12

Debating International Liquidity

This chapter deals with the Reserve Bank of India's involvement in broader issues that dominated the agenda of the International Monetary Fund (IMF) in the second half of the 1960s: international liquidity and the creation of special drawing rights (SDRs). Those were the burning topics of that time, when the world's monetary authorities were preoccupied in finding a new instrument that would enhance world liquidity. Their search lasted for almost a decade, during which plans and counter-plans were proposed. There were clashes of opinions and doctrines, as enquiry gave way to negotiation. The account that follows does not cover every facet of the debate but describes the process that culminated in the advent of SDRs and India's reactions.

The Reserve Bank was not directly involved in conceiving any of the liquidity proposals, though it remained on the periphery of this vital debate, for the Group of Ten (G-10) industrial countries arrogated to themselves the responsibility for provision and distribution of any additional liquidity, arguing that the responsibility should be 'borne by those countries who were best able to shoulder the resulting burden'. As India was one of the more than 90 countries that were not members of G-10, the government looked to the Reserve Bank for guidance on these technical issues. The Bank, through Anjaria and Madan, who were Executive Directors on the Executive Board of the IMF, kept a close and careful watch to see that the developing countries were not confronted with a *fait accompli* in which their legitimate interests were disregarded. In fact, India, being one of the major developing countries, was required to take up the cudgels on behalf of the developing world, and the historical record is replete with evidence to show that India remained a vigilant participant in this debate.

INTERNATIONAL LIQUIDITY: CONCEPT AND FORM

International liquidity has been formally defined as all the resources that are available to the monetary authorities for the purpose of meeting balance of payments deficits, and covers the whole spectrum of financial assets including borrowing facilities. Reserves constitute the most definite and easily measurable form of liquidity; they include official holdings of gold, foreign exchange and the gold tranche position in the IMF.

A question that comes to mind is: why were the developed countries so adamant on restricting the debate to a limited group? A few key statistics on international reserves provide the clue. Over the sixteen-year period 1950–66, international reserves of the United States recorded a sharp decline and those of the United Kingdom showed a modest drop, while the reserves of European countries registered a spectacular rise and those of the developing countries displayed little material change. The entire increase in global reserves over the period was attributable to the European countries. Another troublesome feature was that by end-1966, the monetary reserves of the rest of the world in the form of US dollars exceeded the US reserves. In other words, the monetary liabilities of the US exceeded its monetary assets and herein lay 'the ultimate paradox' to which Triffin (in *Gold and the Dollar Crises*) had drawn attention in the early sixties.

Not all monetary authorities were enthusiastic about continued addition of dollars to their reserves without some form of exchange guarantee. The prolonged deficit in the balance of payments of the United States provided the monetary authorities of other countries with reserves, but the deficit that produced this result also instilled uneasiness about the size of this currency in the reserves.[1] In addition, there was concern that the ability of reserve currency countries to settle international obligations with their own liabilities removed the discipline, imposed on the rest of the world by asset settlement, of maintaining domestic policies inconsistent with balance of payments adjustment. This lack of discipline of reserve currency countries could bring about a collapse of the system.

[1] The supply of national currencies in world reserves was dependent on the deficits of countries of issue and this built into the system a latent instability, for, sheer accumulation, over time, of other countries' sterling and dollar claims in relation to the gold held by the reserve currency centres was likely, at some point, to cause misgivings—and any tendency to liquidate such claims could create serious strains. See Address by Pierre Paul Schweitzer, Managing Director, IMF, to the New York Financial Writers' Association, 17 June 1968.

Origins of the Problem and Early Response

The period 1958–60 witnessed a massive build-up in the external liabilities of the US and the earlier dollar shortage gave way to a dollar glut. Although the British and the EEC countries were aware that continuation of large European surpluses would pose considerable problems for the rest of the world, there was no political will on either side of the Atlantic to come to grips with the liquidity crisis. In fact, the US informed a high-level British mission in mid-1958 that the 'so-called crisis was yet to materialize'. The IMF's studies, too, confirmed the view that there was no lack of liquidity. The same refrain marked the 1961 *Annual Report* of the IMF, although the Managing Director made a proposal to study arrangements for the Fund to borrow the needed currencies and to review the use of the Fund's resources. This, however, did not mean that no thought was given to the problem; the subject featured actively in other fora and studies were afoot in other quarters.[2]

At that point of time, there was no desire to involve the developing countries in this debate. Even so, Indian representatives never missed an opportunity at international gatherings, to bring to the fore the viewpoint of the developing world. At the 1959 annual Fund–Bank meeting, the Governor for India, Morarji Desai, pointed out that industrial countries had greatly added to their reserves in the recent past, whereas the less developed countries, including India, had depleted their reserves. Investment in large reserves of their own necessarily imposed a greater sacrifice on poorer countries than on others, with the result that the secondary line of reserves provided by the Fund assumed much greater importance.

First Phase of the Liquidity Debate

By the spring of 1963, there was a discernible change in the liquidity situation. Final figures of 1962 world reserves revealed that the aggregate of countries' reserves had fallen, in contrast to the increases witnessed over the last

[2] (i) The Maxwell Plan combined the needs of the industrial countries for additional liquidity with the needs of the developing countries for more capital.
(ii) Robert Triffin, Yale University, proposed that an enlarged and amended Fund should provide a new kind of international reserve, and that all reserves except gold should be centralized in the Fund.
(iii) E. Bernstein and the US Treasury Secretary suggested that the gold standard be broadened by a system of multiple reserve currencies. On the other hand, Jacques Rueff of France advocated increasing the price of gold.
(iv) Maulding proposed a mutual currency account.

three years. This signalled the need for the IMF to commence a study of the liquidity issue. Its 1963 *Annual Report* carried a chapter on 'International Reserves and Liquidity', which emphasized that if the problem of expansion of liquidity was approached through the Fund, lack of liquidity was unlikely, in the future, to present a bar to the adoption of desirable policies.

The IMF Managing Director, Schweitzer, who had assumed charge barely eighteen days earlier on the sudden demise of Jaccobson, and who was privy to the idea of the G-10 organizing a discussion of their own on the subject, in an unprecedented move, briefed the Board about the substance of his opening remarks at the forthcoming annual meeting. The message he sought to convey was that the Fund should be the instrument through which the bulk of any required expansion in liquidity is suitably undertaken. But this was not taken seriously by the G-10 representatives. The US Governor, who made a statement on behalf of the G-10 at the 1963 annual meeting, noted that the current national reserves of member countries, supplemented by the resources of the IMF and the network of bilateral facilities, seemed adequate. He went on to add, however, that it would be useful to undertake a thorough review of the future liquidity needs of the international monetary system, and instructed the G-10 Deputies to do so, in collaboration with the IMF. This meant that G-10's involvement remained central to the liquidity debate.

As leader of the Indian delegation, RBI Governor Bhattacharyya sought to confine the debate within the Fund through his intervention, by forcefully reiterating that the Fund was the appropriate focal point for action to safeguard and strengthen the international payments system. Stressing that increase in world liquidity was a problem that concerned all countries, including the less developed, he urged consideration of another general quota increase and the need for mitigation provisions relating to gold subscriptions.

Following on from the 1963 Annual Meeting, the staff of the IMF became actively engaged in examining the liquidity problem from all angles including the analytical and operational aspects of liquidity.[3] But, endorsing the Schweitzer line implied that the members did foresee a shortage of liquidity in the long run. In their perception, liquidity was adequate. What was needed was strengthening the international payments system in

[3] These studies included (i) Marcus Fleming's paper entitled 'Role of the IMF in the Provision of Liquidity' and (ii) the staff paper on the 'Role of Gold in the Fund'. This paper suggested some mitigation in gold payments in connection with quota increases, as well as finding a way of selling the gold held by the IMF in return for currency.

such a way as to avoid situations where they would have to hold unwanted dollars. For them, the urgent problem was to rectify the US payments deficit and not to reinforce liquidity. Despite the cleavage of views, however, the IMF was set on the road towards liquidity studies.

This did not mean that parallel inquiries by the G-10 had receded into the background.[4] The period 1963–64 was marked by hectic intellectual exchanges between the G-10, on the one-hand, and the Managing Director and staff of the IMF, on the other. To cap it all, in the summer of 1964, the G-10 Deputies set up a committee under the chairmanship of Rinaldo Ossola of Italy, to examine various alternative proposals for the creation of additional liquidity. The report submitted by the committee (the Ossola Report or Report of the Study Group on the Creation of Reserve Assets) marked an important step in the evolution of the scheme of SDRs. A little later the G-10 appointed their Deputies to examine the technical aspects involved in the creation of a new reserve asset. Outside the Fund and the G-10, the UNCTAD also published a report in 1965, which outlined various ways of increasing world liquidity.

Confabulations among a limited group naturally upset the non-G-10 countries. What bothered them was that negotiations on a matter as important as international liquidity were proceeding without any participation of 90-odd members of the IMF. The Fund management, aware of their uneasiness, scheduled an internal seminar discussion on a staff paper entitled 'Creation of International Liquidity in the Fund: An Appraisal of Alternative Techniques', on 9 May 1965. The paper suggested two techniques: (i) extension of quasi-automatic drawing rights in the Fund, and (ii) initiation of an investment policy by the Fund on the basis of additional deposits.

The outcome of the seminar was disappointing; there was no consensus on whether to create additional liquidity and through whom. The prospect of any scheme involving special deposits that the Fund could use for investments in less developed countries through the IBRD was dubbed as a mixture of monetary and aid techniques, and hence, unsuitable. The idea of liberalizing tranche policies was attacked. The only technique that gained some support was automatic drawing rights for the industrialized countries in the Fund, on the basis of an understanding that they would give increased deposits to the Fund as and when called upon to do so—a kind of

[4] Edward Bernstein, US, proposed that G-10 countries plus Switzerland should establish a composite reserve unit (CRU) equivalent to gold consisting of a stated proportion of their currencies.

systematization of the GAB-type arrangement directly under the Fund, with a clear differentiation between the rights and privileges of the industrialized countries and the rights and privileges of the rest. The Indian Director saw in this move a concerted effort to create a Group of Ten within the Fund and vehemently opposed the same, stating that he could not subscribe to any scheme that, in terms of eligibility criteria, would create different types of membership.

Discussions on the draft 1965 *Annual Report* proved equally troublesome. The Europeans put up a stiff and concerted fight, arguing that there was no shortage of international liquidity and none was likely in the foreseeable future, and that the function of the Fund was to accelerate adjustment. Moreover, it was dangerous to float the idea of creating additional liquidity via Fund investments in countries other than those that would take on additional responsibilities. The attempt was to delete the portions relating to the techniques of additional reserve creation through the Fund or to hive off the issues to a separate part of the *Report.* The Indian Executive Director, Madan, objected to this. He was supported by all the developing country Directors and even the Managing Director felt it was not right. The end-result was a compromise—an abridged version revealing the bare bones of how reserves could be created.

At the brainstorming sessions on the technical aspects, the Indian Director continued to champion the cause of the 'lowest and the lost'. On distribution of deliberately created reserves, Madan questioned the distinction between the need for reserves to hold and the need for reserves to spend, and underlined that the problem could not be resolved by creating additional liquidity for a small group; a satisfactory scheme had necessarily to encompass *all* the members of the Fund. On distribution, the Indian Director rejected the criteria relating the share in the new assets to existing gold holdings of members or to their total reserve level or contribution to foreign aid, and opted for Fund quotas as the most rational distribution key.

Unmindful of non-G-10 reservations, the G-10, at their Paris meeting of 31 January to 2 February 1966, agreed on some common points.[5] Clearly,

[5] These were: (i) the reserve asset would be created by and under the responsibility of a limited group of countries; (ii) the group would not be a closed one but entry would be subject to qualifying conditions; (iii) initial distribution of the newly created assets was to be based on Fund quotas and GAB commitment formula; and (iv) to take care of countries outside the group, there would be a dual approach in terms of concessional access to Fund resources.

the Paris proposals held no interest for the developing countries. An interesting development at that meeting was the statement made by the Fund representative on behalf of the Managing Director. It stressed admirably the interest of the developing countries in any scheme of international liquidity. A few significant sentences will demonstrate that the Fund was pulling in the right direction.

> We believe … and I want to be blunt about this, that it would be most unfortunate if the proposals as developed here (meaning Paris) did not meet the realities of the wider group…. These realities require a scheme that starts from the recognition of the legitimate reserve needs of the world and not from the needs of the Group of Ten combined with some ex-gratia payments to the rest of the world…. Just as an acceptable programme must start out from the recognition that liquidity is a world-wide problem, so the decision-making process in our opinion should be one that properly reflects these world-wide interests.

Ignoring the global approach, the G-10 came to the decision that three-fourths of the newly created reserves should be distributed among the G-10 and the remaining one-fourth among all members of the Fund. The Germans were the driving force behind this proposal. The Fund management viewed this as a dangerous portent for future monetary cooperation and the Managing Director publicly denounced the proposal. To prevent crystallization of the proposal by the G-10 Finance Ministers, diplomatic pressure was applied by the developing countries at the United Nations, where the UNCTAD was trying to rally support for a global approach. An Expert Group on International Monetary Issues[6] was set up by the UNCTAD, which prepared a report entitled 'International Monetary Issues and Developing Countries'. The main conclusions of this report were: (i) the establishment of a link between the creation of international liquidity and the provision of development finance was both feasible and desirable, and would be detrimental to neither; (ii) the reform of the international system should be truly international; and (iii) developing countries should be represented in the discussions leading to monetary reform and in the operation of the new arrangements.

Meanwhile, the Fund came up with its own scheme for additional

[6] I.G. Patel, Chief Economic Adviser, Ministry of Finance, represented India on this Group and, in his absence, K.N. Raj, Professor of Economics, Delhi School of Economics, was appointed as an additional member.

liquidity creation through the IMF ('Creation of Additional Reserves through International Monetary Fund', Staff Paper SM66/30). One option envisaged the creation of reserves in the form of quasi-automatic drawing rights, and the other involved the creation of a new reserve unit transferable between countries and operated by an affiliate of the Fund. Both schemes were open to participation by all members. The paper unequivocally enunciated the principle that 'reserve creation was the concern of all member countries and all should participate, with due safeguards and in due degree, both in the distribution of the newly created reserves and in the decisions which led to their creation'. The developing countries, having openly denounced the establishment of a group of 'second-class participants', supported the Fund's scheme but the industrialized countries remained non-committed.

Meanwhile, the Managing Director, Schweitzer, persisted in his public utterances on the inappropriateness of the dual approach. Arguing in support of a universal plan, the MD stressed that he could not accept the view ' that all but a few members had little or no need of reserves and were not capable of keeping any that they may receive, nor could he see a way to divide the member countries of the Fund in an objective and non-discriminatory manner into the reliable few and the less irresponsible many. This led to some rethinking and some among the G-10 Deputies became more receptive to a universal approach.

The discussions entered a second phase with the Americans mooting the suggestion to constitute a Committee of Twenty members. The move was resisted, as it was seen as a denial of the functions and privileges assigned to the Executive Directors. Schweitzer's variant of fusing the Deputies and the Fund Board into a single Advisory Committee to the Governors was also dubbed as impracticable by the G-10 Deputies (Communique of the Ministerial Meeting of G-10 in the Hague, 25 July 1966, para 6b). In the circumstances, the only course open was for the Deputies of the G-10 and the Executive Directors to continue their parallel work, with a proviso of holding three to four joint meetings to arrive at a consensus. The Hague communique, while recognizing the interest of the world community in liquidity creation, emphasized that the requisite majorities and voting power were a necessary condition for any decision on reserves creation. This implied a veto power being vested in the G-10 in connection with any decision on reserve creation, which this was totally unacceptable to the Directors of the developing countries.

Anjaria, the Indian Executive Director, was quick to perceive that the move was a determined effort to transfer the decision-making process from the Fund to the G-10. This, as Anjaria reported to the RBI Governor, was the rationale of the parallel forum with a different balance of power, the end-result of which could well be the Fund abdicating some of its functions voluntarily, through these joint meetings, to a rich men's club functioning somewhere in Europe. What the less developed countries were getting out of the 'global approach' of the G-10 was a promised share of the new liquidity to be created. On the vital issue of who takes the decisions, who runs the scheme, the dice were all loaded in favour of an outside mechanism. The less developed countries, Anjaria reported, were forced to take solace from the Managing Director's remark at the ministerial meeting of the G-10 on 25 September 1966, where he said that 'they (implying the non-Ten) were not willing that they be assigned a subordinate role in negotiations affecting the world's monetary system'.

Wiser counsel prevailed, however: starting from November 1966, parallel discussions gave way to direct exchange of views between the Executive Directors and the Deputies through joint meetings, under the joint chairmanship of Schweitzer and Emmingar, chairman of the Deputies of G-10. The first joint meeting[7] revealed not only wide differences but, more importantly, as Anjaria reported to his authorities, that the G-10 countries were not by any means a solid phalanx. On the need to create reserves in unconditional form, there was little disagreement among them, but on its nature and form there were wide divergences. Some favoured reserve units for all countries, others indicated reserve units for the developed countries and drawing rights for the developing countries, and yet others were in favour of drawing rights for all. Opposing the latter, the Indian Director insisted that the solution envisaged should be the same for all, whatever form the reserves creation might take.

The claim of special responsibilities and therefore of special privileges for industrial countries was rebutted by the Directors of the developing countries who argued that no one was really required to finance this initially, as it would be a fiduciary issue, at the time of liquidation, and that the Fund could take care of it.

Through 'harmonization of reserve ratios', the attempt was to bestow gold-like characteristics on the reserve asset whereby the possibility of some

[7] The first joint meeting was held in Washington on 28 through 30 November 1966. The agenda was: (i) aims and objectives of reserve creation and its relationship to adjustment policies and supply of conditional liquidity; (ii) nature and form of deliberately created reserves; (iii) distribution and utilization of new reserve assets including conditions for transfer of and for assuring acceptance of the assets; and (iv) conditions and circumstances for the activation of a contingency plan.

participants unloading their new reserves in order to switch to traditional reserve forms at the expense of others could be avoided. The Indian argument was that the unit could not be made gold-like by tying its use to gold, particularly as so many countries had so little by way of gold reserves; a proper agreement on acceptability was the answer. At the ECOSOC meeting of 19 January 1967, the Indian Ambassador, G. Parthasarthi, also warned: 'We need to beware of any tendency there might be to enthrone old ideas or idols—and to accept a scheme of reserve creation that can only sap the vitality of the system.'

The second joint meeting held in London from 25 to 27 January 1967, discussed the most vital issue of decision-making. Little headway was made as the Europeans hinted that a stronger safeguard was necessary for activation of the new scheme—namely, an 85–90 per cent majority vote, which would give the veto virtually to the ECM. In addition, participants that had accumulated reserve assets would have more voice than others in the decision-making process. Ancillary questions surfaced. Should the distribution of votes be based on Fund quotas or should GAB commitments also be included? Should there be split voting? A meeting of minds on the critical issue of voting was undoubtedly difficult. The developing country Directors *en masse* opposed any scheme that would have the effect of endowing any group of countries with the right to veto any decision. The result was that no broad support for any scheme or any specific decision-making process was forthcoming.

It was the third joint meeting that came to grips with some of the tougher issues, such as rules that would govern the use and transfer of reserves, financial resources that would back the scheme, the kind of reconstitution that ought to be instituted and the decision-making process to be adopted. The European angle on most of these issues was to give a restrictive bias to the scheme. On the other hand, the aim of the developing countries was to have as progressive a scheme of reserves creation as feasible, one that would conform to the requirements of universality and non-discrimination, and one that avoided an adverse impact on the structure and machinery of Bretton Woods.

Between 1965 and 1968, while protracted discussions were on to formulate a scheme, the Economic Department of the Reserve Bank of India carefully studied the various twists and turns in the debate. It advised the government to indicate its preference for a reserve type of scheme, and to also show preference for the organization of a new department with separate accounts and resources and with a separate entity such as an affiliate of the Fund.

By September 1967, agreement was reached by Ministers and Governors on the outline of contingency plan for the creation of special drawing rights in the IMF. The role of the Fund in any new arrangement no longer remained in doubt, for the idea of integrating the new facility had gained acceptance. The need for a supplement to reserves of an unconditional type was also generally accepted and the principle of universality acknowledged. A disheartening development was that the EEC Ministers endorsed the suggestion to create reserves in the form of drawing rights and not as reserve units, for, in their perception, any scheme of international liquidity had essentially to be limited to a willingness to expand international credit and not to print new money. The French, particularly, were averse to the creation of new money, which would compete with or supplant gold. They fought for complete freedom of a member to opt out of any allocation. On the voting issue, the high majority requirement (85 per cent) was made a condition of acceptance for any move forward by members of the EEC—their endeavour was to gain a veto over new liquidity creation.

The fourth joint meeting was held in Paris from 19 to 21 June 1967, to grapple with two contentious points, viz. decision making and reconstitution. It was agreed that special drawing rights were to be distributed at specified intervals over basic periods of normally five years, in proportion to quotas in the Fund. The Managing Director was to formulate the proposal, which had to be approved by a high qualified majority, although, at that point of time, the high qualified majority remained an open issue. Again, use of drawing rights would not be unlimited; there would have to be a provision for reconstitution of assets at appropriate intervals. The debate on this was long and fierce, though the principle of reconstitution was agreed upon. On the voting issue, India, on the advice of its authorities, opposed the Monetary Committee's recommendation to introduce, in addition to an 85 per cent majority, a second-unit vote that included at least half the major creditor countries. India also remained cool to the American band proposal which had a range of voting majority between 75 and 90 per cent, and comprised a double vote. On split voting, Anjaria, the Indian Executive Director, said it would be a retrograde step as the split vote procedure would be divisive and 'would atomize the personality of the executive director who would produce, each time, a new symphony according to the mix of their masters' voices'. Because of the vigorous opposition of the developing countries to bestowing larger votes on the creditors, there remained a strong possibility of this being dropped in the final debate.

The reconstitution provision also continued to balk agreement. The tussle was between the French, supported by other Europeans, who dug their heels in against any use of the new facility in excess of 50 per cent, and others within the G-10, principally the US, who were fighting for non-reconstitution of 75 per cent of the facility.

In retrospect, what were the achievements of the joint meetings so far as the developing countries were concerned? Had their participation made a difference to the outcome of the liquidity debate? The objective of the joint meetings was primarily to ascertain the views and reactions of the non-G-10. The role of the Indian Executive Director, Madan, was to ensure that the basic interests of the non-G-10 were safeguarded. Later, reporting the debate to the Governor, Madan said:

> There were quite a few ghosts of a complex and technical nature that were let loose from various quarters—by the US (the band proposal), the UK (free and unguided transfers) and toughest of them[8] all, by the EEC countries, who sought at various points, to create the Fund into a creditors' club and undermine the new facility completely, through a highly restrictive mechanical formula for reconstitution.

In the assessment of Madan, the contribution of these meetings was 'it laid several of these ghosts to rest'. For instance, on the basis of allocation of the new reserves, at the Paris meeting, in the face of resolute advocacy by Van Lennep of a different basis than Fund quotas, Madan urged not to add this to the pile of outstanding issues and thereby open the biggest of all Pandora's boxes. His able advocacy, along with that of the Fund staff, resulted in the acceptance of quotas as the yardstick for allocation.

On the technical provisions of the extent to which the Fund should 'guide' transfers, the Indian Director sought to steer the discussion on the lines that it was a right to be used in terms of balance of payments need. Here, he ran up against the British, Italian and Nordic countries who pressed for a minimum of guidance and rules of transfer, on the plea of improving the reserve nature of the new assets. But Madan saw in such a provision the possibility of stronger countries using the facility for harmonization or reduction of their new drawing, thereby limiting the utility of the new facility to countries in balance of payments need. Eventually, however, it was decided to adhere to transfer practices the Fund had built up over the years for its regular drawings. Thus, the importance of conformity to principles applicable to all was conceded.

[8] See the Fund staff study entitled 'Outline of a Facility Based on Special Drawing Rights', for five alternative formulations on reconstitution.

The reconstitution provision, too, threw up a large number of alternative solutions. Here also, the Indian Executive Director's intervention dealt a fatal blow to the Ossola formula. The Ossola concept of harmonization was based on proportionality of use of new assets in relation to other reserves by transferor countries, as against proportionality of the holdings of new assets, both of which were possible ways of harmonizing reserves. Because the use of traditional reserves was sometimes subject to statutory requirements, Madan emphasized that there was an important difference between the two techniques, and that any reconstitution provision should take into account the diversity of balance of payments situation that countries may encounter. The result was that the Ossola formula was out and the resultant toned-down version read: 'Participants will be expected not to use their special drawing rights to a disproportionate extent in comparison with the use of their reserves.' But, despite intensive efforts to resolve the reconstitution conflict before the Rio meeting, it remained unresolved, except that the five alternatives narrowed down to two.

DRAFT SDR SCHEME AND RESOLUTION

Following the fourth joint meeting, in mid-1967, the Executive Directors of the Fund were entrusted through a resolution at the Rio meeting, with the responsibility to draw up a scheme for the establishment of SDRs and for improvements in the Rules and Regulations of the Fund. They were also required to submit draft amendments to the Articles of Agreement and Bye Laws for these purposes. The deadline for submission of these reports was set at 31 March 1968 but, in the event, they were delayed by three weeks and were published on 22 April 1968.

In preparing the draft of a final outline as a working document, considerable effort was expended by the Fund staff in search of finding a 'less energetic terminology' that would be acceptable to the majority.[9] The essential point of the Rio resolution was that it made the reform of the Fund a parallel exercise to new liquidity creation. The bracketing of Fund reform with liquidity creation meant further delay in setting up the new facility.

[9] Professor Fritz Machlup described the effort thus: 'The words credit, credit facility, loans, repayment, borrowed reserves—all of them were with great circumspection avoided in the outline drafted. Words not burdened with a history of controversy, not associated with recognizable ideologies and not widely used in monetary theories, words therefore with still neutral and not always fixed connotations, were put in place of the old, battle-scarred and now banished words.' Fritz Machlup, 'Remaking the International Monetary System: The Rio Agreement and Beyond', p. 9.

Eventually, agreement was reached on a brief document entitled 'Outline of a Facility Based on Special Drawing Rights in the Fund'. Thus, after years of patient negotiations was born the basic ingredients of a contingency plan for reserves creation. The plan was only an outline—the task of fleshing out the new facility and incorporating it into the Articles of Agreement remained. The Indian Governor of the Fund, addressing the 1967 annual Fund–Bank meeting, expressed the hope that the liquidity exercise will not remain suspended in 'mid-air', and that the time between the adoption of the contingency plan and the activation of the scheme will be as short as possible.

Amending the Articles

Following the approval of the outline by the Board of Governors, the Fund staff and the IMF Board addressed themselves to the tortuous task of carrying out the first amendment to the Articles of the IMF. The marathon exercise, which lasted from 1 December 1967 to 22 April 1968, entailed 74 sessions covering 170 hours; the Indian Executive Director along with his alternate assisted in hammering out successive drafts of a satisfactory and technically tenable scheme.

What the amendments eventually achieved was to establish the special drawing account within the Fund but not as a separate legal institution. Members of the Fund were entitled but not compelled to participate in the account but participants alone were allocated SDRs. Decisions to allocate SDRs would be taken by the Board of Governors on a proposal formulated by the Managing Director. The hotly contested issue of majority was settled by accepting a majority of 85 per cent of the total voting power for a decision to allocate special drawing rights.[10]

After considerable discussion there was agreement that the reserve assets should be unconditional, and that there should be a more expeditious machinery to activate the use of these reserve assets when conditions demanded it. However, the French were persistent in their objections to unconditional liquidity; they fought for (and won) the use of these drawing rights not being unlimited and for reconstitution of assets at intervals. The debate on this was long and fierce. Again, as a compromise, it was accepted that reconstitution of assets should be to the extent of not less

[10] An 85 per cent majority, in effect, placed a veto in the hands of the common market countries. This demand of the common market countries was to counteract the voting power that was heavily weighted in favour of the US and the UK whose currencies functioned as reserve and trading currencies.

than 30 per cent of the total allocations. In practice, this meant that only up to 70 per cent of the SDRs would have a money-like quality; the rest would represent conditional liquidity with a five-year term for reconstitution.

A number of safeguards and limitations were provided so that confidence in the new assets was not undermined. For instance, a participant could transfer special drawing rights to a participant designated by the Fund only for balance of payments need and not for the sole purpose of changing the composition of its reserves. Economic criteria were established by which the Fund decided which participants would be included in the designation plan. Rules for designation were framed to promote, over time, equality in the ratios of participants' holdings of special drawing rights in excess of net cumulative allocation of their official holdings of other reserves. SDRs were not convertible into gold and would thus function as a final reserve asset along with gold. Reform of the gold tranche was also settled. The amendment recognized the automaticity of the gold tranche drawings by making them no longer subject to challenge or to the need to obtain a waiver, and available to meet large or sustained deficits.

To avoid the risk of prolonged imbalances, reconstitution rules were written into the Articles which required that a participant's net use of special drawing rights must be such that the average of its daily holdings of them, over any five-year period, will not be less than 30 per cent of the average of its net cumulative allocations over the same period. The Articles also sought to improve the asset-like qualities of special drawing rights by allowing transfer of SDRs to other participants without fulfilling the exception of need.

A major point of concern to the developing countries was the simultaneous enforcement of Fund reform with activation of the SDR scheme. On the eve of the G-10 meeting in Stockholm, Madan, as spokesperson for the developing countries, made an impassioned plea not to link the two. This was because the developing countries felt that the acceptance of changes imparting a restrictive bias to the Fund's existing rules and regulations should follow an activated SDR scheme and not precede it. In terms of a compromise, an understanding was reached that the changes would be applied in a spirit of cooperation and that members of the Fund would avoid their application in any unduly restrictive manner.

On 16 April 1968, the Executive Board of the Fund gave final approval to its report to the Board of Governors, giving a full account of the proposed amendments to the IMF Articles and the way the SDR scheme would work. Following the approval of the report by the Governors, the members were notified and asked to 'accept' the amendments. Each member then initiated the legislative steps necessary to do this. The special drawing account, however, would become effective only after members with 75 per cent of the total quotas indicated that they wished to become participants. In the assessment of the Bank of England, the ratification by members' legislatures of the SDR scheme would be a 'significant milestone' in the progress towards a more rational system of expanding international liquidity. So far as changes in rules and practices were concerned, it would not add very much to the effectiveness of the institution; on the other hand, it would not reduce the Fund's ability to assist those of its members that were in temporary balance of payments difficulties.[11]

In retrospect, how far were the basic elements of the scheme, as they emerged out of the amendment exercise, in keeping with the aspirations of the developing countries? Did the qualities and characteristics of the new asset reflect the views of the developing world or was it a industrial product bearing the exclusive hall-mark of the G-10 group? Historical facts confirm that the basic aspects of the scheme did accord in several areas with the views expressed by the Directors of the developing world. Many of them suggested that any new asset should be allocated on a non-discriminatory basis, that it should be distributed universally, that it should be automatically available to any member who wished to participate in the scheme and that the distribution key for drawing rights should be the quotas. The Fund would administer the scheme through a special drawing account, and all decisions and questions on proper use of the asset would be centred in the Fund. In this way the oft-repeated idea of the creation of a reserve asset by a limited group of countries was given a decent burial, and the status of the Fund was preserved and its responsibility enhanced. However, the developing countries regretted that the liquidity proposals were not specifically directed towards meeting development needs. In their reading, with the slowing down of aid flows, the creation of special drawing rights in unconditional form would add to their reserves, which, in turn, would aid their growth and development. Subsequent narration will bring out the fragility of that hope!

Following the approval in principle given by the Board of Governors of the IMF for the introduction of the SDR scheme, Finance Ministry, Law Ministry and Reserve Bank officials were preoccupied in examining the legislative action needed for India to participate in the SDR facility. The Bank's advice was an important element in the amendment of the IMF and

[11] Copy of Leslie Obrien's confidential letter of 19 April 1968 to RBI Governor L.K. Jha, giving the gist of developments in the area of international liquidity.

Bank Act. The amendments authorized the Reserve Bank to receive, acquire, hold, transact and operate SDRs, and to perform all acts incidental thereto, on behalf of Government of India. The procedure to be adopted for recording the transactions relating to SDRs in the Reserve Bank books resulted in considerable interaction between the Finance Ministry, the Bank and the Executive Director.

The Fund's Articles of Agreement did not prescribe any particular domestic treatment for SDRs. In fact, according to the Fund, 'participants were to be guided by their own legislation, policies and practices in regard to (domestic) treatment of Special Drawing Rights'. The one guiding proviso given by the Fund was that the procedures adopted by participants for the use of SDRs should be so devised that the allocation of SDRs to the Central Bank of the country should not lead to an expansionary or contractionary impact on the domestic money supply—in other words, the procedures would have to ensure that SDRs would have a neutral effect on domestic monetary expansion. Use of the new instrument as a method of budgetary assistance was to be eschewed. However, no special procedures were called for in the case of SDRs *acquired* from other participants through balance of payments surplus.

Intensive exchanges followed between the Reserve Bank and the Finance Ministry, to evolve an accounting procedure that would have a neutral impact. The matter was examined threadbare by Seshadri and Anjaria at the Reserve Bank end, and by Ramakrishnayya at the Finance Ministry end, with the Executive Director, Madan, providing guidance on the basis of decisions taken in this regard by some members like the US and the UK. The main difficulty arose out of the Finance Ministry's perception that the government was the recipient of SDRs allocated to a member country, and, so long as SDRs remained as a drawing power, they need not be taken into account either by the government or the Reserve Bank. The Bank considered the approach inappropriate. On the basis of a detailed examination by Seshadri, Deputy Governor Anjaria explained in a telex message to I.G. Patel that a mechanism would have to be devised that will achieve the objective of bringing SDRs even as a drawing power into the Reserve Bank's books and then neutralize the immediate effect of this accrual on government's cash balances. But to do this, it was for the government to transfer SDRs to the Reserve Bank, who would hold it as an asset against a blocked balance in favour of the central government.

The Ministry of Finance had some concerns regarding the procedure suggested by the Bank, resulting mostly from a territorial claim. Treasury officials were unduly sensitive to the idea that SDRs would be treated, even if notionally, as an asset, and exhibited as such in the Bank's balance sheet. Setting aside the procedure suggested by the Bank, C.S. Swaminathan informed the Fund that the government had proceeded on the basis that the SDRs will not be reflected as stock in the balance sheet of the Bank but as flow, i.e. they would be reflected in the books of the Reserve Bank at the point when they are actually utilized. This view, that holdings of SDRs would not be reflected as assets in the RBI's balance sheet, was endorsed by the Central Board of the Bank at its meeting in Patna.

Thus, by legislation, Government of India conferred powers on the Bank to act on its behalf for using, receiving, acquiring, holding, transferring or operating SDRs. However, as it was the practice of the Bank not to show the IMF gold tranche position or a stand-by position as assets in its books, the same treatment would be afforded to the initial allocation of SDRs.[12] The Fund officials were not too sanguine about the allocation procedure outlined by the government, which would not provide direct budgetary support to the government but, nonetheless gave their tacit approval.

Seshadri remained uneasy. Some ancillary issues surfaced, too, such as the inclusion of SDRs in the country's foreign reserves, and the treatment of SDRs in the balance of payments compilation and in relation to the sterling guarantee agreement with the UK. Although status quo was maintained with respect to the procedure adopted for accounting of SDRs, there was great uncertainty within the Bank, whose officials continued to examine various facets of the issue. Ironically, when the Fund requested for factual information on the accounting procedures followed by India, the government, as was customary, passed the buck to the Reserve Bank to answer the Fund's questionnaire, which was duly taken care of by the Economic Department of the Bank. The government, which was keen on taking the initial decision on the SDR issue, was not as keen on replying to the Fund on the accounting issue.

Activating the SDR Facility

As the Fund approached the requirement that members having 75 per cent of the total quotas were ready to deposit instruments of participation in the SDR account, the Managing Director mooted the proposal of a five-year basic period in which annual allocations in the range of $2.5 to $4 billion a year could be considered. To compensate for the slow growth of global

[12] The initial allocation would, under government procedure, be reflected in a proforma account, and this account would reflect all transactions involving SDRs for the internal records of the government.

reserves and the decline in official gold holdings, he further suggested 'some front loading' in the initial years. The general tenor of the Board was supportive of the Managing Director's proposal; however, several Directors urged that the magnitudes of the quota increase and the allocation of SDRs should be considered in tandem. Madan, the Indian Executive Director, was quick to perceive the danger of such a course. Presenting the developing countries' viewpoint, he said: 'Like the industrial countries, the developing countries too had been adversely affected by the steady erosion in the supply of liquidity, as evidenced by the shrinking proportion of reserves to imports and international trade and capital movements.' Emphasizing that the developing countries were keenly interested in the activation of the SDR facility and bearing in mind the hints earlier given by some industrial countries for large special increases in quotas, Madan made no bones about opposing large special increases in the structure of Fund quotas. He was supported by the developing countries' members who wanted an assurance that activation of the SDR facility would not shortchange the outcome of the quota review.

From the above, it is clear that the special drawing rights scheme was a product of protracted debates, negotiations and compromises within and outside the IMF, spread over a period of nearly five years. The final decision to make the scheme operative came with formal approval by the Board of Governors at the Fund's annual meeting at Washington, on 29 September–3 October 1969. In accordance with this approval, the IMF was to allocate SDRs to the tune of \$3.5 billion in the first year and \$3 billion each on 1 January 1971 and 1972. A three-year interval rather than a five-year one was chosen for the first basic period because of the difficulty of estimation of reserve needs over a longer period.

In retrospect, how far were the basic elements of the scheme, as they emerged from the amendment exercise, conducive to the aspirations of the developing countries? The basic aspects of the scheme did accord in several areas with the views expressed by the Directors from the developing world. In a memorandum to the Central Board of the Bank, 'the development was described as a new era in international monetary management'. Deliberate creation of international liquidity on the basis of assured needs and under the auspices of an international agency of high competence and rich experience, in the assessment of the Reserve Bank, was 'unquestionably a momentous step forward'. The main regret of the developing countries was that the liquidity proposals were not specifically directed towards development needs. In the Bank's thinking, an automatic link of this 'fiduciary' money with aid for economic development would have been helpful, but it remained optimistic that the idea recommended strongly by a number of distinguished experts[13] would find acceptance later. Also, the high qualified majority and right of veto given to some groups of countries disturbed the Bank.

Overall, however, the Reserve Bank was receptive to the proposals, for in its reading, with the slowing down of aid flows, the creation of special drawing rights would add to reserves, which, in turn, would aid growth and development. As for the government, I.G. Patel, then Special Secretary in the Ministry of Finance, advised Madan in a letter dated 26 August 1969, that the Indian government, in the interests of the SDR scheme, would go along with the consensus; however, the scheme overlooked the needs of reserve facilities needed by the developing countries—who were 'holding just one-third of the voting power—and the share in SDRs'. Linking the distribution of SDRs with quotas and changing the latter in a way that might further reduce the weightage of the developing countries would be a retrograde act, not conducive to creating a proper climate for international cooperation. India was accepting the proposals on the assumption that the proposed quota revisions would not aggravate the present situation and some rectification by way of a link between SDR creation and assistance for development would be considered.

Between September and December 1969, the requisite decisions concerning convertible currencies, rules for designation and acceptance of SDRs for charges and repurchases, and a few other technical points were ironed out. On 1 January 1970, the first allocation planned at SDR 3.5 billion was made. India was a recipient of SDR 126 million at the beginning of 1970, SDR 100.6 million in 1971 and SDR 99.6 million in 1972. The allocations came at a time when India's reserves position was relatively strong. As a consequence, India found itself included in the designation plan among twenty-five countries selected by the IMF to accept SDR 14 million and to provide convertible currency to other participants. The new obligation was accepted with some satisfaction as it was a reflection of the significant improvement in India's balance of payments position. From now on, the responsibility of maintaining the books reflecting SDR transactions and making arrangements with the Bank of England to provide convertible currency devolved on the Reserve Bank. It was a new experience and responsibility that was discharged ably and efficiently by the Bank.

[13] UNCTAD Expert Group on International Monetary Issues had recommended the establishment of a link between SDRs and additional development assistance.

But the travails of SDR were not over. Although the second activation came through in 1979, in a speech at Brookings Institution, Ossola indicated that 'second activation appears difficult if Europe is still then awash with dollars'. Despite these ripples of doubt, however, within less than two years, SDRs became an accepted reserve asset. Almost all members of the IMF became participants in the scheme, and the usage and conversion procedures agreed upon between the Fund and issuers of currencies functioned well. As confidence in the US dollar as a reserve currency retreated, there were suggestions to make the SDR the numeraire of the monetary system.

Controversy over SDR–Development Finance Link

But the SDR link (specifically, the link between reserve creation and development funding) issue remained unresolved. As part of their preparations for the annual meeting in Copenhagen, on 21–25 September 1970, the Group of 77 developing countries considered this issue afresh, and, at the Commonwealth Finance Ministers' Meeting in Cyprus, they urged reconsideration of the link. At the annual IMF meeting, several Governors representing the developing countries pressed for a reconsideration of a link between SDR and development finance. The Managing Director, in his concluding remarks, assured them that this subject would figure in the future work programme of the Fund. A UN document outlining 'An International Development Strategy for the Second United Nations Development Decade' also sought to nudge the conscience of the developed world to seriously reconsider the possibility of establishing a link between the allocation of new SDRs and provision of additional finance for economic development. But the wall of resistance raised by the developed nations to the very idea of such a link made further progress difficult.

Early in 1971, the Fund staff came up with a paper containing a lucid explanation of the case for the link by the Secretary General of UNCTAD, and called upon the Board to identify the main lines of enquiry that should be pursued. Preliminary discussion revealed agreement on the point that the impact of the link on the volume, regularity and quality of aid would have to be carefully analysed. Directors from the developed countries expressed reservations regarding the advisability of such a study but were prepared to examine the implications of an inorganic link rather than an organic one. The need for two specific studies was agreed upon, viz. (i) a comparison of the main types of link proposals and their implications for aid and for SDR allocations, and (ii) an analysis of the different link schemes from the viewpoint of the monetary character of SDRs and the longer-run developments envisaged for the SDR facility.

It is worthwhile to mention that the Directors of the less developed countries met regularly as a group in this period to discuss the organizational and substantive aspects of the monetary system. The Indian Executive Director's office at times served as the secretariat and accepted the responsibility of preparing background papers, as was the case for the Caracas meeting of the G-24. The Fund management had initially expressed considerable unhappiness at the birth of the G-24 but then appeared reconciled to the idea of living with the less developed countries' group, especially after Prasad, the Indian Executive Director, assured Schweitzer that the group was not aimed at or against the Fund as such but was merely an answer by the developing countries to the other pressure group set up by the G-10. The aim of the G-24 was to coordinate the activities of the Directors of less developed countries and to ensure a certain measure of political support for coordination from a wider political group. It may be recalled that, despite the Indian delegation's attempt, at the time of framing the original Articles of Agreement, to include development as a purpose of the Fund in the preamble, the Indian initiative had met with stiff resistance. Except for the creation of compensatory and, later, buffer stock facilities in the 1960s, there was little evidence to indicate that the policies were intended to benefit the developing countries.

The inability of the developing countries to get agreement on a link between allocation of SDRs and the provision of financing for economic development convinced them that the existing monetary system and the manner in which it operated would not safeguard their interests. However, Prasad, the Indian Executive Director at the Fund, lost no opportunity to ram home the point that any report on monetary reform must contain proposals on arrangements for linking SDRs with development finance. In this context, he reserved his views on proposals for consolidating the then overhang of dollars and the asset settlement scheme outlined in the draft report on monetary reform. He saw in the scheme for asset settlement, an attempt to settle the large liabilities of main reserve centres and to make the poor countries even more dependent on the reserve centres. Prasad cautioned the management that creating SDRs on a scale needed for this purpose would 'seriously cripple the confidence in the new instrument' as a reserve asset. Truly progressive reform required the monetary system to become a handmaiden of development and trade, and to ensure the related aspect of a link between money and development finance. As there were reservations of a fundamental nature in regard to the approach outlined in the draft report, defending the link became the primary objective of representatives from the developing countries. And so, grudgingly, the link issue was brought back on the agenda for monetary reform.

In September 1972, the IMF staff prepared a paper in which it described five types of schemes[14] by which a link could be established between SDRs and development finance. The paper went so far as to say that 'direct repercussions of any of the schemes on aggregate world demand and hence on inflation were not likely to be sizeable'. Discussions on the link towards the end of 1972 and early 1973 revealed that most of the industrialized countries, including the US, were against using SDRs to increase assistance to the developing countries. However, with the threat of the coming into being of the G-24, there was a distinct thawing of attitudes of developed countries, to permit a discussion of the idea in the context of monetary reform. The debate was indicative of the fact that the industrial countries were not in a mood to forge an explicit link between SDR allocation and development finance. The nine Executive Directors elected exclusively by the developing countries' members, all spoke out resolutely in favour of a link of some kind.

India, being a keen proponent of the idea, battled hard for its recognition. The thrust of Prasad's intervention was that SDR-based development finance was not a risky idea fraught with disaster, as many seemed to think, and that it had potentialities that needed to be explored. After all, the ultimate stability of the international system was related to growth and trade, and some kind of a link between the monetary system and development finance was inevitable. Emphasizing that the Fund's purposes were broad, aiming at full use of world resources to achieve full employment and higher living standards was not such a bad idea. Prasad cautioned the Board not to be obsessed with balance of payments equilibrium as the sole objective to be obtained at all costs, and accused the Fund of losing sight of its basic principles. He was vigorously supported by his G-9 colleagues. Some came up with even newer arguments for the link, the burden of their song being

[14] Type A scheme, in which the Fund would directly allocate SDRs to international institutions. Type B scheme, in which developing countries would be given a larger share of SDR allocations than corresponding to their share in Fund quotas. Type C scheme, in which the share of developing members' initial quotas and hence in SDR allocations would be raised. Type D scheme, in which national governments receiving SDR allocations contributed a predetermined proportion of their SDR allocations to development finance institutions. Type E scheme, which depended on the creation of a substitution account and amounts of interest received by the Fund from operations with the account would be contributed to development finance institutions.

that the gap between the needs of the less favoured Fund members and the amount of resources available needed to be filled either through the link or through alteration of the Fund's policies pertaining to the use of regular resources.

The several hours of discussion left no one in doubt that the task of hammering out a new monetary system would indeed be a difficult one, entailing hard bargaining. These were preliminary skirmishes and many more battles would have to be fought before one could get down to the brass tacks of devising a new system. But the one fall-out of the link discussions was that the Managing Director and staff of the IMF became seriously interested in finding some way of channelling a larger quantum of financial resources to the developing countries. The upshot of this change of heart on the part of the staff was the idea of instituting a new facility that would provide larger resources for longer periods to developing countries for undertaking structural adjustment of their economies; a 'link within the Fund', so to say, meaning that assistance to developing countries would come directly from the Fund. The suggestion roused the interest of the developed and developing country members and, within a year, after careful study, the Extended Fund Facility was instituted in 1974.

This, however, did not mean that the demand for the SDR link faded away. At the May 1973 meeting of Deputies of the C-20, the G-24 presented the consensus of officials of developing countries in a report[15] on the link. The report emphasized that transfer of real resources to developing countries ought to be an integral part of reform of the system. At the meeting, the developing countries stated their commitment to the link and indicated their preference for the type B scheme. Rehearsing familiar arguments against the link, the developed countries warned that the Fund should be cautious in entering the field of development finance, that a link would reduce confidence in the SDR, and that balance of payments adjustment would be adversely affected.

While the idea of linking SDRs to development finance was eminently attractive to the developing country members, the developed country members refused to see the logical connection between SDR creation and development finance. The key industrialized countries were adamant that development aid should not be linked with the global need for SDR creation; if the decision was dictated by that need, the outcome could well be that liquidity creation would be excessive, uneashing inflationary tendencies that

[15] Lal Jayawardena of Sri Lanka was the chairman of the Working Party on the Link.

would shake the confidence of the SDR. This attitude of the industrial countries provoked the Indian Executive Director Prasad to remark: 'Acceptance of a reformed system that included the link might be politically difficult to some developed members; acceptance of a reformed system which did not include the link would equally be politically difficult for many developing countries.'

The outcome of the May 1973 deliberations was that the link issue could not be usefully pursued by the C-20. However, to keep the issue alive, a Technical Group on 'SDR–Aid Link and Related Proposals' was set up in May 1973, to examine in depth the modality through which the link could be instituted, and to examine other technical aspects such as the amount, timing and distribution key for SDR allocations. Despite the negative approach of the industrial countries, the developing country members continued to vigorously argue in favour of the link. The Technical Group had representatives from Central Banks and Ministries of Finance of developing countries, who were aided by their Executive Directors. India was represented on the Technical Group by I.G. Patel from the Finance Ministry and Kadam from the Reserve Bank. The Group met twice and gave its report to the Deputies. Suffice it to say, there was no shift in the entrenched national positions but the lobby of representatives from developing countries remained firm on their preference for a type B scheme. They viewed the proposed extended facility, the easing of conditionalities and enlarged drawings under the compensatory financing facility, and the buffer stock facilities, not as substitutes for a 'link' but as 'welcome supplements'. But it was pretty obvious that the European countries were resisting, in every way possible, attempts at diverting the new reserve medium for aid. Articles that appeared in a German daily displayed the mood and thinking of the Europeans on this issue.[16]

[16] *Neue Zuercher Zeitung* stated that the less developed countries had acquired newfound energy after the activation of SDRs, an activation that completely ignored statutory preconditions and which was anything but restrictive in measuring out the amounts involved. The developing countries for some time had been urging pressingly for a larger share of new SDR allocations, demanding vehemently an institutionalized link between SDR creation and development aid, and would like a special SDR allocation to compensate their losses from last year's realignment of industrial countries' exchange rates. The article went on to say that expansion of the former G-10 into a G-20 to include developing countries was a significant sign of lowered resistance from some industrialized nations. It disputed that the developing countries were under-represented in the Fund, adding that the third world receives proportionately more SDRs from the IMF than it would if total reserves were used as the basis for allocation. The above observations were indicative of the uphill task that the developing countries would have to face in the G-20 discussions on the subject.

July and August 1973 saw frenzied activity in the Committee of Twenty (C-20) to reach agreement on the outline of reform before the annual meeting in Nairobi. Entrenched positions, however, came in the way of an agreement as models for adjustment and for convertibility were discussed. Neither was agreement forthcoming on the valuation of gold. As for the SDR link, the developing countries were eager to establish a reformed international monetary system that would 'promote an increasing net flow of real resources to developing countries'. The possibility of establishing a link between development finance and SDR allocation in the context of the reform was closely examined but no agreement was reached.

Nevertheless, the demand for a link between SDR and development finance was forcefully reiterated by several of the Governors of developing countries at the 1973 annual Fund–Bank meeting in Nairobi. India's Finance Minister, Y.B. Chavan, who attended the meeting said 'the link could be established through regular transfer of a certain proportion of newly created SDRs, which would provide an additional flow of resources needed for economic development and thus would help to fulfil a function that is essential over the longer run for the adjustment process to function efficiently.' He warned that 'it would be incorrect to distribute new reserve assets entirely as some sort of unearned dividend on the basis of Fund quotas'. The outline of reform declared firmly that 'if a link were to be established, the amount of SDR allocations and the principal characteristics of SDRs should continue to be determined solely on the basis of global monetary requirements'.

The only outcome of these deliberations was the establishment of yet another Technical Group on the Transfer of Real Resources. This Group met four times between November 1973 and April 1974. While the developing countries wanted the Technical Group to go into the full range of topics, from trade and investment to development aid, participants representing the developed group of countries were only prepared to confer a narrower mandate on the Group; they wanted it to confine its examination to a much shorter list of questions pertaining to resource transfers, and specifically related to the features expected in a reformed international monetary system. In view of the differences that surfaced over the very terms of reference of the Technical Group and since the C-20 was to wind up its work, it was decided to limit the work of the Group to issues concerned with arrangements for the international monetary system, leaving aside the wider issues of transfer of real resources to be considered later by some other committee.

The sum and substance of the Technical Group's conclusions were that an improved, smoothly working adjustment process would be beneficial to the developing country members, and that developed country members should undertake corrective measures so as not to disrupt the development programmes of developing country members. Issues such as exchange rate mechanism and the effect on borrowing by developing country members, consolidation of currency reserves and financing of the enlarged deficits resulting from the increase in oil prices of non-oil developing countries, were also covered by the report of the Group. Finally, the Group recommended the establishment of new institutional arrangements for study of the broad questions involved in the transfer of real resources to developing countries. Thus the seed was sown for the setting up of a joint Fund–World Bank Ministerial Group to consider issues pertaining to transfer of real resources to developing country members. The subsequent creation of the Development Committee was an outcome of this recommendation.

By the beginning of 1974, it was evident that the C-20 was about to abandon its efforts to reform the international monetary system. India had the rare distinction, along with two other countries, of having Y.B. Chavan as the ministerial representative at six C-20 meetings; in the case of most of the others, there was a change of faces but little change in positions. Representatives of Belgium, France, Italy and the UK supported type A or B schemes; Japan, Australia and the Netherlands were supportive of a link but preferred type D schemes. But Germany and the USA continued to oppose the idea; Shultz of the USA went as far as to declare, that the United States had grave reservations about the link. Burns, in support of Shultz, said that 'the link would undermine confidence in the SDR and would provide a good excuse to the US Congress not to vote for the aid appropriations'. Hope was expressed that constructive compromises would enable the C-20 to put together an Outline of Reform of the International Monetary System. But long standing patterns of behaviour of the key countries made such constructive compromises extremely difficult. Meanwhile, the international payments scenario was overtaken by a sharp increase in the price of crude oil.

Disappointed with the turn of developments and realizing that the C-20 was likely to give up its efforts to reform the international monetary system, as a last-ditch effort, the G-24 met in Rome on 16 January 1974. They pressed home the point that they wanted early agreement on all outstanding issues, including an improved trading system and an improved system of transferring real resources from developed to developing countries. Since the prospects appeared dim, the G-24 officials stated their positions on various aspects of the reform. Briefly put, their demand was that arrangements should be made to facilitate use of the SDR in official settlements; and that there should be changes in the structure of members' quotas in the Fund and in their voting power so as to give developing country members a larger share in decision-making; that a permanent Council of Governors could be created to help run the Fund and developing country members should be given adequate representation on that Council; and that some kind of link arrangement should be established without further delay.

All that came out of the pressurizing by developing country members was that the outline contained a separate section on the link and on credit facilities in favour of the developing countries; the substantive decision to establish a link between SDR allocation and development finance was shelved. It was a sad commentary that after years of intense negotiation at various levels, financial officials were unable to come to an agreement on creating a reformed monetary system. Morse, chairman of the C-20, attributed the failure of the Committee to lack of political will. But the work of the Committee was significant in facilitating agreement, later, on aspects of the evolving architecture of the monetary system, such as guidelines for floating and valuation of the SDR. Agreement on a number of points were later incorporated into the second amendment of the Articles of Agreement.

By early 1974, an atmosphere of crisis had gripped the international monetary system. There were wide swings in the exchange rates for the main currencies but there were no international rules for exchange. Commodity prices were zooming and speculative stockpiling was in evidence. Some of the industrial countries were experiencing inflation rates of 10 per cent. The inflationary flame was further ignited by an unprecedented rise in crude oil prices; this development gave the C-20 a readymade alibi to state that it was 'overtaken by events'. The fact, however, was that the political will for creating a reformed system just did not exist.

The years from 1974 onwards saw a non-system in place that led to increased volatility in exchange rates and capital flows, and a slowdown in the growth of world trade and output. The IMF attempted to adjust the nature of its facilities, added new ones like the Oil Facility and the Extended Fund Facility, and displayed a little more flexibility in its approach to conditionality, in order to improve its effectiveness as a lender to developing countries. In preparation for an evolving system, a special consultation procedure was inaugurated, the central rate decision was revised, and discussions were initiated to determine the value of the SDR and its rate of interest, which, in turn, led to a discussion on related changes in the rate of remuneration and charges. Tackling this heavy agenda meant many more Board meetings and intensive study of the issues, requiring the Indian Executive Directors, Prasad, S. Jagannathan and S.D. Deshmukh (who succeeded Jagannathan in 1977), to remain ever-viligant to safeguard the interests of the constituency they represented.

It may be recalled that in the absence of a proposal by the Managing Director, the second basic period—1 January 1973 to 31 December 1977—began as an empty period. When it came to considering an allocation for the second basic period, there was a good measure of support, particularly from developing country Directors, for further allocation over a short basic period. Admittedly, there was a very large increase in reserves, but they pointed to the uneven distribution of the reserves. The Directors regarded it important to continue allocation, even if on a smaller scale, as failure to do so would lead to adverse political reactions among the less developed countries.

The Indian Executive Director, Prasad, ably argued the case for an allocation. He tellingly brought out the inequity of the international financial system by stating that although the Articles of Agreement do speak of 'reserve needs reckoned on a global basis', the Fund should develop a more sophisticated concept of assessing reserve needs, according to different regions and different types of countries; that reserve excess in some areas and reserve stringency in others might coexist, and, unless varying situations are duly taken into account, developing countries would be faced with hardships simply because a few of the developed countries had managed to pile up reserves. This argument received considerable support from developing country Directors but a group of developed country Directors refused to be swayed in their interpretation of 'global need', and literally clung to their own concept of need. Throughout the second half of 1972, the Managing Director continued his consultations. But, as there was no broad support for an allocation proposal, he ceased his consultations following the very large increase in foreign exchange reserves (about US$ 20 billion) that took place in the first quarter of 1973. Hence the second basic period began as an empty period on 1 January 1973.

It was not till early 1977, then, that the Interim Committee requested the Board to consider whether a further allocation of special drawing rights was warranted. A staff paper had made a convincing case in support of further allocation of SDRs in the range of 5 to 8 billion per annum. Developing countries supported the staff analysis and pointed out that continued laxity in SDR allocation would have a detrimental effect on the viability of the SDR. Some developing country Directors went as far as to say that they would find it difficult to support proposals to make SDR a more attractive asset unless the Board adopted a more positive stance on the allocation issue. Deshmukh, the Indian Executive Director, stressed the importance of a fresh dispensation as a crucial and essential step in the march towards making the SDR the principal reserve asset of the system, and urged that since the possibility of making a supplementary financing facility appeared remote and quota negotiations were time-consuming, positive action was needed on the allocation front. Supporting the staff's conclusion that the expansionary effect of an SDR allocation would be very small, Deshmukh said that an allocation would help in broader distribution of reserves and reduce reliance on commercial banks for countries facing debt servicing problems.

But most of the arguments, no matter how convincing, failed to wash with the hardliners—Japan, Germany and the USA. Japan's concern was the impact of a sizeable allocation of SDRs on the size of the seventh quota increase and its adverse effects on Japan's chances of getting a special increase. Germany and the USA continued to express the view that there was no general shortage of liquidity and that the issue should be addressed after a lapse of two to three years. Despite the staff pointing out that there would be need for annual allocation of SDRs to satisfy the members' need for a secular growth in their reserves due to expanding world trade, the developed countries stonewalled the proposal with the intention of extracting concessions from the developing countries that they would support proposals for improvement in yield on SDR and also cover issues regarding the size and distribution of the seventh quota increase. In light of the above, the Managing Director concluded that he could not make any proposal for an allocation at that point of time. He said that the Board should consider all aspects of the SDR question and when these issues were resolved, he would submit a proposal for an SDR allocation. Thus the first year of the third basic period began as an empty year with no fresh allocation.

It was not till mid-1978 that the Managing Director, in an Aide Memoir, suggested an allocation of SDR 4 to 6 billion a year for a period of three years, 1979 to 1981, and utilization of part of the allocation towards payment of 25 per cent of the quota increase. When the proposal was forwarded to the Reserve Bank for comment, Governor I.G. Patel was of the view that we should not readily support the proposal and that our support could be used for bargaining to have SDRs created at a satisfactory rate. The Aide Memoir came up for discussion, but there was little evidence of a consensus and hope of reaching an agreed position appeared dim. On the quantum of allocation, the numbers varied from SDR 6 billion supported by the G-9 directors, to SDR 4–5 billion favoured by Italy, to a token allocation supported by the USA and Canada, with Germany, as usual, urging the Managing Director not to make any proposal for an allocation. Such divergent views made reconciliation of positions difficult. On the Managing Director's proposal of 25 per cent increase in quotas in SDRs, while many developed countries were inclined to extend support, Germany and Italy did not show any special interest. Deshmukh, the Indian Executive Director, based on instructions received from his authorities,[17] proposed an allocation of SDR 6 billion a year without the conditionality of part payment of the quota, and showed willingness to go along with SDR 6 billion with link but at a lower rate than the proposed 25 per cent of quota increase payment in SDRs. On the other elements of the package, viz. increase in charges, rate of remuneration and relaxation of the reconstitution provision, although differences did surface, they appeared to be manageable. The Indian Executive Director's evaluation was that consensus could emerge on SDR allocation of SDR 3–4 billion a year, 80/90 combination rates for charges, remuneration, and reduction in the reconstitution provision to 20 per cent.

The Interim Committee meeting of 24 September 1978, which stated that, 'in the Committee's view, the Fund should make allocations of 4 billion SDRs in each of the next three years 1979 to 1981', gave the Managing Director the necessary mandate to establish that 'a long-term global need existed … to supplement existing reserve assets'. Accordingly, on 19 October 1978, a redraft of his proposal for allocation of special drawing rights during the third basic period, from 1 January 1979 to 31 December 1981, was brought before the IMF Board. Based on consensus in the Board, the Governors approved the resolution on 11 December 1978. While advising the Indian government to cast an affirmative vote on the package, the Reserve Bank, in a cable to Manmohan Singh, said that 'the consensus evolved on which the vote is being taken is the best that we could secure in the present circumstances'. In a brief message, the immediate implications of the approval for India were spelt out. India was to receive an allocation of SDR 119 million, Bangladesh SDR 15.8 million and Sri Lanka SDR 12.4

[17] Governor I.G. Patel's view was that an allocation of SDR 6 billion, with part payment in respect of increase in quota to take place thereafter in the form of SDRs, may be preferred to a lower allocation of SDR 4 billion per year, and if that was not possible, to bargain for an unconditional allocation of SDR 5 billion. The RBI brief rightly pointed out that if 25 per cent of the increase in quotas is payable in SDRs and the seventh quota review is to raise the size of the Fund by 50 per cent, i.e. by SDR 19.5 billion, there would, in effect, be no SDR allocation in the year in which the quota increase became effective.

million, which amounted to 10.4 per cent of their quota as on 11 December 1978. The rate of interest on SDRs would form 80 per cent of the combined rate, whereas the remuneration rate would be 90 per cent of the SDR rate and the reconstitution provision 15 per cent.

Apart from this exercise of advocacy in favour of a large SDR allocation, the Reserve Bank assisted the government in responding to the Fund's questionnaire to members on the accounting aspects of SDR allocations and holdings. Information was also sought by the IMF on the manner in which members finance and account for subscription payments and other operations with the Fund. The questionnaire contained thirteen questions. The Bank's Economic Department, in collaboration with the Chief Accountant's office, prepared comprehensive replies, setting out the procedure and accounting aspects of the questionnaire, and underlining the fact that until such time as the SDRs were actually utilized, it was not the practice of Government of India to treat mere drawing power as cash and to account for it as a receipt.

On 1 January 1980, under the decision covering the third basic period, the IMF allocated SDR 4.033 billion to 139 members. The allocation for the members of the Indian constituency was the same as in the previous year. The last allocation under the third basic period was scheduled for 1 January 1981 and this, as previously intimated by Deshmukh to I.G. Patel, was affected by changes in quota shares following the coming into effect of the seventh quota increase. Moreover, under the amended Articles, 25 per cent of the quota increase had to be effected in SDRs. With the last SDR allocation of the third basic period likely to be completed on 1 January 1981, the cumulative allocation of SDRs after 1969 came to SDR 21.4 billion.

Meanwhile, against the backdrop of a sharp deterioration of the world economic scenario in the early 1980s, marked by lower industrial growth, much higher levels of inflation, slowdown in the volume of world trade and a dramatic increase in payments imbalances among major country groups, questions arose regarding changing the rate of SDR allocation for the remainder of the third basic period and of the appropriate rate of allocation for the fourth basic period. These issues were raised in the outline for a 'Programme of Action on Monetary Reform' of the G-24 in Hamburg in April 1980, and in the Brandt Commission Report.

In response to the demands contained in the G-24 Action Programme, the Managing Director of the IMF, on 8 August 1980, as required under Article XVIII, circulated a staff paper entitled 'Considerations Relating to the Size of SDR Allocations'. The two aspects addressed in this paper related to: (i) whether a supplemental allocation of SDRs because of unexpected major developments was desirable in the third basic period, and (ii) the size of SDR allocation during the fourth basic period. Through circulation of the paper, the Managing Director sought to ascertain whether there was support for his initiative.

As was customary, the paper was forwarded to the Reserve Bank for comments. The Bank's conclusion was that there were strong elements in the world's economic situation—inflation, stagnation, unemployment and large payments imbalances—that justified prompt reconsideration of SDR allocations in the third basic period. The value of world trade in 1981 could be at least 30 per cent higher than the value projected for that year in 1978, which formed the basis for determining the size of allocation for the third basic period. As Finance Minister R. Venkataraman pointed out in his 1981 annual meeting address, 'the problems were deep-seated and no country had escaped unscathed'. The Reserve Bank of India brief further stressed that the large imbalances of major country groups following a marked shift in the terms of trade was another factor that needed serious consideration. As far as the low-income countries were concerned, their terms of trade had deteriorated sharply at a time when their export markets were stagnant and protectionism had increased. Their combined current account deficit had risen from $37 billion in 1978 to $84 in 1980, a factor not taken into account when the decision on allocation for the third basic period was taken. The substantially larger level of trade transactions than anticipated earlier, it was argued, would call for a much higher level of global reserves. There was absolutely no doubt in the minds of Reserve Bank officials, that the level and distribution of reserves among the country groups had altered significantly enough between 1978 and 1981 to warrant a further allocation. A larger allocation of SDRs would also facilitate the recycling of resources, which had assumed great importance in a period of vastly increased imbalances. Emphasizing strongly that 'unexpected major developments' justified an increase in the rate of allocations in the third basic period, the Bank indicated SDR 6 billion as the size of the supplemental allocation.

On the size of the allocation for the fourth basic period, the Reserve Bank's thinking was that even the outside limit of SDR 10 billion per annum suggested by the IMF staff was on the conservative side. With the slippage in the proportion of SDRs in non-gold reserves, the official Indian view was that permitting the trend to continue would mean moving away from the objective of the Articles of Agreement of the Fund to make the SDR the principal reserve asset of the system. The fact that the proportion of SDRs had declined even below the level at the end of 1978 was a pointer that the international community was moving away from the goal. Noting the decision to raise the SDR rate to 100 per cent of the combined market rate and other measures taken towards making the SDR the principal reserve asset of the system, it was felt there was enough justification to significantly speed up the allocation of SDRs in the fourth basic period.

But, despite the strong and irrefutable arguments for a sizeable SDR allocation put forward by the developing countries, the Board discussion revealed a divergence of views, ranging from a large allocation to a modest one and even no allocation, leading the Managing Director to conclude that many had emphasized that 'it would be important to present a very clear case for an allocation that was fully compatible with the Articles'. The thrust of the developed countries' argument was that reserve creation through the capital markets was adequate; given the strong inflationary tendency, since it was the primary responsibility of the Fund to check inflation, it had to be cautious in allocating SDRs. This line of reasoning was stoutly rebutted by Executive Directors from the developing world who urged that a cooperative institution like the Fund could not ignore the distributional aspect of SDRs, and that allocation of SDRs should deal with this aspect, for there were many members that were experiencing difficulties in gaining access to the capital market. The industrial country Directors, while harping on qualitative improvement in SDRs, held fast to the view that quantitative increases would affect the quality and credibility of the SDR. Other approaches for enhancing the role of the SDR, such as the Fund borrowing in terms of SDRs, were not considered as appropriate substitutes for SDR allocations.

In an effort to enable the Managing Director to make a proposal for SDR allocation in the fourth basic period before the Gabon Interim Committee meeting, a paper entitled 'Further Considerations Relating to the Size of SDR allocations in the Fourth Basic Period' was brought up for discussion in mid-April 1981. The paper sought to answer some of the concerns voiced by the Executive Directors. The material provided in it strengthened the argument for a fairly sizeable allocation based on the long-term global need for reserves to grow, and indicated that annual allocations in the region of SDR 11 to 14 billion would be justified. It may be recalled that India had favoured a sizeable allocation of SDR 19 billion, which the developed countries had resisted.

In consultation with Narasimham, the then Executive Director at the Fund, and based on a brief provided by the government, the Alternate Director Kannangara further reinforced the argument for a sizeable allocation by pointing out that even with an annual allocation of SDR 12–13 billion, the non-oil developing countries would receive unconditional liquidity in the form of SDRs of only 3 billion, whereas their borrowings from the Fund representing conditional liquidity would be SDR 9–11 billion. The external debt of these countries, besides, would rise at an annual rate of SDR 32–42 billion. Urging that the grim debt prospects, lack of access to capital markets and the need for a proper balance between conditional and unconditional liquidity be taken into account, the Indian demand was for an allocation larger than SDR 3 billion to non-oil developing countries. Alternately, if the level of SDR 12–13 billion suggested by the staff was agreed to, then India wanted a change in the basis of distribution of SDRs from the existing one related to quotas to one of voluntary renunciation by industrial and oil exporting countries in favour of non-oil developing countries.

Despite the positive tenor of the IMF staff paper, the developed countries continued to pick holes in its analysis. The Americans, Japanese and French said they were studying the issue and had not made up their minds. The British argued that it was important for the Fund to adopt a cautious stance—'the Fund cannot be seen by the outside world as being ambivalent to inflation'. The upshot was that the debate was again inconclusive. True, the matter was complex and not one of mathematical evidence alone, but the Managing Director urged the Board to reflect on the issue and come up with numbers at Libreville. Reminding the Board that the Fund was a cooperative institution that had to take into account the needs of *all* members, he urged it to adopt a cooperative stance. He summed up the discussion by stating that the 'Board was not in a position to take a final view'.

To sum up, on 3 October 1969, with the approval of the first allocation of SDRs, the SDR was established as a reserve asset. Developments in the 1980s indicated the fragility of the hope that the SDR would become the centrepiece of the monetary system. At the time of the first allocation itself, L.K. Jha (Governor for India) urged that the whole question of a formal link between the creation of liquidity and development aid, which had been shelved, should be considered afresh. Thirteen years later, at the annual IMF meeting in 1983, Manmohan Singh reminded the gathering of the urgent need for a fresh allocation of the SDR. Singh pointed out that even though steps had been taken to improve the characteristics of the SDR and it had been brought as close as possible in alignment with currency assets, a disappointing feature was that the proportion of SDRs in non-gold reserves had slipped further. In effect, he said, 'we had moved a step away from the objective of the Articles of Agreement of the Fund to make the SDR the principal reserve asset'. He strongly advocated a reasonable allocation of

SDRs, which would help to activate the unutilized capacities around the world, and rebutted the argument that it would rekindle inflation.

It is indeed a sad commentary that, more than thirty years down the line, the high qualified majority has worked to prevent the growth of the SDR. The developed countries tightly controlled its creation with only four allocations over a span of thirty years totalling SDR 21.4 billion and forming a very small proportion of total reserves, barely 4 per cent, for there were several empty periods in which no allocations were effected. The expectation of the developing countries that, sooner or later, the opportunity would be used to establish a 'link' between the SDR and additional development assistance, remained a fond hope. For over thirty years the developing countries have clamoured for the link, but the prospects have not only receded but the very idea has been buffeted and obliterated from the international agenda by the winds of the liquidity debate. In September 1997, through a proposed fourth amendment to the Articles of Agreement, a move made for a special one-time allocation of SDR 21.4 billion, which would raise all participants' ratios of cumulative SDR allocation to quota under the ninth general review to a common benchmark ratio of 29.32 per cent. To date, the proposed amendment has not been ratified.