OPM.779/69 No. 1370

MEMO BY THE MINISTER OF FINANCE, CUSTOMS AND PORT (Ad int.)

Participation in the Special Drawing Account of the International Monetary Fund; General increase in IMF Members' quotas and special increase in Malta quota.

1. Special Drawing Rights Participation

At a meeting of the Cabinet held on the 22nd July, 1969, Ministers agreed to Malta's acceptance of the scheme for creating special drawing rights as a supplementary monetary reserve as proposed in the amendment to the Articles of Agreement of the International Monetary Fund. The required ratification by 60% of the members of the Fund holding 80% of the votes in accordance with Article XVII has now been given and the amendment to the articles entered into force for all members as of July 28, 1969. Under the amendment, decisions regarding the Special Drawing Account will be taken by, and allocations of special drawing rights will be limited to, those members which have deposited instruments of participation in accordance with Article XXIII Section 1 of the Agreement. The Special Drawing Account becomes operative when members with 75% of Fund quotas have deposited such instruments of participation and as of 6th August, 1969, 50 members with more than 75% of total Fund quotas have deposited these instruments. Malta has been asked to state whether it intends to deposit its instrument of participation at an early date so as to enable it to play its role in the functioning of that account.

Preparations in international circles for the activation of SDRs are now understood to be moving ahead very rapidly and expectations are that sufficient progress will be made on technical details (particularly on the size of the total SDRs allocations to which reference is made below) to enable the Managing Director of the Fund to make a definite proposal early in September, 1969, for formal approval at the Fund Annual Meeting at the end of that month. Great importance is attached to the observance of this time table because failure to do so may result in world wide competition for existing reserves and a serious recession in international trade.

The pros and cons of Malta's participation in SDRs were set out in the note by the Central Bank attached to the Memo to Ministers in connection with the Cabinet meeting above referred to. A further note by the Central Bank, Appendix I, is herewith attached. Ministers will note that an instrument of participation does not commit Malta to accept an allocation and it is therefore proposed that such an instrument be deposited with the Fund. However the advice of the Crown Advocate General is still being awaited as to whether any further legislative action is required to lodge the necessary instrument of participation. In anticipation of this advice, Ministers are being asked to agree in principle to participation in SDRs and to the lodgement of the necessary instrument with the Fund as soon as legal requirements, if any, are met.

As stated above, the size of the total SDRs allocations has still to be determined by the Fund. Various views have been expressed on the size of the additional reserves required in form of SDRs and the Executive Board of the Fund is itself still divided between $ 2500 million and $ 5500 million a year for five years. The Group of Ten are likely to favour annual allocations in the region of $ 3000 million a year over three years. The advice of the Central Bank is to the effect that this strikes a reasonable balance between the various estimates of what is required and the need to preserve a prudent approach to what is, after all, a new and untried scheme. As Malta is neither in urgent need of a replenishment of external reserves (such as might justify aiming at the highest possible allocation) nor in chronic balance of payments surplus (such as might entail a substantial accretion of SDRs from other countries and therefore make it desirable to keep allocations to a minimum), the Governor of the Central Bank feels that this half way position also suits Malta's interests in the foreseeable future. Ministers are asked to approve that such line of policy be adopted.

2. <u>General Increase in IMF quotas and special increase in Malta quota</u>

Article III Section 2 of the IMF agreement provides for a general review of the quotas of the members at intervals of not more than five years and also for the adjustment at any other time of any particular quota at the request of the member concerned. The next general review of quotas is due in December, 1969, but as this ties up with the scheme for increased international liquidity through SDRs it seems that there is general consensus that the size of the increase in quotas as well as the size of total allocation of SDRs should be considered at the same time. In the case of Malta there are, moreover, grounds for a special increase in quota. According to some tentative recalculations by the Fund, Malta's present quota of $ 10 million might conceivably go up to $ 19/$ 24 million.

A note prepared by the Governor of the Central Bank (see Appendix II) on the question of general increase in quotas and of a special increase in Malta's quota, is attached.

Considering that:

(a) an increase in quota implies only a redistribution of Malta's gold reserves without any loss of earnings;

(b) an increase in quota would probably entitle Malta to a larger allocation of SDRs if so desired; and

(c) in the light of Malta's present stage of economic development it is prudent to provide for the maximum amount of help available in case of need;

Ministers are asked to approve that steps be taken to obtain IMF agreement to a special increase of Malta's quota by $ 10 million.

With regard to the general review of quotas, Ministers are also asked to agree to the Central Bank's proposal that Malta should fall in with the general European view of a 33% overall increase in quotas provided such an increase leaves sufficient room for adequate special increases in which Malta has, as already stated, an important interest.

12 AUG 1969

APPENDIX I

Special Drawing Rights Participation

1. The pros and cons of participating in SDRs were set out in the note attached to the Memo to Cabinet of the 22nd July, 1969. The main disadvantage that we see is that, owing to its present strong external reserve position, Malta might rank as a 'designated' country and be called upon to supply other participants with convertible foreign exchange (such as Sterling, U.S. dollars or Swiss francs) against payment in SDRs, carrying only 1½% interest. The amount of SDRs Malta could be called upon to take is, however, limited, and the general impression is that, in the long-run, developing countries have far more to gain from the scheme, both individually and collectively, than they are likely to have to contribute. The probability is that Malta will need to draw on its reserves over the next five years and may be very glad to have SDRs at its disposal. Unlike ordinary IMF quotas (above the 'gold tranche') the use of these SDRs would be unconditional.

2. It should be noted that the act of lodging an instrument of participation does not commit a member irrevocably to accepting the scheme in full, because:-

(a) A participant need not receive any SDRs if it did not vote in favour of the general allocation and informs the Fund that it does not wish any allocations to be made to it;

(b) A participant may at any time terminate its participation in the Special Drawing Account. In the absence of any other agreement, a net balance would be settled in ten semi-annual instalments.

3. Latest reports suggest that the Fund may advocate an initial allocation of U.S. $ 3500 million SDRs a year for a period of five years. If accepted, this would mean $ 1.7 million of SDRs would be allocated the first year to Malta, who might be obliged to accept another $3.5 million from other participants. Over a full 5-year period the maximum holding would rise to $26 million, but this is most unlikely to happen.

4. Seeing that the lodgement of an instrument of participation does not commit Malta to accept an allocation, there is no point in delaying this step : indeed, to do so without any apparent justification might be regarded as un-cooperative.

APPENDIX II

I.M.F. : INCREASED QUOTAS

1. The calculation of members' quotas is largely based on an original "Bretton Woods" formula, which took into account national income, foreign exchange reserves, imports and exports etc. In practice, however, a number of other factors have since come into play and when a new member joins the Fund there is usually a fair margin for negotiation, to cater for its own special circumstances and monetary policy. Existing quotas are reviewed every five years, to take account of the growth in national income, foreign trade etc. The last review took place in 1964-65 and resulted in a general increase of 25% in all existing quotas and the offer of special increases to 16 individual countries. The next review is due to start in December, 1969, but there seems to be a general desire to advance the exercise by several months owing to the obviously close connection between Ordinary Quotas and Special Drawing Rights (which it is hoped to activate before the end of the year).

2. Discussions have, in fact, already been taking place in the I.M.F. Executive Board. The subject has also been under close study in the "Group of Ten" countries, "Working Party No. 3" of the O.E.C.D. and in other regional organisations. According to Mr Palamenghi-Crispi, there is fairly general agreement in the Executive Board that there should be a substantial increase in the total of Fund quotas. However, opinions differ widely as to its appropriate size - ranging from an overall increase (i.e. general plus special) of $5,000 million (about 25%) to $10,500 million (50%). Sir Leslie O'Brien has just informed me, confidentially, that the U.K. will support an overall increase of the order of 30% (plus or minus 3%) which is in line with the general consensus of opinion among the "Group of Ten" Deputies. This figure appears to be a compromise between (a) the desire of "Developing Countries" for as large as possible a "General Increase" in quotas and (b) the aim of some "Industrialised Countries" (particularly those in the Common Market), which have made considerable economic progress in recent years, to secure "Special Increases" that will enhance their voting strength and general influence in the Fund. I would think that Malta would be well advised to fall in with the general European view, provided that a 33% Overall Increase still leaves sufficient room for adequate Special Increases, in which Malta has an important interest - for reasons stated below.

3. One of the documents produced by the I. M. F. Staff (SM/69/58) is designed to point out cases where existing quotas are out of line with the general pattern of quotas calculated on up-to-date economic data. This provides the statistical basis for putting forward a claim for a "Special Increase". The following figures, taken from this document illustrate very forcibly the degree to which Malta's present quota is under-average. It is also interesting to compare the position with Cyprus which, in so many other respects, is faced with similar circumstances.

Country	Present Quota	Calculated Quotas	
($ mns)		A(2)	B(2)
MALTA	10	19	24
CYPRUS	20	21	24

Footnote A(2) = Revised Bretton Woods formula (trade data)
B(2) = Modified formulae (trade and invisibles)

In other words, there is a strong case for arguing that Malta is entitled to a Special Increase of at least 100% and should be roughly on a par with Cyprus. Apart from the statistical evidence, the following practical considerations should be taken into account:-

(a) The present $ 10 million quota was calculated at the beginning of 1964 and is now completely out of date.

(b) The whole country is rapidly changing its character from a military base to an economy based on tourism and industry.

(c) The balance of payments may in future be subject to much wider fluctuations, especially as such a large proportion of the Island's requirements have to be imported from abroad.

(d) Cyprus had a "special increase" in 1968, not enjoyed by Malta.

4. An increased quota of $10 million would mean that an additional gold subscription of $ 2.5 million would have to be paid to the Fund, but this would merely represent a redistribution of the Central Bank's reserve, without any loss of earnings.

It is most important not to miss the present chance of increasing the quota, as there may not be another opportunity for 5 years. During that time Malta might easily suffer a substantial loss of reserves and if they could not be replenished speedily the effect on public confidence might be serious. I.M.F. drawing rights provide the quickest, and often the <u>only</u> available, means of foreign assistance in an emergency.

mrc