ESSAYS IN INTERNATIONAL FINANCE

No. 100, September 1973

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This is the one-hundredth number in the series ESSAYS IN INTERNATIONAL FINANCE, *published from time to time by the International Finance Section of the Department of Economics of Princeton University.*

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Department of Economics
Princeton University
L.C. Card No. 73-10880
ISSN 0071-142X

Printed in the United States of America by Princeton University Press
at Princeton, New Jersey

The Link between Special Drawing Rights and Development Finance

The question of a link between Special Drawing Rights and development finance is only one of the many issues facing the reformers of the international monetary system. According to the International Monetary Fund (1972), the current agenda for monetary reform includes a new exchange-rate mechanism to improve the balance-of-payments adjustment process; better arrangements to settle payments imbalances among countries; a redefinition of the roles of various reserve assets such as reserve currencies, gold, and SDRs; and solution of the problem of disequilibrating capital movements.

The IMF also recognizes, however, that international monetary reform should include consideration of new measures directly addressed to the needs of developing countries, and most controversial among them is the suggestion that the flows of development aid be supplemented by linking creation of SDRs with assistance to developing countries. This controversy is unique because the link has become a major point of confrontation between the wealthy industrial countries and the poor developing countries.

The case for a link derives fundamentally from an analogy between official reserves and private money balances in a national monetary system. In addition to the primary effect of increasing liquidity, issuance of national money is also associated with a transfer of resources to the government, or with the financing of real expenditure within the country through the lending activities of the banking system. As Professor Tinbergen (Netherlands National Committee, 1972) argues, the creation of new money always implies that the first recipient gets the money without having produced something, and this privilege should be given to the poor countries of the world community rather than to the rich. Opponents of the link argue contrarily that the liquidity-creating and liquidity-distributing functions of a banking system are conceptually distinct and that the primary emphasis in the creation of SDRs should be placed on the liquidity-creating function (Group of Ten, 1965). This latter view prevailed in 1969 when the Special Drawing Account was established in the IMF and, as a result, the link was not incorporated in the present SDR system.

Controversy over the link has increased in recent years, involving academic economists as well as officials of governments and international organizations. Discussions of the link are proceeding concurrently at two levels: At one level, there is debate concerning acceptance or rejection of the link. At a second, there is debate as to the form the link should take if it is accepted. The first debate is concerned with arguments for and against the link; the second deals with the plethora of link proposals that have been advanced. The two questions are interrelated, however, because some of the objections to the link are concerned only with certain aspects of some link proposals. Thus, in order to evaluate arguments for and against the link, it is necessary first to understand the various link proposals.

Development of the Link Concept

The link concept is not necessarily tied to a particular reserve medium such as SDRs. In fact, the original proposal for a link developed well before the birth of the SDR. The pre-SDR link proposals have little practical importance today, but it is useful to trace the development of the link concept to gain a better understanding of the post-SDR proposals.

Perhaps the oldest proposal for a link between international reserve creation and economic development was contained in the so-called "Keynes Plan" for an international clearing union (ICU) made during World War II. In preparation for the postwar international monetary system, a group of experts at the British Treasury, led by Keynes, proposed to set up an ICU with the power to issue international currency, tentatively named "bancor." In addition to its primary function as world central bank, the ICU would help to finance several international organizations pursuing such internationally desired objectives as postwar relief, rehabilitation, and reconstruction; the preservation of the peace and maintenance of international order; and the management of commodities (*ICU*, 1943).

The British experts were careful to point out that their suggestion of a link was not an essential part of the plan for the ICU. It is interesting to note, however, that they envisaged a far more extensive link between international reserve creation and other internationally desired objectives than is implied by more recent proposals.

It was not until 1958 that the link concept was first proposed in its present form. At that time, Maxwell Stamp (1958) urged that the IMF be empowered to issue Fund Certificates to supplement international liquidity. In addition to its primary role as an international reserve asset, the Fund Certificate would also be used in development finance by the

International Bank for Reconstruction and Development and the International Finance Corporation. [In 1961, Stamp (p. 11) described his proposal for credit creation by the IMF but mentioned neither the IBRD nor the IFC; instead, he suggested simply an aid-coordinating agency to allocate Fund Certificates to the less-developed countries.] In an elaboration of his link proposal, Stamp (1962) suggested that member countries of the IMF be obliged by an agreement to receive Fund Certificates in settlement of international obligations and treat them as foreign-exchange reserves. The IMF would then put the Fund Certificates into circulation by lending them on a long-term basis to the International Development Association for use in IDA development credits to the less-developed countries. The IDA would obtain the currencies required for loan disbursements by presenting Fund Certificates to the country from which either equipment or technology would be bought for a development project. If any member country was suffering from inflation, and therefore unwilling to accept additional export orders, it could notify the IDA that it did not wish IDA loans to be spent within its economy or could limit the purposes for which they could be spent.

The Stamp Plan for the link was given prominence by Triffin (1959, pp. 171–172), who also proposed his own version of the link. Since he thought that the use of *national* currencies as *international* reserves constituted a "built-in destabilizer" of the world monetary system, he advocated internationalization of the foreign-exchange component of monetary reserves by transforming them into currency deposits with the IMF. The currency deposits could be used by the IMF in a way similar to national central banks' credit operations: advances, standbys, and overdrafts undertaken at the initiative of the borrowing country on the one hand, and open-market operations and investments undertaken at the initiative of the IMF itself, on the other. Within the latter category, the IMF could make investments in the financial markets of member countries or in the long-term bonds of the IBRD or other institutions for economic development. This proposal was one of several link proposals considered in a report written by a group of economists in which they analyzed various plans for reform of the international monetary system and clarified differences among them (International Study Group, 1964, pp. 85–88). Two other link proposals were also mentioned in the report:

1. Special development certificates: As special support for development aid, the IMF could issue each year a predetermined volume of special certificates to be given to the IDA. These would be accepted in settlement by all members of the IMF. They would add them to

their reserves but could not convert them into gold. Membership in such a scheme would be voluntary.

2. Special IMF account for aid: Member countries of the IMF receiving Fund Certificates like those proposed by Stamp would deposit a small fixed portion of their certificates in a special account at the IMF, to be lent to the less-developed countries. Countries receiving such deposits in payment for goods and services could transfer them to other countries to make payments settlements but could not convert them into gold.

A group of experts appointed by the United Nations Conference on Trade and Development (1965) issued a report supporting a link plan similar to the one proposed by Triffin. The UNCTAD report proposed an international monetary system in which the IMF would issue the Fund units to all its member countries against currencies deposited by the members. The IMF would invest a portion of these currency deposits in IBRD bonds. The IBRD would then transfer some of its additional resources to the IDA, as it is the IDA, not the IBRD, which needs additional resources most urgently, and its long-term low-interest loans are best suited to the basic needs of the less-developed countries. (The IDA does not issue bonds of its own.) This proposal by the UNCTAD experts was supported by the Inter-American Committee on the Alliance for Progress (1966).

In 1964, Scitovsky proposed a link plan different from those of Triffin and others in several respects (see Scitovsky, 1965). He suggested that a new international currency be issued to deficit countries in need of reserves. They would make national currency deposits at the IMF in payment for the issue. But international currency issued in this way would not be given directly to the deficit country. It would be allocated first to an LDC for the specific purpose of financing imports connected with a development project approved and perhaps supervised by some such agency as the IDA. The LDC receiving the currency could spend it *only* in the country against whose currency it was originally issued. Once in that country's hands, the currency would become unrestricted international liquidity, spendable and acceptable anywhere. In this way, the LDC would receive a "tied grant," which Scitovsky thought far preferable to a tied loan, and the deficit country would receive additional external reserves, but only in exchange for real resources supplied to the developing country. Two years later, Scitovsky (1966, p. 1218) changed his initial link plan slightly; instead of handing the currency directly to an LDC, the IMF would transfer it first to the IDA, which would in turn use it to finance development projects approved by the

World Bank's regular screening machinery as technically feasible and economically sound. The IDA would then spend the currency only in the deficit country against whose own currency it was originally issued.

While various link proposals were thus being debated among academic and international experts, the U.S. Congress was also urged to endorse the concept in 1961. Day (U.S. Congress Subcommittee, 1961, p. 329) advocated a link plan similar to that of Triffin in a statement before the Subcommittee on International Exchange and Payments of the Joint Economic Committee. In 1965, the Subcommittee itself observed that, while new international reserves could not be used as a primary foreign-aid device "because securing them by the credit of less developed countries might impair their acceptability," the need to promote economic development could be recognized by selecting suitable standards for allocating new reserves (U.S. Congress Subcommittee, 1965, p. 11). Representatives Reuss and Ellsworth (1965, p. 16) wanted to go further. They stated that the World Bank, as an experienced and well-regarded international development agency, "should take the initiative in asking the IMF to dedicate some part of reserve creation to long-term aid. Once the IMF and the Group of Ten have tentatively agreed on a new mechanism for creating reserves, the World Bank should propose that the International Development Association be financed in part by the conventional national contributions and in part by IMF purchases of IDA bonds, guaranteed by the World Bank, with a portion of the new reserve assets." Two years later, the Subcommittee (1967, pp. 7–10) expressed its unanimous support for these same views.

The link proposal did not find favor, however, with most of the officials engaged in actual negotiations on international monetary reform. The Group of Ten opposed the link in 1965, on grounds to be described later on. Systematic international reserve creation came under consideration by the Group of Ten as early as 1963, when meetings of the Deputies of the Group of Ten became a permanent forum for discussion of international monetary matters (Haan, 1971, p. 78). During the early stages, the Group of Ten toyed with the idea of creating reserves only within a limited group of developed countries. This appeared justifiable to the industrial countries, because they thought that an international asset should be based on the credit of participants and that this credit should be unquestioned. Furthermore, the Group of Ten believed that their countries, as the chief holders of reserves, should be allowed to create additional reserves without having to "earn" them through transfers of real resources (Machlup, 1965, p. 355). For this reason, other members of the IMF were virtually excluded from deliberations on international reserve creation until 1966, when the Ministers and Governors of the Group of Ten, in an apparent change of heart, instructed their Deputies to confer with the Executive Directors of the IMF. They "thought it appropriate to look for a wider framework in which to consider the questions that affect the world economy as a whole" (Group of Ten, 1966). Four joint meetings of the Deputies of the Group of Ten and the Executive Directors of the IMF were then held in 1966 and 1967. These meetings enabled the developing countries to participate in the discussions to a limited extent, albeit against a double representation of the Group of Ten countries, both as members of the Group of Ten and as members of the IMF. During these meetings the idea of limiting reserve creation to a group of developed countries was abandoned (Haan, 1971, p. 78).

The Ossola Report (Group of Ten, 1965, par. 121) contains the rationale used by the Group of Ten for dropping the limited-group approach:

> [The] limited arrangement would be exposed to disadvantages which would outweigh the advantages claimed for it. For a group of industrially-advanced countries to increase, by a stroke of the pen, as it were, their own monetary reserves and appear to make themselves thereby the richer, would invite criticism from other countries, who would declare that their own need for more elbow room in their international payments was, proportionately, no less than that of the members of the group. A number of the smaller countries could show that they have maintained a good reserve position and their balance of payments' record compared favorably with that of countries within the group. It would be arbitrary to deny participation to such countries. In any limited membership, the difficulty of borderline cases is likely to arise. For this reason, those who hold this view favor an approach that is not strictly limited in the width of membership. They prefer an approach that embodies a self-qualifying element and would therefore be more open than a grouping that is strictly limited to a small number of countries. They point out that many countries throughout the world feel, or will feel, a need for growing reserves; yet countries excluded from the group would be able to increase their reserves only by surrendering real resources or attracting capital inflow. To exclude these countries would risk creating a sense of discrimination which would hamper monetary cooperation and understanding and which might well lead to demand for compensation in other ways. As a technical matter, the more limited the group the more likely it is that individual members of the group will accumulate an undue amount of the new asset; this would occur if such members, even when in payments' balance with the entire world, had a surplus with the group and a deficit with the rest of the world.

In this sense, the Group of Ten made a concession to the developing countries. Even if no link plan were to be built into the SDR system, inclusion of the LDCs in the system was indeed a major improvement over the limited-group approach.

Main Types of Link Proposals

There is more than one way to achieve a link and a number of link plans have been proposed, but those which were proposed before establishment of the SDR facility have little relevance to the present discussion. In the early monetary discussions, "backing" for new reserves was considered essential to the success of any scheme for reserves. Such backing would take the form of currency deposits held by the IMF. Thus, Triffin's link proposal required currency deposits against which international reserves such as SDRs would be issued; the IMF would then invest the currency in long-term IBRD bonds. Since the present SDR system has disposed of "the old myth of backing" (Machlup, 1968, p. 65) and the SDRs are distributed "free" and directly to participating countries without any currency deposits, the Triffin-type link is not likely to be accepted now. Similarly, the tied-grant link proposed by Scitovsky (1966) envisaged an SDR scheme in which *all* new SDRs would be turned over to the IDA to finance development projects. This type of link, however, is also not compatible with the present SDR system, where all the SDRs are first distributed among the participating countries.

Once the present SDR scheme obtained official blessings at the 1967 annual meeting of the IMF in Rio de Janeiro, new link proposals were put forward, taking into consideration the new arrangements and premises. These proposals are usually grouped into two categories: those involving a direct or "organic" link and those involving an indirect or "inorganic" link. Under an organic link, provisions for development assistance would be directly incorporated into the SDR system itself, requiring an amendment to the Articles of Agreement of the IMF to achieve the link. Under an inorganic link, wealthy countries would make *voluntary* contributions of currencies or SDRs to development agencies at the time of each SDR allocation.

The Inorganic Link

The inorganic link was first introduced by Patel (1967). He suggested that the simplest way to establish a link would be an agreement among the rich countries that they would make voluntary contributions to the IDA whenever new SDRs were allocated. The contributions would be in national currencies, but would represent a uniform proportion of each contributor's SDR allocation. Scitovsky (U.S. Congress Subcommittee, 1969a, p. 39) has suggested a slightly different version of an inorganic link. At the time of an SDR allocation, the developed countries would make tied contributions (perhaps in their own currencies) for development aid; these funds would be spent *only* in the contributing countries. The advantage of these link proposals is ease of implementation; no amendment to the IMF Articles of Agreement is required. For this reason, Colombo (1968, p. 81, and 1969, p. 71), Dell (U.S. Congress Subcommittee, 1969a), and Prebisch (U.S. Congress Subcommittee, 1969a) have supported an inorganic link. As establishment of the SDR facility had already necessitated a substantial amendment of the IMF Articles, they thought it would be difficult to obtain support for an organic link involving additional amendments. In fact, among many objections to the link in general, perhaps the strongest is based on the argument that the link, especially the organic link, would immensely complicate reserve creation. Haberler (1971) and Johnson (U.S. Congress Subcommittee, 1969a, pp. 19 and 20), among others, have suggested that it will be hard enough to establish the SDR system firmly and manage it properly without the additional complications created by the link. This argument has also been used by officials from developed countries as a major cause for opposing the link, and the inorganic link was proposed precisely to meet this objection. Some supporters of the inorganic link believe that an organic link should be adopted in the long run (see U.S. Congress Subcommittee, 1969a, pp. 4 and 30).

Despite apparent ease of implementation, the inorganic link has several major disadvantages. As originally proposed by Patel and subsequently supported by others, the proposal calls for a "voluntary" contribution by developed countries. That is why the inorganic link is sometimes called the voluntary link. As long as it is on a voluntary basis, however, there is always the danger that one or two major countries may not contribute, or that a country may make its contribution contingent on the condition of its balance of payments. This difficulty has been cited by the Inter-American Committee on the Alliance for Progress (1966, p. 33). Furthermore, in order to make currency contributions to international development agencies such as the IDA, the governments of developed countries would have to budget their contributions in the ordinary way. Their parliaments would have to approve those contributions, and this would create the same difficulties as regular foreign-aid appropriations. This being so, there would be little reason to push for a link. One might just as well urge countries to furnish more development aid in the name of enlightened self-interest, humanitarianism, etc. This was why the Subcommittee on International Exchange and Payments of the U.S. Congress, sympathetic to a link, recommended adoption of the organic instead of the inorganic form (U.S. Congress Subcommittee, 1969b). The raison d'être for a link is precisely to avoid the budgetary process; that process has proven inadequate to raise sufficient funds for development aid. Foreign aid has no political constituency and has been losing support in the parliaments of the rich countries in recent years. The dilemma inherent in an inorganic link was expressed most lucidly by Representative Reuss during a Congressional hearing on the link:

> If you pursue the so-called nonorganic link, I do not see at this moment how you have accomplished very much in political terms that could not be accomplished by a more heroic frontal attack, namely induce the U.S. Congress to pass a law which says we up our miserable present IDA contribution by three times, having in mind that we are now better able to do this, because we have now a regime of SDRs and much of our reserve problems will therefore be alleviated. I do not think that in a nonorganic or so-called parallel way of proceeding with the link we accomplish very much. If, however, we get organic, then you may be able to achieve some fiscal monkey business, which would be all to the good (U.S. Congress Subcommittee, 1969a, pp. 70–71).

The Organic Link

A number of proposals for an organic link were put forward before the final format of the SDR facility was decided. Proponents of an organic link thought that, since a new system for reserve creation was to be set up anyway, the link provision should be incorporated into the new reserve system at the same time. Thus, the early link proposals of Stamp (1958), Triffin (1959), Scitovsky (1965), and others were of the organic type. After the SDR resolution was passed in 1967, other organic-link proposals were also advanced. Most comprehensive among them was one recommended in 1969 by the Subcommittee on International Exchange and Payments of the Joint Economic Committee. The Subcommittee (1969b) proposed that the IMF Articles be amended to allow the IMF to retain as "treasury stock" 25 per cent of the SDR allocations of the eighteen wealthy countries which are Part I members of the IDA. The SDRs retained would be "cashed" at the joint direction of the IMF and IDA to finance expanded IDA development assistance.

In general, we can classify the current proposals for an organic link into four groups:

1. *Increase in the SDR quotas of the less-developed countries.* This proposal looks to a change in the distribution formula for SDRs. At present, SDRs are allocated to each participating member country according to its quota in the IMF. Distribution in this way has been criticized