INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/129

3:00 p.m., August 4, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	K. Yao, Temporary
	D. C. Templeman, Temporary
J. de Groote	
M. Finaish	
	M. Sugita
	B. Goos
Huang F.	
J. E. Ismael	
	J. Hospedales, Temporary
	S. King, Temporary
	I. Puro, Temporary
	L. Leonard
E. I. M. Mtei	
	M. A. Weitz, Temporary
	J. E. Suraisry
P. Pérez	
	S. de Forges
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	
S. Zecchini	

L. Van Houtven, Secretary
S. J. Fennell, Assistant

1. SDR - Approaches to Influencing Share in Members' International Reserves; and Development of Voluntary Transfers Among Participants and Prescribed Holders . . . Page 3

Also Present
Legal Department: R. H. Munzberg. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; A. Craig, D. Folkerts-Landau, D. J. Mathieson. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; W. L. Coats, Jr., E. Decarli, S. I, Fawzi, P. Ross. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: W.-R. Bengs, L. P. Ebrill, K. Murakami, P. Péterfalvy, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, O. S.-M. Bethel, B. Bogdanovic, W. N. Engert, V. Govindarajan, G. K. Hodges, J. M. Jones, L. de Montpellier, T. Morita, A. H. Mustafa, J. Reddy, J. E. Rodríguez, D. Saha, B. Tamami, H. van der Burg.

1. SDR - APPROACHES TO INFLUENCING SHARE IN MEMBERS' INTERNATIONAL RESERVES; AND DEVELOPMENT OF VOLUNTARY TRANSFERS AMONG PARTICIPANTS AND PRESCRIBED HOLDERS

The Executive Directors continued from the previous meeting (EBM/86/128, 8/4/86) their consideration of the staff papers on alternative approaches to influencing the share of SDRs in members' international reserves (SM/86/169, 7/9/86) and on the development of voluntary transfers of SDRs among participants and prescribed holders (SM/86/142, 5/18/86). They also had before them as background information a paper on holding and use of SDRs by Fund members (DM/86/48, 7/28/86).

Mr. Salehkhou remarked that the staff papers had been prepared in response to the recommendation of the Interim Committee that the Executive Board should study possible improvements in the monetary characteristics of the SDR that would increase its attractiveness and usefulness as a component of monetary reserves. It had urged the Board to discuss possibilities for obtaining a more balanced and stable proportion of SDRs in members' reserves. The Committee's recommendation had been prompted by the Chairman's summing up, in which he had indicated that the unwillingness to allocate SDRs was to some extent a manifestation of the unwillingness to hold SDRs. Apart from looking at the need for an SDR allocation, the Board should consider aspects of the use of the SDR and its acquisition and holding by members. The use of SDRs benefited most member countries, as it helped them to increase their reserves without having to resort to borrowed resources, while pursuing orderly adjustment efforts. As such, SDRs helped to alleviate the existing asymmetries in the international monetary system, provide adequate liquidity, and expand foreign trade. However, a number of countries were unwilling to acquire and hold SDRs. The concern of a few Directors that the persistent net use of SDRs would constitute a permanent transfer of resources or impede the necessary adjustment efforts was less relevant to their resistance to a further allocation than their unwillingness to hold SDRs. The unwillingness to hold SDRs in excess of cumulative allocation for a sustained period had led to serious concern over the prolonged net use of SDRs by some members, including those capital-importing developing countries with debt-servicing problems.

Ways should be found to enhance the attractiveness and usefulness of SDRs to encouarge members to acquire and hold them, Mr. Salehkhou considered. He commended the staff for its efforts in enhancing the role of the SDR in voluntary transfers among participants and prescribed holders and in reducing the waiting time for voluntary transactions, which had to some extent led to a reduction in the need for the designation mechanism. The rapid growth of voluntary transactions in SDRs had been due largely to members' obligations to make repayments to the Fund rather than from a preference to hold SDRs for transactions other than those with the Fund. There was room for increasing further the usability of SDRs by promoting the SDR as a unit of account, broadening its uses by the Fund, and allowing participants and other holders greater latitude in arranging operations in SDRs. The staff had explored possible regulations and economic incentives that would help to stabilize the proportion of SDRs in members' reserves.

With respect to economic incentives, the current rate of interest on the SDR was appropriate, Mr. Salehkhou remarked. A rise in the rate would not increase the willingness of members to hold that asset. Demand for reserves by central banks depended on and was influenced by other factors. The monetary characteristics of international reserves required that the arrangement for acquiring, holding, and using them be simple. In spite of the advantages that were envisaged for the SDR, including the lower potential risks of default, imposition of restrictions to use or hold SDRs would weaken the attractiveness and usefulness of the asset. The major impediment that had led a few members to oppose an allocation was the current limitation for holders that were unable to use their SDRs rather than the interest rate on the SDR.

The staff had suggested the reintroduction of the reconstitution requirement, abrogated in 1981, as a way to achieve more balanced and stable distribution of SDRs in members' reserves, Mr. Salehkhou noted. That requirement, which restricted the use of the SDR, would weaken the monetary characteristics of the SDR as an international reserve asset. Indeed, the Chairman had stated in August 1979 that the increased attractiveness of the SDR resulting from proposed improvements should reduce the need for reconstitution provision. Directors had been of the view that the below market interest rate on the SDR and the reconstitution requirement reduced the attractiveness of the SDR vis-à-vis other reserve assets. Therefore, it seemed inappropriate to reintroduce that regulation particularly as the SDR interest rate had been increased to the combined market rate and, therefore, the net uses of SDRs were not subsidized by the net recipients. Alternative approaches should be considered and discussed by the Executive Board. However, if the resumption of an allocation was to be subject to a stable distribution of SDRs among members through regulation, he was prepared to go along with the introduction of regulation on the net use of SDRs relative to the net use of other reserves. That approach, which was consistent with the notion of balance suggested in Schedule G, Section 1(b) of the Articles of Agreement was more feasible than Schedule G, Section 1(a). However, he agreed with Mr. Polak that reserve management under the kind of rule described would involve some cost for net users of SDRs, compared with the present policy many of them pursued of allowing their SDR holdings to be run down to very low levels. A new allocation could mitigate the burden of the sustained net users of SDRs by enabling them to hold a reasonable amount of SDRs in proportion to their international reserve holdings.

Mr. Finaish noted that the present pattern of SDR holdings showed that most capital-importing developing countries had tended to be net users of SDRs in recent years. That fact had been viewed by some Directors during recent Board discussions on the SDR as contradictory to the often cited need of those countries for higher reserves and to the justification for new SDR allocations. The point had also been made that sustained net use of SDRs led to permanent transfers of real resources.

Countries held reserves for the benefits they yielded, but holding reserves involved costs, Mr. Finaish pointed out. The benefits of holding reserves tended to be relatively greater for developing countries than for developed countries. As a result, developing countries had shown a willingness to replenish and hold reserves at costs that were frequently higher than the similar costs incurred by developed countries. The pattern of reserve holdings of many developing countries following the sharp fall in reserve holdings in 1982 provided supportive evidence. Reserve accumulation had taken place since then, in many cases at the high real costs associated with current account adjustment. The fact that many developing countries had not replenished their SDRs in recent years along with the buildup of other assets did not necessarily indicate a lack of demand for reserves by those countries, but was rather a likely consequence of the relative unattractiveness of the SDR.

The pattern net use of SDRs did not necessarily give rise to a similar pattern of permanent transfer of real resources, Mr. Finaish indicated. One would think that the extent of the transfer of real resources depended on the volume of net SDR use and the extent to which the SDR rate of interest was below a relevant market rate of interest. Concerning the volume of net SDR use, when actual reserves were below desired levels, the SDRs used had tended to be substituted by additions of other reserve assets at times of reserve build-up. The staff might wish to comment on whether many developing countries that gained real resources from the use of SDRs had not in fact experienced offsetting outward flows of real resources in the process of rebuilding their reserves, particularly through deflationary policies. In other words, when abstracting from an interest rate subsidy, if any, was it not true that actions affecting reserves that resulted ultimately in exchanging SDRs, in effect, for other preferred reserve assets offset partly or fully the initial gain arising from the net use of SDRs? At any rate, whatever the volume of the net use of SDRs whose impact was not offset by additions to reserves of other assets, the unit subsidy would depend on the extent to which the SDR interest rate differed from a comparable market rate of interest. Recipients of designated SDRs earned the SDR rate of interest, which was close, from their perspective, to a market rate of interest. Therefore, in terms of the interest foregone, the burden of such a subsidy, if any, arising from having to give up currency in exchange for designated SDRs was generally small. In contrast, the use of SDRs conferred a larger benefit on developing countries with constrained or no access to international financial markets, suggesting that the SDR system had the potential to provide a framework for meeting at least part of the liquidity needs of developing countries at limited costs to creditors. In that light, it might be useful to elaborate the concept of, and estimate the flows of, transfers of real resources arising from the net use of SDRs from the standpoint of both the SDR recipient and user countries.

Large or small, the burdens associated with holding an excess of SDRs made it desirable to promote a more balanced distribution of holdings as part of the effort to generate sufficient support for a resumption of SDR allocations, given the costs that the absence of SDR allocations imposed on developing countries as well as those arising from limiting the potential role of the SDR in the international monetary system, Mr. Finaish said. For those reasons, there was rationale for promoting a more balanced distribution of SDR holdings among member countries.

As the staff paper showed, a more balanced distribution of SDR holdings could be promoted through reliance on regulation or on economic incentives, or through some combination of both, Mr. Finaish stated. While he had an open mind regarding all efforts that would generate sufficient support for a resumption of SDR allocations, he recognized that there were clear advantages, at least from the efficiency viewpoint, to the economic incentives approach over that of regulation. The economic incentives approach promoted demand for SDRs by improving the SDR characteristics and, thus it limited the costs associated with the holding of unwanted SDRs and the divergence of actual reserves from desired levels. A major determinant of the demand for SDRs that needed to be focused upon was the usability of the SDR relative to other reserve assets. In that context, it should be noted that the liquidity of the SDR was limited for holders unable to use their SDRs with designation and that there were potential benefits associated with a more direct use of official SDRs for foreign exchange market intervention as well as the promotion of the private use of the SDR. The other important determinant of the willingness to hold SDRs was the SDR yield relative to yields of other reserve assets. In that regard, it seemed that the present method of valuation and interest rate determination generated SDR yields that were generally close to those on other competing assets. Therefore, it might be unadvisable to raise significantly the interest rate on the SDR to offset shortcomings arising from limitations on relative usability. Such an approach to promoting demand for SDRs would constrain the use of the SDR by making it more costly.

Regulation to balance the distribution of SDRs among participants was generally not an attractive alternative to the economic incentives approach except perhaps from a practical standpoint, Mr. Finaish considered. Regulation imposed costs beyond those of administering the system, as it would require participants to hold levels of SDR that would tend to differ from desired levels. That would reduce the attractiveness of the SDR and might contribute to some members' reluctance to agreeing to new SDR allocations, even if it were possible to achieve, through regulation, a more balanced distribution of the burdens associated with excess SDR holdings. Therefore, regulations might limit the potential role of the SDR in the international monetary system and might make it more difficult to achieve the status of the principal reserve asset as envisaged in the Articles of Agreement.

The staff paper discussed two types of regulations corresponding to those identified in Schedule G of the Articles of Agreement; regulation of net use of SDRs relative to net cumulative allocations and regulation of net use of SDRs relative to the use of other reserve assets. Important distinctions between the two types of regulations related to the implications that each had for various countries in light of their likely use or acquisition of SDRs as well as their reserve holding behavior. Restrictions on the use of SDRs relative to cumulative allocations could impose a burden on user countries in the event that an obligation to reconstitute arose at a time of balance of payments need. While the possibility of such a hardship could be avoided under a reserve-based constraint on SDR use that type of regulation could, however, reinforce the pattern of SDR holdings in excess of cumulative allocations that developed under the current designation scheme, which tended to harmonize ratios of excess SDR holdings relative to reserves, not cumulative allocations. As shown in column (4) of the table presented by Mr. Polak, the current designation scheme had resulted in an average ratio of SDR holdings relative to cumulative allocations that was significantly higher, at 1.87, for the group of capital-exporting developing countries, than the corresponding ratio, at 1.03, for the group of industrial countries. Thus, in relation to cumulative allocations, the first group had borne a disproportionate share of any burdens associated with excess SDR holdings. Given that SDRs were allocated in proportion to quota and given the tendency of some countries to hold relatively higher reserves than others owing to differences in circumstances, it could be that cumulative SDR allocations constituted a more appropriate basis than the pattern of reserve holdings for distributing the burdens associated with excess SDR holdings arising from designation. Furthermore, reserve-based regulations to balance the distribution of SDR holdings tended to be, in the staff's view, more difficult to administer than regulations based on cumulative allocations. As pointed out by the staff, there were differences among countries with respect to recording of official reserves as well as with respect to the availability and confidentiality of reserve data.

As he was in broad agreement with the staff's conclusions on the voluntary transfers of SDRs, he would make only three brief comments, Mr. Finaish indicated. Voluntary transfers of SDRs have increased substantially and have exceeded designated transactions in recent years, a welcome development. He commended the efforts made by the staff and supported the continuation of efforts in this direction. The rapid growth of voluntary transfers of SDRs in recent years had been motivated largely by the need to use SDRs in transactions with the Fund rather than by a preference to hold SDRs. Therefore, his authorities supported the further steps suggested by the staff to promote the voluntary transfer of SDRs. He welcomed the example set by Austria in making a standing arrangement with the Fund to buy and sell SDRs, within certain limits. Such arrangements with the large industrial countries would reduce the scope of designation and enhance the attractiveness of SDRs.

The Economic Counsellor remarked that the purpose of reserves, in whatever form, was to permit on occasion a transfer of real resources. However, such a transfer of real resources was expected to be temporary in nature, although the financing of current account deficits by borrowed resources might well be prolonged, especially in a country that had not yet become a capital exporter. He agreed with Directors that it was not inconsistent with the appropriate working of the system that there be a temporary transfer of real resources.

In his opening statement, Mr. Polak had stated that any inadequacies of the SDR as a reserve asset would have to be corrected by measures that increased the usability of the SDR rather than by increasing the rate of interest for the SDR, the Economic Counsellor recalled. He agreed with that view if Mr. Polak had meant that priority should be given to formulating measures that would help establish a market in SDRs rather than to increasing the yield of the SDR. However, if Mr. Polak had in fact been denying the efficiency of price incentives, he did not agree with him. The future of the SDR depended on the perceived need for that asset in the system. However, the development of a market in SDRs and in private liabilities denominated in SDRs would not be easy if the use of those assets by their holders was hedged by a variety of regulations.

The Treasurer remarked that the objective of the voluntary standing agreements to buy and sell SDRs was to allow participants to express freely their willingness to accept and trade SDRs. The staff had been aiming to gradually eliminate in practice the requirement need for acceptance of obligations, which had been laid down in the Articles of Agreement in order to provide a minimum assurance that SDRs could be used in case of a balance of payments need. The creators of the SDR had envisaged that voluntary transfers would eventually take the place of designation requirements.

One Director had pointed out that given the rules of designation, if a country sold SDRs, its excess holdings ratio would decline--other things being equal--and the country might be subject to further designation, the Treasurer recalled. He had pointed out that such a situation would undermine the objective of using SDRs voluntarily. However, if there were voluntary buyers, there would be less need for designation. In fact, if there were enough buyers and sellers of SDRs on a voluntary basis, no designation plan would be needed at all. Eventually, the designation plan might be only a safeguard that would be referred to only in the event that there were no willing buyers or sellers that stood ready to make a market in SDRs.

The principal advantage of the two-way arrangements between the Fund and members to buy and sell SDRs would be the resulting increase in the liquidity of the SDR, the Treasurer stated. Furthermore, such arrangements would reduce the need for designation and would encourage holders to buy SDRs. In addition, the existence of voluntary bilateral arrangements would eliminate the need for a member to assert that it had a balance of payments need to use its SDRs. A number of members had been reluctant to use SDRs because they did not wish to make a public declaration that they had a balance of payments problem. Such arrangements would make the SDR more like any other reserve asset.

While a number of members had welcomed the two-way arrangement with Austria and had indicated their authorities' willingness to consider agreeing to a two-way arrangement under certain conditions, the imposition of such conditions would in effect introduce an element of regulation and would therefore diminish the willingness and ability of members to participate in such arrangements, the Treasurer pointed out. It would be wrong to assume that only the large industrial countries should enter into two-way arrangements. All countries had a need to hold reserves and to use them. In fact, one of the major buyers of SDRs was a developing country.

SDRs could be used in a large number of transactions and operations and it was likely that the use of SDRs could be expanded, the Treasurer indicated. However, it was difficult for holders of SDRs to determine whether an operation would be compatible with the Fund's decisions regarding operations in SDRs, but as the staff had proposed several years previously, SDRs could be made easier to use if the Fund's requirements for their use were reduced and simplified.

Mr. Polak stated that while he agreed that it would be useful if a number of countries, including smaller industrial and developing countries, entered into two-way arrangements with the Fund, it was clear that the United States had a considerable comparative advantage to enter into such an arrangement. The United States economy was considerably larger than most countries: it had virtually no reserves and therefore had a greater potential interest in acquiring additional SDRs than other countries with large reserves; and it would have little difficulty in coming up with the dollars necessary to pay for SDRs. The United States could help to improve the functioning of the international monetary system considerably by undertaking to buy and sell SDRs as needed.

Mr. de Groote remarked that he agreed fully with Mr. Polak. Based on the data provided by Mr. Polak, it was clear that a couple of industrial countries would be required to make adjustments if some kind of rule were applied on minimum additional holdings of SDRs. Some developing countries, such as Mexico, would not have to adjust to the same extent as would the industrial countries. It would be useful if the staff could prepare a paper on the issue of the transfer of real resources in relation to the use of SDRs.

He had thought that one of the objectives of the current discussion was to consider ways to overcome a number of members' unwillingness to hold SDRs in an effort to reduce the opposition of some members to a further allocation of SDRs, Mr. de Groote indicated. However, a number of Directors had stated at the present meeting that they considered the question of an SDR allocation to be completely separate from the issues presented in the staff papers. It therefore seemed that the rules of the game had been changed.

Mr. Goos reiterated that the only relevant justification for an SDR allocation was the existence of a global need for additional reserves. It was inappropriate to change the criteria on which an SDR allocation should be based.

Mr. Templeman noted that based on the information provided in the table presented by Mr. Polak, the United States would be ranked number 4 in terms of the ratio of SDR holdings to total reserves behind Laos, the Congo, and Cameroon. Furthermore, the ratio of SDR holdings to cumulative allocations for the United States was higher than that for all other industrial countries except for Japan and Norway.

Mr. Zecchini commented that Directors should be cautious in drawing quick inferences from data included in the table presented by Mr. Polak. The factors underlying the different ratios should be analyzed in an effort to address the problems associated with the uneven distribution of SDR holdings. Only by improving the attractiveness of the SDR as a reserve asset could members' perceptions about holding SDRs be changed.

The Chairman stated that he considered the SDR to be a liquid asset. There had been no case when a country with a balance of payments need had been unable to use its SDRs. If the SDR was considered as an asset to be used in the face of a liquidity problem, it was a perfectly liquid instrument.

Mr. Zecchini remarked that the liquidity of the SDR was not the same as the liquidity of any other major reserve asset for a variety of reasons. First, the Fund was involved as an intermediary in ensuring the liquidity of the SDR. Furthermore, countries sometimes had to demonstrate a balance of payments need in order to sell SDRs. It was difficult for countries to admit to a balance of payments need, which could be perceived as a negative factor by the international community. Second, the SDR could not be used for all purposes. The rules of the Fund limited the liquidity of the SDR by establishing a list of transactions. Third, the appropriate yield for the SDR was difficult to determine in the absence of a real market for SDRs.

Mr. Polak commented that if a small country wished to use SDRs in a transaction with designation, the few SDRs that it wished to dispose of would be absorbed in the general holdings of all other countries. However, a large country might be reluctant to use SDRs, as the relatively large quantity could end up with its neighbors, which did not necessarily wish to increase their holdings of SDRs.

Mr. Sengupta noted that the United States held relatively more SDRs in its reserves than a number of other industrial countries. It was clear that the United States attached considerable importance to holding SDRs, a point Mr. Templeman had made. While the final decision on a further allocation of SDRs was dependent on the political will of members, two factors were clearly of importance to many members when considering that issue: the question of the net transfer of resources and the question of a global need for reserves. It would be useful if the staff could prepare a paper on the concept of global need, setting out objective criteria, on the basis of which Directors could consider whether there was a global need or not. Furthermore, a paper on the transfer of resources would be helpful. In particular, the staff should elaborate on the point made by the Economic Counsellor that it was quite appropriate to have a temporary transfer of resources. The staff had stated in its paper that the failure to allocate sufficient SDRs in the face of a shortfall of reserves in relation to demand would result in balance of payments adjustments leading to an outward transfer of real resources. Further explanation of that concept would also be useful.

Mr. de Groote stated that he strongly supported the request of previous speakers for further staff papers on the notion of global need and on the transfer of resources. In its paper on voluntary transfers, the staff had described a number of innovations in SDR uses, including the purchases of official SDRs with private SDRs. There was also a possibility that private SDRs could be purchased with official SDRs through a third party. For example, certificates could be issued representing a certain quantity of SDRs, which could in turn be sold by the World Bank or any other financial institution to a private party or commercial bank. There could be portfolio considerations that might induce private holders, especially commercial banks or other financial intermediaries, to hold certificates representing official SDRs and to acquire them from designated holders against other assets.

Mr. Zecchini pointed out that the staff, in preparing its paper, should examine the economic and financial literature on the problem of creating a bridge between official and private holders of the SDR.

Mr. de Groote commented that the staff paper on the global need for reserves should examine the relevance of that criterion for an allocation of SDRs in the current functioning of the international monetary system.

Mr. Goos remarked that he was concerned that it appeared from a number of Directors' comments that the Articles of Agreement as they related to a further allocation were being questioned. It seemed inappropriate for the Executive Board to decide that the Articles of Agreement should be reconsidered. It would be preferable if the issue was first presented to the Interim Committee.

Mr. Sengupta stated that the decision on an allocation of SDRs was based on factors that were not entirely determined by the global need for reserves or the transfer of resources. However, he had proposed that the Board should discuss the concept of global need for reserves, considering the different factors that should be taken into account. Such a discussion would encourage Directors to focus their attention and express their views on the concept of global need, irrespective of the question of an SDR allocation.

Mr. Goos remarked that his authorities considered that in the present system of floating exchange rates and highly responsive capital markets, the requirements for international liquidity could basically be met out of existing credit sources. As such, there was no global need that justified a further allocation of SDRs. But he would not exclude that a situation might arise where the existing mechanisms did not provide sufficient liquidity.

Mr. Polak stated that most members did not interpret global need in the same way as the German authorities. Furthermore, that was not the interpretation that had been implicitly accepted by the Executive Board in 1978, when it had been unanimously agreed that an allocation was needed.

The Chairman made the following concluding remarks:

> Regarding the alternative approaches to influencing the share of SDRs in members' reserves, the issues concerning distribution of SDR holdings that have arisen in recent years have been well described in the staff paper (SM/86/169, 7/9/86) and illustrated in the graphs and tables included in that paper, and in Mr. Polak's statement (Buff 86/148, 7/30/86).
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> A number of Directors, from both capital-importing and industrial countries, argued that the drawdown of SDR holdings by many capital-importing countries was temporary rather than structural in that it reflected the severely strained balance of payments positions experienced by many countries, in particular by those that have been facing heavy debt-servicing problems over recent years. SDR holdings were drawn down to finance balance of payments deficits, including to discharge financial obligations to the Fund. The same group of Directors indicated that recent developments, especially those reflected in the data for 1985, showed an incipient reversal of the earlier trend of a drawdown of SDR balances. Moreover, they added that average holdings of the group of capital-importing countries remained well above the threshold of the earlier reconstitution requirements. Last, but not least, these Directors emphasized that SDR allocations had failed to keep pace with the growth of other non-gold reserves.
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> Other Directors, particularly those from some industrial countries, emphasized that prolonged net use of SDRs was, in their view, inconsistent with the monetary character of the instrument; that it represented a form of permanent transfer of resources; and that it delayed balance of payments adjustment. The point was also made that if only a limited number of countries held most SDRs, questions might arise as to the usability of these holdings in case of need. While these Directors were willing to examine the staff paper and its proposals in the context of the present role of the SDR, they were not prepared

to see it as a step on the road to resuming SDR allocations, as the staff seemed to have seen it. In the view of these Directors, a resumption of SDR allocations was directly linked to the notion of global need. Be that as it may, there was a rather widely held view that the pattern of SDR holdings in relation to other forms of reserve assets should become more balanced over time.

On the ways to achieve such a better balance, views were divided. Twelve Directors holding 62 percent of the total voting power preferred the use of economic incentives over regulation to influence the share of SDRs in members' reserves. Interestingly, this group of Directors included Directors both for and against an allocation. While there was little support in the Board for the reintroduction of some form of reconstitution requirement, 12 Directors holding some 40 percent of the voting power could support the idea of a regulation constraining the use of SDRs based on a ratio of SDR holdings to total reserve holdings. This group includes Mr. Ismael and Mr. Salehkhou, although their first preference is for no regulation. Several Directors, including Mr. Ismael, saw merit in examining a combination of the two types of regulations: based on ratios of SDRs to net cumulative allocations and to total reserves. Only 4 Directors representing some 33 percent of the voting power, with the qualified support of a few others, believed it useful to raise the SDR interest rate. Mr. Zecchini made an interesting suggestion regarding penalty charges for countries continuing to use SDRs beyond the ratios that would be set under some of these proposals. Such penalty charges would in a way be an intrinsic method of combining the regulatory and the incentive--or disincentive--approach. There was also broad agreement in the Board on the desirability of improving further the liquidity and usability characteristics of the SDR.

Directors noted the substantial increase in the volume of voluntary transfers, which is related to a large extent to the increase in the number of transactions between members and the Fund. They welcomed the active role played by the staff in helping members to arrange these voluntary transactions. Indeed, these transactions helped to promote the liquidity of the SDR and to reduce the heavy reliance on designation. They welcomed the two-way arrangement that Austria had agreed upon, and a number of Directors urged other countries, in particular large countries, to follow suit.

Directors requested that in its work program, the staff include an analysis of the concept of global need in the context of the new conditions under which the exchange rate and international monetary system is operating, and an analysis of transfers of SDRs or SDR-denominated instruments to and between third parties. It was also suggested that the concept of the transfer of resources through the SDR system be looked at in more depth.

These are issues that the Board has been asked by the Interim Committee to pursue within the context of its analysis of the SDR. But today's discussion should not prevent the Board from examining in the coming weeks the legitimacy of or the justification for an SDR allocation.

APPROVED: April 21, 1987

JOSEPH W. LANG, JR.
Acting Secretary