countries, many of which do not have ready access to the international capital markets. However, the nature of this difficulty varies considerably from case to case. For some, these problems reflect inadequate adjustment policies; other countries that have begun to implement more appropriate policies might not yet have convinced the international financial community that these policies will be fully and consistently implemented. In addition, there might be some examples of countries that have implemented appropriate adjustment policies but have been unable to regain access to the international capital markets and therefore to borrowed reserves. For the first two groups of countries that I have identified, the appropriate response to their reserve shortage does not seem to be to design new financing arrangements such as those mechanisms that we are considering today or by some other means. Rather, the solution to increasing their reserves is to maintain and where necessary strengthen their adjustment efforts. Turning to the third group, I have reservations about attempting to solve the difficulties that they face by creating new financing mechanisms. The Fund's existing facilities already provide access to borrowed reserves and in many cases also have a catalytic role. Therefore, I do not see the need to create new mechanisms at the present stage.

The issue of how to finance the Fund is separate from the question of the appropriate level of access under Fund programs. In this connection, these proposals, particularly Mr. de Groote's, seem to go some way toward interrelating these essentially separate topics. More generally, if one of the schemes were put into effect, it would probably have widespread implications for other Fund policies, including the level of access under Fund programs, which should be discussed independently. Schemes of this nature also of course have the potential to cause legislative and administrative difficulties for some countries.

The SDR should remain a monetary instrument. The proposed schemes seem to potentially involve an element of resource transfer, and the constraints that they impose on the use of the additional SDRs created under the schemes will reduce somewhat the quality of the SDR as an owned asset. Improving this aspect of the SDR has been an important objective of my authorities, and they therefore see these schemes as being in the nature of a potentially retrogressive step.

Mr. Mtei made the following statement:

The staff paper is a product of the generally held belief that there is a need to alter the distribution of newly allocated SDRs in order to increase the proportion going to countries with relatively large reserve needs. In other words, the distribution of newly created reserves should have some relationship to the current need for reserves. I note from the staff paper that all three of the proponents of supplementary post-SDR allocation arrangements to improve the distribution of reserves agree that such a step would reduce the relentless pressures on the external positions of a large number of developing countries, improve adjustment efforts, and enhance the international adjustment process.

The mechanism for a transfer of additional SDRs to developing countries should take into account the needs of the world economy, the efficiency of the distribution of the new international reserves, and the retention of the SDR's unconditional character. In this connection, I support the proposal by Mr. Sengupta, which has several merits, including especially the avoidance of conditional use of SDRs. Unfortunately, both the French and, particularly, the Belgian proposals stress the utilization of transferred SDRs in connection with a member's adjustment program agreed with the Fund or appraised by the Fund.

I share the view that transferred SDRs should become reserve assets of the recipient countries and should therefore be allowed to function fully, freely, and unconditionally. An arrangement for transferring allocated SDRs should be concerned primarily with improving the liquidity requirements of deficit countries. Of course, there is no doubt that an allocation of SDRs would permit the pursuit of adjustment policies without unduly severe austerity in a number of developing countries. But such use of SDRs for adjustment purposes is voluntary and unconditional and therefore acceptable. I do not consider it helpful to associate conditionality with access to transferred SDRs, as this would be tantamount to devising an entirely new approach to the use of SDRs.

On the issue of compensation to transferors of SDRs, much depends upon the specific form of the arrangement between the two parties involved. Nevertheless, whatever the form of arrangement, Article XX, which governs interest and charges on SDRs, would prevail. This means that "interest 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 charges at the same rate for all participants shall be paid to the Fund by each participant on the amount of its net cumulative allocation of special drawing rights...." Therefore, it goes without saying that the recipient of the transferred SDRs would have to make interest payments at the SDR rate of interest to the transferor if that is among the terms of the agreement between it and the transferor. I would support any reasonable and appropriate compensation from the recipients of SDRs to enable transferors to fulfill their obligation to pay SDR charges. As for the terms of repayment of borrowed SDRs, there is a need for a repayment period that would include a grace period. Mr. Sengupta has suggested a period of three years, and I am inclined to go along with him, although a longer period would be preferable. Some form of reconstitution or repayment might be in order, as it could provide an incentive to transferors and ensure that recipients would hold the allotted SDRs for use in seasonal or other difficulties and not merely for reserves.

The Fund should not become seriously involved in these arrangements. A situation in which the Fund deliberately sought to strengthen its role in the process through a high level of involvement would be unnecessary. The provisions of Article V, Section 2(b) could sufficiently guide the Fund in its role in this regard. As the staff has said, "the Fund would serve as a general monitor to oversee and record transactions among participants...." Thus, although according to Mr. Sengupta's proposal the Fund might administer the transfer of SDRs among participants, the Fund would not be asked to advise on recipients' economic policies in connection with the arrangement, and the Fund's resources would not be engaged.

The redistribution of newly allocated SDRs so that additional reserves are transferred to countries with relatively large reserve needs is a constructive proposal, and appropriate action in that direction is warranted. The mechanism for such SDR transfers should be as simple as possible, involving largely the transferors and the recipients, with the Fund playing an administrative role as an overseer or coordinator guided mainly by the relevant provisions of Article XIX and Article XX. Operationally, the arrangement should be stripped of the requirement of Fund conditionality. However, a crucial question that the Fund and all members should concentrate on instead of these and other very interesting proposals is a new allocation of SDRs itself in the conventional way, which, regrettably, for reasons that I consider to be indefensible, has not taken place during the entire fourth basic period. I agree with Mr. Kafka that there is nothing in the Articles to prevent holders of SDRs from transferring them freely or on bilaterally agreed terms.

Mr. Alhaimus made the following statement:

Like some previous speakers, I agree with the broad objective of the three proposals of trying to address the problem of the present asymmetry in the distribution of reserves that has been accentuated by perceptions of creditworthiness in private capital markets. These proposals, as well as Mr. Nebbia's, which was described at the present meeting, are a commendable attempt to overcome the insurmountable hesitation to effect any form of SDR allocation.

Of the three schemes that are analyzed in the staff paper, the Indian one is clearly more in line with the objective of meeting the need for reserves to hold, but it is not without some implications for the present SDR system that we seek to preserve. Nevertheless, these proposals can be pursued further if it appears they can contribute to progress in the discussion on a meaningful SDR allocation in the near future.

Mr. Romuâldez made the following statement:

I appreciate the efforts by Mr. Sengupta, Mr. de Maulde, Mr. de Groote, and Mr. Nebbia to propose a solution to the SDR allocation problem. My constituency is divided on the issues before us today. At least one member of my constituency--probably more, if all of them had been able to make known their views on these issues--tends to support Mr. Sengupta's proposals. My authorities in that country feel that, by assuming that an allocation should be made on the basis of a long-term global need and by including a reconstitution requirement, Mr. Sengupta's proposal safeguards the reserve asset character of the SDR as a mechanism that is designed to assist in the management of the monetary system. It allows the Fund a way of shifting, after an allocation, the distributive mechanism in such as way as to take into account the actual specific needs of the global economy at the moment that an allocation is made, and it does so while avoiding the inclusion of conditionality in the mechanism. On balance, however, the drift within our constituency seems to be stronger away from any kind of support for the proposals by Mr. Sengupta, Mr. de Maulde, and Mr. de Groote.

There are several arguments against these proposals. I doubt whether the use of conditional SDRs, as suggested under the French and Belgian proposals, offers anything to the recipient that could not be more appropriately gained through access to the Fund's general resources under normal Fund programs. It is pointed out that the Belgian and French proposals basically make available additional resources to support adjustment under Fund or Fund-influenced auspices; it is felt by those among us who oppose these proposals that if additional financing is required for conditional lending, these needs can more appropriately be met through an increase in the Fund's ordinary or borrowed resources rather than through the allocation of SDRs, which would have implications for global liquidity.

Mr. Sengupta's proposal would encourage gradualism in adjustment and place at risk the pace and effectiveness of required adjustment in those countries that the proposal is designed to help.

All these proposals appear to their opponents to be contrary to the role of the SDR in the international monetary system that was envisaged by the Interim Committee at its most recent meeting. In sum, as on the issue of an allocation itself, this constituency remains divided on these three proposals, although the greater weight seems to fall on the side of opposing their adoption.

Mr. Kabbaj made the following statement:

At the outset I wish to stress that while I appreciate the efforts of Mr. de Groote, Mr. de Maulde, Mr. Sengupta, and Mr. Nebbia to devise mechanisms that could facilitate achieving the needed consensus for the resumption of SDR allocations and for a more efficient utilization of the additional reserves, and while I am grateful to the staff for its efforts to adapt the various proposals to the Fund's Articles, the proposed procedures and their analysis should not be allowed to delay excessively our decision on a new series of SDR allocations. This issue has been debated extensively by the Executive Board and supported in detailed and convincing staff papers that have been further strengthened by the recent trends with respect to world inflation, international reserves, and adjustment. I appreciate that the Managing Director's recent report to the Board of Governors had to state again that there continues to be an insufficient majority in favor of the resumption of SDR allocations, and that the main objective of the proposals before us is precisely to permit such a decision by addressing some of the concerns expressed by the few Executive Directors still opposed to allocations. Still, I am afraid that our opposition to SDR allocations might stem from factors beyond the technicalities of the distribution of SDRs. Thus, in the absence of a prior commitment to SDR allocations, it might be judicious to direct the staff's energies to more useful tasks. Of course, this applies not only to the paper before us, but also to others that are to be examined by the Executive Board in coming weeks.

In commenting on SM/86/154 I would note first that the three proposals examined in the paper address the concerns of those Executive Directors who are unable to support an SDR allocation for the time being, especially with respect to an allocation's potential adverse impact on inflation and adjustment, as well as the concerns of most supporters of the SDR. The latter group has always considered unsatisfactory the obvious asymmetry between individual allocations and actual needs for international reserves. New mechanisms could be supported if they would improve the distribution of SDR allocations by increasing the share of those members whose insufficient access to capital markets requires the realization of current account surpluses in order to accumulate or maintain an adequate level of international reserves. However, it is important that, in examining the various proposals, particular attention is devoted to the extent to which each would preserve the basic characteristics of the SDR.

In this context, while I fully share the staff's view that the concept of a global need for reserves should continue to be the main criterion for an allocation, I believe that it is equally necessary to stress both the unconditional and the additional characteristics of the SDR and how they are altered by proposed mechanisms to improve the distribution of SDRs.

Although the degree of conditionality involved in each of the three proposals will differ widely, it is clear that none of the proposals is or can be genuinely unconditional, including Mr. Sengupta's, which would link the "overdraft facility" to a repayment or reconstitution clause. The latter system would, however, go beyond the former reconstitution scheme as it would ensure a distribution of SDRs that is more in line with actual individual countries' reserve needs. The Belgian proposal, and to a lesser extent the French proposal, would obviously involve a much higher degree of conditionality; for all practical purposes, the former would substitute an SDR allocation for a formal quota increase or for other ways of raising resources, such as borrowing. While the French proposal would skip the procedure of direct disbursement by the Fund, it is not clear to me how flexible the link would be between the disbursement or transfer of SDRs to user members and the "appraisal" by the Fund of these members' policies and reserve needs. Would this procedure be along the lines of practices with respect to enhanced surveillance?

There appear to be doubts about the additionality of the three proposed schemes. The staff makes it clear that any decision on the use of Fund resources will take into account the availability to the member of additional SDRs--in other words, there would be a reduction of an individual member's access to Fund facilities. If the objective of the SDR distribution schemes is to enhance developing countries' reserves and creditworthiness, it would be necessary to ensure true additionality under the proposed schemes and to differentiate between SDR transfers and transfers that were aimed at facilitating foreign debt and import financing.

Mr. Nimatallah remarked that Mr. de Groote's proposal seemed to be closely linked with the acceptance of the idea of a new allocation of SDRs. In fact, Mr. de Groote's proposal could well stand on its own.

Mr. de Groote said that his proposal had been formulated with a view to convincing certain Executive Directors that an allocation could take place without any of the dangers that those Directors seemed to fear. However, he agreed with Mr. Nimatallah that the proposal could stand on its own. If the proposal were linked with an allocation, the proposal would involve a change in the composition of international reserves.

A number of Executive Directors had suggested that his proposal was designed only to remedy the possible insufficiency of the Fund's liquidity, Mr. de Groote continued. That assessment was not entirely accurate. An allocation might well be appropriate even if the Fund's liquidity were abundant, since his proposal would in effect change the composition of members' reserves. Anyone who argued that all Fund financing should be covered by borrowing and quota increases was in effect saying that he was satisfied with the present composition of international reserves. It was for that reason that his proposal was linked with an allocation, although his proposal could be implemented using existing SDRs. One of the main issues at hand was the importance that was attached to the objective of making the SDR the principal reserve asset. Under the amended Articles, that objective was clearly linked with the notion of a global need for reserves as a criterion for a new allocation. It was not clear to him how the SDR could be made the principal reserve asset in the absence of fresh allocations. His proposal need not involve an increase in international liquidity; it might reduce the demand for other forms of international assets.

Mr. Sugita made the following statement:

> It is noted in the staff paper that although the three proposals would either temporarily or permanently modify the distribution of SDRs, the decision on an allocation of SDRs would continue to be governed by the requirements of the Articles, namely, the existence of a long-term global need to supplement existing reserve assets. It is also noted that the proposals are designed to help to encourage a new allocation of SDRs.
>
> My authorities believe that the criterion of the existence of a long-term global need should be judged on its own merits, and that this discussion is not the proper occasion on which to consider that criterion in detail. However, I would like to make a few brief comments, without entering into a discussion of the operational details of the proposals.
>
> First, the major objective of the proposals is to facilitate the accumulation of reserves by members that have limited access to private financial markets. This objective could be met if the recipient countries held the transferred SDRs or maintained the

level of overall reserves when the transferred SDRs were converted into foreign exchange reserves. However, the sustained use of the transferred SDRs would clearly be inconsistent with the objective of reserve accumulation. A related point is that the repayment or reconstitution obligations that would accompany the transfer of SDRs would eventually lead to a reduction of reserves of those countries that had not successfully restored their access to private financial markets at the end of the arrangement period.

Second, from the viewpoint of the countries that are supposed to lend SDRs or currencies under the proposals, it would be important to have appropriate liquidity or to preserve the lenders' claims. In that connection, a proposal that envisages permanent earmarking or transfers of SDRs is less appealing than other proposals.

Third, potential lenders would also be concerned that the transferors of SDRs would have to bear the risk directly or indirectly of nonpayment of interest by recipients.

Fourth, the proposals have direct and indirect implications for the Fund's basic policies, including the use of Fund reserves and programs. In this connection, my authorities agree with the G-10 Deputies that such proposals could blur the distinction between SDRs and traditional Fund credit. For countries that have lost their creditworthiness as a result of recent debt problems there is a need to provide conditional liquidity, and that need can best be met by securing adequate financial resources in the General Department.

Mr. Nimatallah made the following statement:

It is unfortunate that the SDR proposals are essentially linked to the resumption of SDR allocations. The way in which my authorities and I see it is that there is a specific international problem, namely, that there is a deflationary bias in the system that is created by the needs of many small developing countries in their efforts to reduce their current account imbalances. Since they are unable to borrow in the private capital market even when they have adjustment policies in place, they are forced to cut their imports further. The objective of any proposal or mechanism for redistributing SDR reserves should therefore be to reduce that deflationary bias in the system.

If that is the objective, then what are the means? First, there has to be a comprehensive adjustment and growth program in place, adopted by the specific country or countries that cannot borrow in the private market. That means that conditionality is required before any country can benefit from this proposed mechanism. The mechanism that I have in mind, therefore, is the kind of mechanism that exists under the structural adjustment facility. It is intended to enable the Fund to acquire more resources for a country that asks for the Fund's financial support from other members on a voluntary basis. It is in essence like increasing the access of that member to more Fund resources selectively. Second, the kind of members that will require these additional resources are usually the ones that suffer from structural imbalances that call for medium-term adjustment programs. Therefore, it is also important that any Fund help should be combined and coordinated with help from other lending institutions, particularly development institutions.

Third, owing to the latest worsening of the problem of overdue obligations, any mechanism that is designed along the lines that I have just mentioned should include preventive measures against delays in the settlement of obligations. It is very unfortunate that, while some members make every effort to find additional resources for needy members, some of those needy members fail to fulfill their responsibility to utilize those resources effectively and to repay creditors, particularly the Fund.

In sum, I can think of a mechanism along the lines of Mr. de Groote's proposal that would be complementary to the structural adjustment facility with or without an SDR allocation. I think that it will help to increase the access of certain individual members, irrespective of the size of the Fund's ordinary and borrowed resources. This approach will show that the Fund and perhaps the World Bank, acting in their catalytic role, can participate with a higher proportion of a financing package that might induce some additional commercial financing.

Mr. Sengupta remarked that the question of the distribution of SDRs was closely related to the measurement of the global need for additional liquidity. None of the proposals was inconsistent with his assessment of the existence of a global need. The main question at hand was whether the distribution of reserves was appropriate, and whether a quota-based allocation of SDRs was the proper method of distribution.

His proposal was designed to answer the charge that suggestions for redistributing SDRs after an allocation were actually connected with the link proposal and were therefore in fact proposals to introduce mechanisms by which SDRs would be spent by developing countries rather than held as reserve assets, Mr. Sengupta continued. In other words, his proposal was meant to preserve the main, monetary characteristic of the SDR. The "overdraft facility" that he had proposed was meant to ensure that the reallocated SDRs would be a close substitute for other kinds of reserve assets held by members. The proposal was based on the fact that developing countries held reserve assets, and that the characteristics of the

SDR had to be such that the SDR was as attractive as other assets that were held by members. A permanent overdraft facility would enable developing countries to use the SDRs whenever the need to do so arose. There should be no conditions on that use; the inclusion of conditions would mean that the reallocated SDRs could not be used like other reserve assets.

Mr. de Groote's proposal would be very attractive if it were not linked with meeting the Fund's financing requirements, Mr. Sengupta commented. Fund resources should continue to be based on quotas. He agreed with Mr. Polak that there was no reason to feel that the Fund was short of resources at the present stage. In any event, if such a shortage were felt to exist, it should be addressed through an increase in quotas. Mr. de Groote's proposal could usefully be amended along the lines that Mr. Nebbia had suggested. In his view, it would make no difference to have the surplus SDRs allocated to developed countries be given to a contingency fund or the structural adjustment facility--rather than directly to the Fund--which could then provide loans to developing countries. That approach was close to the staff's original proposal.

As he understood it, Mr. Zecchini opposed his proposal because it was similar to the development link, while Mr. Zecchini could support the proposals of Mr. de Groote or Mr. de Maulde, mainly because they involved conditionality, Mr. Sengupta commented. He agreed with Mr. Zecchini that conditional assistance need not be associated with the concept of the link. His proposal was clearly designed on the assumption that developing countries would hold SDRs as reserves.

Mr. de Groote made the following statement:

> Today's discussion has been particularly productive, as it has demonstrated a growing interest by the Executive Board in the two objectives underlying the proposals under discussion: enhancing the role of the SDR in the international monetary system and its importance in members' reserves, and reducing the deflationary pressures resulting from the need for some countries to establish an appropriate reserve level. It is unnecessary to deal now in detail with the different issues raised by Executive Directors, since most of them require further analysis by the staff and the Executive Board. Therefore, I intend to consult the staff on all the substantive points that have been made, and I will communicate to members of the Executive Board any conclusions or written material that might result from these exchanges of views.
>
> At this stage, I can distinguish four main questions that deserve further study. The first is the distinction between owned and used reserves. Interesting as this distinction might be from a theoretical viewpoint, any attempt to apply it to a stock of existing reserves will bring us into the deep waters that were navigated by the Ossala Report. A country does not

keep its reserves unless it follows certain policies. Similarly, except for the SDR, countries acquire reserves only if they follow certain policies. Using borrowed reserves, whether in the form of SDRs or some other asset, helps to reconstitute the desired level of owned reserves if appropriate policies are followed. Therefore, I do not see much merit in the view of some Executive Directors that the use of SDRs to support Fund programs would be contrary to the exclusive characteristic of owned reserves that in their view the SDR should have. In my opinion, denying that an allocation of SDRs can be "lent" to the Fund and further used in Fund credit operations, because allocations have to answer a need for owned reserves, is a futile attempt to impose on reality a distinction that disassociates two aspects of all reserves, not two different categories of reserves. By the way, I am not aware of any reference to the notion of owned reserves in the Articles or of any restrictions based on this notion with respect to the use of SDRs.

The second question is the alleged incompatibility between the nature of SDRs and their use in Fund programs. This question partly overlaps the first question but has an additional legal and operational dimension, since it is inferred by several Executive Directors that the Fund had no capacity to use the SDR for the purpose that I have suggested. I have great difficulty with this interpretation, because the Fund has already financed ordinary programs with SDRs from the General Account, with the SDRs coming from quota subscriptions and reimbursements. In general, I fail to see why the use of SDRs in credit operations would be incompatible with the nature of the SDR, which is supposed to be one among other reserve assets and open for all uses to which such assets can be applied. In that connection, Decision No. 6001, adopted on December 28, 1978, explicitly provides for the use of SDRs in loans in accordance with Article XIX, Section 2(c).

The third question is the difference between funding the Fund through quota increases or through a "loan" to the Fund of an SDR allocation. Several Executive Directors seem to have great difficulty with the possibility of using an allocation to finance Fund-supported programs. Pending further study of this important question I do not share their misgivings. No form of funding the institution is superior in principle to another, and the Articles and our practices do not include the proposition that quota increases are somehow more "normal" than other forms of financing. How otherwise could we have been willing to finance an important part of our activities with resources directly borrowed from members, and how otherwise could we explain that among the basic features of the institution's funding mechanisms are the Special Arrangements to Borrow? Moreover, and more important, there is an essential difference between funding through quota increases and funding through the "lending" to the Fund of an allocation, since only the latter increases the share of SDRs in total reserves. I am surprised to see that other Executive Directors so often quote the passage of the Articles that refers to global need but never the passage in Article XXII that recommends making the SDR the primary reserve asset in the international monetary system. Financing the Fund through a post-allocation "loan" of SDRs has a distinct superiority in this regard.

The fourth question has to do with Mr. Nebbia's proposal to transfer the allocation of the industrial countries to a special account managed by the Fund, instead of transferring the allocation to the Fund itself. I am especially interested in Mr. Nebbia's proposal, which is particularly constructive. It obviously displays many similarities to the Belgian proposal. When we developed the Belgian proposal, our preoccupation was to integrate fully our recommendation into the Fund's practices without considering the possibility of opening up new accounts, a possibility that at the time was considered critically by the General Counsel. However, our proposal explicitly incorporates the possibility for the Fund to use the SDRs transferred to it for different types of programs. Mr. Nebbia's proposal has the great merit of making that even more explicit by envisaging that the "loans" could support programs under special contingency clauses such as those that are found in the current Mexican program, to which could be added programs that could be specifically redirected at replenishing members' reserves. My initial reaction is that I am especially attracted by Mr. Nebbia's very imaginative suggestion, and I would have no major difficulty in accepting it, provided that the reserve characteristics of the loan made to a special account would be as clearly established as the reserve characteristics of loans of SDRs made to the Fund itself. At first glance, I would assume that monetary authorities would be more inclined to consider as reserves a claim on the Fund than a claim on an account in which the liquidity of claims was guaranteed only by debtor countries.

Mr. de Forges recalled that the French proposal had been made in the context of the debate on a new allocation of SDRs. The staff should further examine all the proposals that had been made.

Mr. Nimatallah noted that Mr. Sengupta had mentioned that he was willing to consider Mr. de Groote's scheme, except for the funding of the Fund that would be involved, because the Fund already had sufficient resources. However, it was important to consider the possibility of increasing the access of individual members to Fund resources in support of adjustment programs. Certain programs might need more financing than could be provided under the present practices. Mr. de Groote's proposal could help to enhance the access of individual members. By increasing its participation in a financing package the Fund could encourage commercial lenders to play a larger role in the financing.

Mr. Zecchini said that, as he understood it, one of the basic features of Mr. Sengupta's proposal was that it would allow debtor countries with limited access to increase their reserves. A question that came immediately to mind was why such countries would hold more reserves rather than use additional reserves. In that connection, it was useful to examine the function of the debtor countries' demand for reserves. The function included a transactions demand component, a precautionary demand component, and a guaranteed demand component. The transactions demand implied that a country needed working balances to deal with sudden fluctuations in the country's need for cash to support a certain course of policies. Accordingly, the member concerned wished to add reserves as a short-term or medium-term shelter for the maintenance of policies for which financing was not available in the market. The precautionary demand suggested that some reserves were held only for the purpose of meeting unforeseen fluctuations in a country's external current account balance. However, he doubted whether it was advisable for debtor countries to add to reserves for that reason, since meeting the precautionary demand involved opportunity costs of holding idle reserves. The guaranteed demand component suggested that a member might wish to hold additional reserves in order to enable the country to borrow in the financial markets. In that event, additional reserves played an indirect role. As he understood it, Mr. Sengupta's proposal was presented in a way that would not involve any immediate and direct use of reserves and implied a release of resources in an indirect manner for the purpose of supporting policies that might not be fully consistent with the requirements of the international adjustment process.

Mr. Nebbia commented that all the proposals under consideration had been devised mainly in response to views of the advocates of the proposals and of the Fund that there was a long-term global need for additional reserves and that the distribution of reserves was uneven. The logical instrument to use in responding to those views was an allocation of SDRs, which could be used as additional financing in support of the adjustment efforts of a number of members. The proposals could in principle stand on their own, without an allocation of SDRs. However, in the absence of an allocation, the proposals would lack the resources to provide additional financing in support of members' adjustment efforts. It was useful to note that only one of the various proposals--Mr. de Groote's--provided for a solution in a genuinely multilateral environment. The Fund could continue to make substantial efforts to find additional financing for individual countries over relatively short periods, but it might be preferable to have a multilateral system devised by the Fund and providing an account into which contributing members could place resources.

The Director of the Research Department said that the staff looked forward to studying Mr. Nebbia's proposal. At first glance, Mr. Nebbia's proposal seemed to bear a strong resemblance to Mr. de Groote's scheme. It would be important to clarify which members would be expected to make available the $16 million mentioned in Mr. Nebbia's proposal. There was no reason why the application of Mr. Nebbia's proposal would be inconsistent with the essential characteristics of the SDR.

The question had been asked by Mr. Kafka whether the Fund could not stand ready to cooperate with any member that wished to operate under any of the mechanisms that had been proposed, the Director recalled. At present, it was possible for any member to lend or give its SDRs to any other participant in the SDR scheme, and the good offices of the Fund were available to facilitate such transactions. One of the main questions at hand was whether the Fund wished to have a kind of tap issue of Fund liabilities to countries that wished to invest SDRs in such liabilities. That approach might not be the most orderly possible way in which to provide resources to the Fund, but tap issues of official liabilities had been arranged in the past.

Another question that had been raised by Mr. Kafka was whether the Fund needed a generalized system of redistribution of SDRs, the Director said. He did not propose to answer that question, but it was useful to note that the Fund itself was such a generalized system.

It had been suggested by Mr. Pérez that conditionality was a kind of rationing device, the Director recalled. In that connection, Mr. Pérez had suggested that conditionality was used by the Fund to ration the use of Fund resources; in other words, if the Fund had more resources, it could apply less conditionality. In the staff's view, the measure of conditionality applied by the Fund was not a function of the volume of resources that was available to the Fund. Mr. Pérez had used the concept of conditionality as a rationing device in another, more subtle sense, namely, as a means of rationing the scarce resources that were available to a particular country that had a balance of payments deficit. It was conceivable that a member with such a deficit would have to adjust its balance of payments to the resources that could be made available to the country. Within the context of the country's debt servicing capability, the authorities had various policy options available, such as increasing or decreasing the volume of foreign debt. However, when a country had moved beyond its debt servicing capacity, it became necessary sooner or later to bring the country back within that capacity and, in that context, rationing would occur. The process would be orderly if the policies of the country were appropriate. In such cases, the Fund's conditionality and financing in support of the appropriate policies would in effect enable the country to have a smaller degree of rationing than would otherwise be required.

The question of owned versus borrowed reserves was complex and much debated, the Director of the Research Department remarked. As Mr. de Groote had stressed, if a country maintained inadequate policies it would be unable to retain for long either its owned or borrowed reserves. The staff also agreed with Mr. de Groote that there was no obvious reason to feel that lending of SDRs was incompatible with the nature of the SDR.

The Deputy Director of the Research Department said that he agreed with Mr. de Groote that the distinction between proposals that would increase credit and those that would augment reserves was somewhat artificial. Any resources that were available to increase the volume of reserves could also be used to finance a balance of payments deficit. Fund programs would continue to be used largely to help members to finance external deficits, although the Fund's resources could conceivably also be used by a member to increase its reserves. In practice, it would not be easy to determine to what extent the Fund's resources were being used by a member with a Fund-supported program for either purpose. Mr. Sengupta had stressed, however, that a principal purpose of his scheme was to enable members to build up their reserves.

The three proposals that were assessed in the staff paper were not mutually exclusive, the Deputy Director of the Research Department remarked responding to a point raised by Mr. Kafka. There would be no obstacle to a country lending SDRs to another country under the French proposal while simultaneously making SDRs available to the Fund under the Belgian proposal as well as to certain members in line with Mr. Sengupta's scheme.

Mr. Pérez commented that he had meant to say that there was a widespread belief that conditionality was not only a fair instrument for securing the efficient use of Fund resources but also lent itself to being used as a rationing mechanism. In that connection, there was a trade-off between adjustment and financing: a lack of financing could cause a member to have to rely upon a major adjustment effort that would involve lower rates of public investment and economic growth than might be possible if more financing were available.

The Chairman made the following summing up:

> The proposals are intended to improve the distribution of reserves and to increase the amount of owned reserves in countries that are having difficulty in gaining access to financial markets even though they are maintaining appropriate policies. The proposals involve voluntary transfers of all or part of newly allocated SDRs received by countries with strong reserve positions to countries with weak reserve positions.
>
> These proposals are also intended to alleviate some of the fears that seem to have impaired progress toward reaching a consensus on an SDR allocation. Accordingly, the Belgian proposal provides for Fund-directed conditionality, the French proposal involves a general assessment of economic policies, and Mr. Sengupta's proposal includes a reconstitution provision. These suggestions are intended to ensure that the transfers of SDRs would not weaken the adjustment process, and that the monetary character of the SDR would be preserved.
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> The discussion today showed that the Executive Directors who oppose an allocation of SDRs also have objections to the three proposals. In addition, two Executive Directors who support an SDR allocation said that they favored none of the three proposals. Thus, eight Executive Directors, in all representing

some 51 percent of the voting power, stated that they could not accept any of the proposals. Furthermore, three Directors, with an aggregate voting power of some 10 percent, had great difficulty with each of the three proposals, but they could accept further examination of the Belgian proposal. Including the latter Directors, as well as Mr. Nimatallah and Mr. Nebbia, there are seven Directors, representing 22 percent of the voting power, who endorse or could go along with further study of a proposal along the lines of that of Mr. de Groote. Six Directors, having an aggregate voting power of 17 percent, favored Mr. Sengupta's proposal. That group includes one Director who could go along with either the French or Mr. Sengupta's proposal, and one Director who was willing to have all three proposals further examined. Four Directors said that the French proposal was acceptable, with some caveats. They represent about 15 percent of the voting power.

Among the arguments against the three proposals, I noted the following main ones. First, the proposals do not seem to be compatible with the original SDR scheme, which was designed to meet the growing need for reserves of the entire membership over time. The second objection--which is a corollary of the first objection--is that the Fund should not use an SDR allocation to improve the reserves of a particular group of countries. Third, in objecting to the Belgian and French proposals some Directors argued that there is no proven shortage of conditional liquidity, and that since the Belgian proposal would tend to increase the volume of Fund resources available for financing of Fund operations, it could detract from the objective of maintaining quotas and quota increases as the primary source of Fund financing. Fourth, some Executive Directors feel that Mr. Sengupta's proposal is too close to a development aid link, although Mr. Sengupta made it clear that that is not the intention of his proposal.

Those who favor some or all aspects of the proposals made the following points. First, the existence of a large, although not universal, reserve problem has implications for the entire system and could have--indeed, in the view of some, is already having--a recessionary effect that is inconsistent with the Articles. Second, the skewed distribution of reserves and the impaired access to financial markets of some countries that have adopted adjustment policies justify corrective action by the Fund. Third, several Directors stressed that the limits on access to conditional resources are unsatisfactory. Fourth, there is a need to increase not only conditional resources, but also owned reserves, in order to reinforce the reserve position of countries, especially those that are implementing structural, growth-oriented adjustment programs.

During today's discussion Mr. Nimatallah and Mr. Nebbia added new ideas to the debate. Some Directors asked the staff to examine what appear to be the complementarity or possible bridges between the three proposals and the ideas put forward by Mr. Nebbia and Mr. Nimatallah. In addition, the staff will wish to consider the questions that were posed by Mr. de Groote, Mr. Nimatallah, and Mr. Nebbia in particular, and the various observations that were made by Mr. Sengupta and other Directors.

Several ideas or objectives were widely stressed during the discussion. One is the need to improve the reserve position of certain members in order to enhance their creditworthiness without obliging them to achieve a balance of payments surplus. A second idea is that to the extent possible these extra reserves should not be spent; they should cushion the reserve position of the members concerned. To that end, there would have to be some assurance that their policies would enable those countries to avoid an immediate depletion of the supplemental reserves; it is for that reason that all these proposals discussed today include some form of, if not conditionality, at least assurance that the policies will be appropriate ones.

We will consider, in the context of our work program after the Annual Meetings, how these ideas are to be pursued in the context of further work on the role of the SDR.

2. TANZANIA - OVERDUE FINANCIAL OBLIGATIONS

The Chairman informed the Executive Directors that Tanzania had eliminated its overdue financial obligations in the General Resources Account and that the declaration of ineligibility to use the Fund's general resources had been lifted. Tanzania was still overdue by a small amount to the Trust Fund, but that overdue payment did not affect the lifting of the declaration of ineligibility. A friendly country was expected to finance a payment to the Fund of SDR 1.7 million in the near future.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/124 (7/30/86) and EBM/86/125 (7/30/86).

3. CENTRAL AFRICAN REPUBLIC - TECHNICAL ASSISTANCE

In response to a request from the Minister of Finance of the Central African Republic for technical assistance in the tax field, the Executive Board approves the proposal set forth in EBD/86/205 (7/24/86).

Adopted July 30, 1986

APPROVED: April 15, 1987

JOSEPH W. LANG, JR.
Acting Secretary