Ministry Paper No. 41

Special Drawing Rights Scheme

This Ministry Paper gives details of the Special Drawing Rights Scheme, as approved by the Board of Governors of the International Monetary Fund, as a background to the discussion on the Bill entitled the "Bretton Woods Agreement (Amendment) Act, 1968." Mention is also made of other amendments to the Articles of Agreement of the Fund. The detailed provisions of the amendments to the Articles of Agreement of the International Monetary Fund, to establish the Special Drawing Rights Facility in the Fund, will be incorporated in an Order to be made under Bretton Woods Agreement (Amendment) Act, 1968, which is before the House. The Order will be laid on the Table of the House as soon as the amendment referred to above is approved by both Houses of Parliament and assented to.

2. Since the late 1950s there has been a growing recognition of a shortage of international liquidity i.e. the means of financing disequilibria in balance of payments of countries. The Fund, in the 10 years preceding 1959, passed up the opportunity at its regular quinquennial review of increasing members quotas in the Fund on two occasions. The judgement at the time was that the level of international liquidity was adequate and there was no need to increase the volume of the Fund resources to be available to member countries, by increasing quotas. By 1958, however, the position changed. The Fund before the normal quinquennial review of the quotas, agreed on a large quota increase of 50% plus important special increases. This was followed in 1965 by a general increase of 25% with special increases for 16 members, including Jamaica. The facts are that in relation to the volume of world trade, the stock of world reserves has been declining. The following table illustrates the point.

	World reserves as percentage of world imports
1937/38	107%
1963	46.2%
1964	45.9%
1965	42.5%
1966	37.3
1967	35.5%

3. Between 1960 and 1964, the growth in world reserves averaged $2.1 billion (US) or about 3.3% p.a., whereas the growth in world imports averaged 7.7%. Since 1964 stocks of world reserves have remained more or less constant, except for the results of some special operations. At the end of 1967 the stock was as follows:-

	$ US (BILLION)
Gold	41 (59%)
Dollars	15 (20%)
Sterling	6 (9%)
Reserve position in IMF	6 (9%)
Miscellaneous	2 (3%)
	$70 billion.

An analysis of the composition of world reserves show that -

(a) since the end of 1964 there was virtually no net addition of gold to international monetary reserves; in fact at the end of March, 1968, gold holdings in world reserves declined from $40.0 billion to $37.8 billion, the lowest in a decade;

(b) the growth in the normal foreign exchange component of reserves has come to a halt; special increases under currency swap arrangements occured in the first half of 1968, but some of these are temporary;

(c) the area in which significant growth in reserves has been taking place is "the Reserve position in the IMF". However, at present, this is a relatively small component of total reserves (about 9%).

It is against the above background of the world reserves position that the S.D.R. scheme should be assessed.

------ 4. Attached is an extract from the 1968 Annual Report of the IMF which gives a summary of the S.D.R. scheme and other amendments to the Articles of Agreement of the Fund.

5. If S.D.R's totalling $1,000 million p.a. are created over the next five years it is estimated that, based on present members' quotas, the distribution will be as follows:-

Developing.....

Developing countries as a group	$280 M.
United States	250 M.
European Common Market countries	180 M.
United Kingdom	115 M.
Other Developed countries ..	175 M.
	$1,000 M.

Jamaica's quota in the Fund is 0.14% of total, therefore, from each $1,000million of S.D.R's created, Jamaica would be allocated $1.4 million p.a. or slightly less than £600,000.

Edward Seaga,
Minister of Finance and Planning
17th December, 1968.

EXTRACT FROM 1968 ANNUAL REPORT OF
INTERNATIONAL MONETARY FUND

"NEW FACILITY BASED ON SPECIAL
DRAWING RIGHTS

The proposed new facility based on special drawing rights to meet the need, as and when it arises, for a supplement to existing reserve assets reflects the basic principles that were developed over the years of study, preparation, and discussion. In this effort the Fund also benefited from the deliberations conducted in various groups and the suggestions made by them. The establishment of the facility requires, in addition to the acceptance of the Proposed Amendment by the required majorities, the participation of members having quotas amounting to at least 75 per cent of total Fund quotas.

Only members of the Fund can become participants in the facility. Allocations of special drawing rights will be made to individual participants in proportion to their quotas in the Fund. Decisions to allocate will normally be made for five-year periods ahead, with allocations being made at yearly intervals. A participant may, however, elect not to receive allocations made under a decision if it did not vote in favour of that decision.

Countries will be able to use the special drawing rights unconditionally whenever they have a balance of payments or reserve need to do so. Correspondingly, participants will be obliged, whenever designated to do so, to accept special drawing rights and in exchange to provide currency convertible in fact, a term which is defined in the Proposed Amendment. A participant will normally be designated for this purpose only when its balance of payments and gross reserve position is sufficiently strong. The magnitude of the obligation to accept is determined by the total amount of special drawing rights allocated to the participant less any part thereof that has been canceled. This amount is termed the net cumulative allocation, and the participant's obligation to accept special drawing rights from other participants extends to the point where its holdings of special drawing rights equal the amount received as its net cumulative allocation, plus twice this amount. As a result of these provisions, participants will be able to use the new special drawing rights in much the same manner as they use their holdings of traditional reserves.

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In the elaboration of the provisions for the facility, great care was taken that any decision to allocate special drawing rights should have broad support. Decisions on allocation can only be made on a proposal by the Managing Director of the Fund, concurred in by the Executive Directors, and approved by the Governors by an 85 per cent majority of the total voting power. The Proposed Amendment spells out the principles and considerations applying to any such proposal. The first decision to allocate special drawing rights will have to take into account a collective judgment that there is a global need to supplement reserves, and the attainment of a better balance of payments equilibrium, as well as the likelihood of a better working of the adjustment process in the future.

It has been provided that a participant's net use of its special drawing rights must be such that the average of its holdings of special drawing rights over a five-year period will not be less than 30 per cent of the average of its net cumulative allocations of special drawing rights over the same period. Participants that have, during some part of any five-year period, used more than 70 per cent of their average net cumulative allocation may, therefore, have to reconstitute their holdings in order to ensure that their average use does not exceed the specified proportion.

With the establishment of the new facility, the Fund will maintain and conduct its operations through two separate accounts. Operations and transactions involving special drawing rights will be conducted through the Special Drawing Account, and the present operations and transactions of the Fund will be conducted through the General Account. The Fund will meet the cost of conducting the business of the Special Drawing Account from the General Account, but these costs will be reimbursed to the General Account from time to time by assessments on participants to be paid in special drawing rights. Special drawing rights can also be acquired by the Fund in the General Account as a result of their use by members, in repurchases and in the payment of charges. The Fund will be able to use the special drawing rights which it holds in the General Account to replenish its holdings of currencies and to make special drawing rights available, against gold or convertible currencies, to participants that need to acquire them.

Each participant's holdings of special drawin rights are to be recorded in the Special Drawing Account. The account of each

participant.....

participant will be credited with the amount of special drawing rights allocated to it and debited in the event of a decision to cancel special drawing rights. The use by a participant of its special drawing rights will result in debits to its account and equivalent credits to the accounts of one or more other participants. It will be noted that the functioning of the special drawing rights facility, in contrast to the operations of the present Fund, will not be based on the Fund's holdings of gold and member currencies. Special drawing rights will thus derive their strength not from a pool of assets held by the Fund, but from the acceptance obligations of participants to provide exchange from their own holdings to other participants entitled to use their special drawing rights.

The Special Drawing Account will also record the Fund's holdings of special drawing rights held in the General Account as well as those held by any other holder which the Fund may have prescribed.

The value of special drawing rights is fixed in terms of gold. A participant will earn interest on its holdings of special drawing rights, and will pay a charge on the amount of its net cumulative allocation. The participant's position in the Special Drawing Account will determine whether, on balance, it will receive interest or pay charges. The rate of interest and the rate of charge will be the same; both will initially be 1½ per cent, with some room for later changes. Interest will be credited and charges debited to participants' accounts in special drawing rights.

CHANGES IN FUND RULES AND PRACTICES

The changes in the rules and practices of the Fund proposed in the form of certain amendments to the existing 20 Articles of the Fund Agreement cover a number of provisions. First, there are changes in the majorities required for certain important Fund decisions. Changes in quotas, insofar as they are the result of a general review of quotas, will require a majority of 85 per cent of the total voting power, and the same majority will apply in respect of decisions on certain questions closely related to general quota increases, such as the question whether a member will be permitted to pay less than the standard 25 per cent of its additional subscription in gold. An 85 per cent majority will also be required for decisions adopted by the Fund under the provisions in the Articles that relate to a uniform proportionate change in par values.

Decisions.....

Decisions requiring an 85 per cent majority under the Proposed Amendment, whether with respect to the General Account or the Special Drawing Account, are to be taken by the Board of Governors.

There are a number of proposed changes relating to the formal status of the member's entitlement to buy the currency of other members from the Fund. Gold tranche purchases, which are now practically automatic, will become legally automatic under the new provisions. At the same time, the Articles will be amended to make explicit what had been implicit before: that use of the Fund's resources must be temporary in character and that the Fund must adopt policies to this end. Under the new provisions, the Fund will no longer have the legal power to make the use of Fund resources outside of the gold tranche quasi-automatic and quasi-unconditional, in view of the availability of the new special drawing rights facility to take care of any need for additions to existing unconditional reserve assets. On the other hand, these proposed changes in the legal status of a member's entitlement to buy currency from the Fund in a transaction conducted through the General Account are not intended to make the rules with respect to use of the Fund's resources more restrictive than they are now.

The Proposed Amendment also provides for the payment of remuneration to members that hold what has become known as a super gold tranche position in the Fund. (That is, the amount by which 75 per cent of a member's quota exceeds the Fund's holdings of its currency.) The rate of remuneration will be 1½ per cent per annum, but the Executive Directors would be authorized to make changes in this rate.

In addition, the Articles as amended will permit the Fund to reduce or eliminate the service charge (presently at ½ per cent) on gold tranche purchases.

The Proposed Amendment calls for substantial changes in repurchases governed by Article V, Section 7. These changes involve, inter alia, the transition from a concept of monetary reserves net of currency liabilities to a gross concept. The changes can affect the amounts to be repurchased and also the media in which repurchases are to be made.

Finally, the Proposed Amendment envisages a change in the procedure to deal with questions of interpretation. Essentially,

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this change involves the creation of a Standing Committee on Interpretation of the Board of Governors, which will have to consider any question of interpretation referred to the Board of Governors at the request of a member. The decision of this Committee will be final unless the Board of Governors decides otherwise by an 85 per cent majority of the total voting power. Each member of the Committee on Interpretation will have one vote.

The Proposed Amendment will require changes and additions in the By-Laws and in the Rules and Regulations as well as in some of the previous decisions of the Fund. In the course of the coming months, the Executive Directors intend to make appropriate communications on these matters to the Governors.

CONCLUSION

The broad impact of the new facility will be that it will permit the Fund to assure an appropriate level of international reserves in the light of the needs of the world economy, by supplementing the existing reserve assets in the form of gold and reserve currencies. For the first time, therefore, the total stock of reserves and its rate of growth will reflect deliberate international decisions rather than being determined solely by the availability of gold for official reserves and the accumulation of balances in reserve currencies. At the same time the present mechanism of the Fund, which provides members primarily with liquidity of a conditional character, will continue to operate as in the past. Thus the Fund will become a major source for the supply of both unconditional and conditional liquidity."