OPM.779/69 No. 1346

MEMO BY THE MINISTER OF FINANCE,
CUSTOMS AND PORT (AD INT) FOR THE INFORMATION OF MINISTERS

Special Drawing Rights as a Supplementary Monetary Reserve
of the International Monetary Fund

The Board of Governors of the International Monetary Fund have approved the final text of a scheme for creating special drawing rights as a supplementary monetary reserve and are now requesting member governments to signify formally their acceptance of the consequential amendment to the A ticles of Agreement of the I.M.F. This is in accordance with Article XVII which requires ratification by 60% of members, holding 80% of votes, before the Proposed Amendment becomes effective.

C.A.G. has been asked to advise whether any Parliamentary authority is required to accept the Proposed Amendment or whether Section 3 of the Malta Membership of the International Monetary Fund Act, 1968, which provides for the Minister s authorization for signing and acceptance of the Fund Agreement, is sufficient for that purpose.

The legal advice,a copy of which is attached as Appendix A, confirms that no Parliamentary approval is necessary but that "it would be desirable to bring the same amendments, when they have come into force, to the knowledge of the House of Representatives by laying a copy thereof on the Table of the House".

Although, as further observed by C.A.G., "the amendments under reference would become effective, independently of the attitude of our Government, as soon as 3/5 of the members of the Fund, having 4/5 of the total voting power, have accepted them", participation in the Special Drawing Account will not be compulsory on any member Government. The question of participation however is not as urgent as the matter of acceptance of the amendments and will be considered separately in due course. It is interesting to note, however, from the attached copy of a note by the General Manager of the Central Bank (Appendix B) on Special Drawing Rights that, on balance, Malta would stand to gain by participating in the Special Drawing Rights.

Ministers may wish to note therefore that the Secretary of the I.M.F. is being informed of Malta's acceptance of the proposed amendment to the Articles of Agreement of the I.M.F. as explained above.

7th July, 1969.

L-ARKIVJI NAZZJONALI TA' MALTA

APPENDIX A

CROWN ADVOCATE-GENERAL'S CHAMBERS,
Malta.

28th May, 1969.

Hon. Minister of Finance, Customs
and Port

(thro' Secretary, Ministry of Finance,
Customs and Port).

I refer to the letter-minute dated 20th May, 1969, concerning I.M.F. - Special Drawing Rights, addressed by the Governor of the Central Bank of Malta to the Secretary of your Ministry.

When Parliament authorized the Minister for Finance, under section 3 of the Malta Membership of the International Monetary Fund Act, 1968, to sign the Fund Agreement, it approved whatever is contained in such Agreement including the possibility of amendments being carried out pursuant to its provisions and acceptance of such amendments. Moreover, the amendments under reference would become effective, independently of the attitude of our Government, as soon as 3/5 of the members of the Fund, having 4/5 of the total voting power, have accepted them. I would not, therefore, think that Government is to obtain Parliament's approval before it accepts the amendments in question nor that it is to amend the Act above referred to if and when the amendments become effective. I do, however, think that it would be desirable to bring the same amendments, when they have come into force, to the knowledge of the House of Representatives by laying a copy thereof on the Table of the House.

As to the matter of participation in the Special Drawing Rights, I understand that it is not as urgent as the matter of acceptance of the amendments, and I will be replying on the issues concerning it at a later stage.

(Sgd) M. Tufigno
Crown Advocate-General

L-ARKIVJI NAZZJONALI TA' MALTA

APPENDIX B

MALTA AND THE SPECIAL DRAWING RIGHTS

1. World trade has grown far more rapidly since World War II than the world's supply of monetary reserves; i.e. gold and foreign exchange. Repeated studies during the past decade have concluded that the world one day will suffer from a critical shortage of monetary reserves unless positive steps are taken to avert it. A shortage would cause a serious slump in trade which would plunge the world into a devastating deflationary spiral leading to sharply rising unemployment, falling incomes, a general reduction in standards of living and a worldwide depression.

L-ARKIVJI NAZZJONALI TA' MALTA

2. Today, increases in the world's supply of international reserves depend chiefly on (a) gold production, and (b) deficits in the U.S. and U.K. balance of payments. In recent years the world's official gold reserves have actually declined largely because much has gone into private hoard. Relying on U.S. and U.K. deficits to supply international liquidity indefinitely is certainly not a satisfactory longer-run solution. Therefore, after years of study, by the International Monetary Fund and the Group of Ten major trading countries, a compromise solution has been hammered out under which expansions in the international liquidity need no longer depend on the growth of official holdings of gold and foreign exchange. The new scheme is designed to supplement and not to supplant existing facilities.

3. When adopted, the world will have, for the first time, a set of rules for creating and using an international reserve asset which is fiduciary, managed, deliberately created for the machanism as a whole and not for the needs of any individual member, and freely transferable within the scheme's provisions.

4. The new reserve scheme is based on Special Drawing Rights (SDRs) to be operated through the International Monetary Fund. The SDR values are guaranteed in terms of a weight of gold

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The SDR scheme differs appreciably from the existing IMF system. Under the present arrangement, members like Malta transfer gold from their external reserves to the IMF to pay their "gold tranche" subscription and obtain in exchange an equivalent reserve position in the Fund. Such transactions simply change the composition of a member's reserves, neither increasing them or international liquidity. Under the SDR scheme, on the other hand, there will be a permanent net addition to reserve assets.

5. The SDR scheme, presently in the form of a proposed amendment to the Articles of Agreement of the IMF, was approved by the Fund's Board of Governors in May 1968, a few months before Malta joined the IMF. To ensure that it will be introduced only if widely supported, the proposed amendment must be accepted by 60% of the member countries and by those having 80% of the Fund's total voting power. In addition, members having 75% of the Fund's aggregate quotas must deposit instruments of participation in a Special Drawing Account before the scheme will be established and available for activation. As of the moment less than the requisite 80% of the members have ratified the proposed amended Articles of Agreement.

6. Once the hurdles noted above are passed, decisions to create SDRs can only be made on a proposal by the Fund's Managing Director, concurred in by the institution's Executive Directors and approved by its Governors by an 85% majority of total voting power. Thus, the SDR scheme itself passes no judgment on whether there is now a shortage of international liquidity. That is left for determination later by the 85% majority vote of the participants.

7. In any decision on the amount of SDRs to be created and allocated among the participating members, the critical factors will be the Fund's collective judgment on the need to supplement the world's reserves, the attainment of a better balance of payments equilibrium, and the likelihood of a better working of the international monetary adjustment process in the future.

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L-ARKIVJI NAZZJONALI TA' MALTA

8. Participating countries can use the new Drawing Rights unconditionally - transferring them, in the books of the IMF, to another participant (designated by the Fund) which will be obliged to supply its own or another convertible currency in exchange. This means that Malta could be required to supply Malta pounds or, if necessary, any convertible currency in its official external reserve holdings.

9. When the new scheme is implemented participating members (and all may participate) will receive allocations of Special Drawing Rights at yearly intervals during a basic period lasting five years. The SDR allocations will be in proportion to a participant's quota in the IMF. Malta's quota is US $10 million, or slightly less than 0.05% of the Fund's total on 31st March, 1969.

10. Here is how the system would work, using Malta's quota as the basis. Assume that the IMF's Board of Governors approves the creation of US $1,000 million of SDRs. Malta's share, based on its quota, would be $500,000. Suppose now that because of balance of payments deficits Malta has a need to use some of the SDRs. It would have to exchange them for suitable convertible currencies. Malta, therefore, would request the Fund's advice into what currencies it could convert, say, 50% of its SDRs. The Fund at any given time would have a list of participating members whose balance of payments and reserves positions were regarded as reasonably satisfactory. From this list it would designate appropriate countries. Assume that West Germany and Italy are designated. The Fund would notify them that it was increasing each of their Special Drawing Accounts with the equivalent of $125,000 in SDRs and the two countries in turn would be requested to credit Malta's account, in the books of their central banks, with a corresponding amount of Deutsche marks and Lire. At the same time, the Fund would reduce Malta's Special Drawing Account by the $250,000 of SDRs used.

L-ARKIVJI NAZZJONALI TA' MALTA

11. As a result of these transactions, the SDR reserves Malta gave up would be replaced by the equivalent of $250,000 of convertible currencies which it could then spend. The reserves of Germany and Italy, at the same time, would increase, at least initially, by $125,000 each owing to the receipt of SDRs from Malta.

12. The SDRs, thus, will be a reserve asset in the same sense as monetary gold now is; i.e., they will not be traded directly in any market but will be transferred between central banks to acquire for the transferor (Malta in the illustration) the currencies needed for its market intervention.

13. Malta would be charged a moderate rate of of interest - 1½% a year, at least at the beginning - on the amount of SDRs used, while Germany and Italy would be paid interest at that minimal same rate.

14. Malta would be under no obligation to buy back (reconstitute) SDRs so long as during any five-year period its daily average holdings of SDRs was equal to at least 30% of the total amount allocated to it. Malta could, of course, use 100% of its SDRs for a time, but then it would have to buy back enough of them, in any five-year period, so as to reduce its average use of SDRs to 70%. The object is to prevent SDRs from piling up in the hands of a few countries.

15. No country, unless it so desires, will be obliged to accept from other countries any additional SDRs once its total holdings are equal to three times the amount received under cumulative allocations. Thus, if Malta were allocated $500,000 of SDRs, it could refuse to accept any more from other members once its total holdings reached three times that figure, or $1.5 million.

16. No firm agreement presently exists on the initial amount of SDRs to be created. Suggestions range from $1,000 million to as much as $10,000 million.

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L-ARKIVJI NAZZJONALI TA' MALTA

17. Implications. Malta will benefit by accepting the proposed amendments to the IMF's Articles of Agreement. By participating in the scheme, Malta gains external reserves when SDRs are allocated. The amounts, of course, will be relatively small simply because Malta's share of the IMF's total quotas is small. By participating Malta will also be making a contribution, along with other nations, to the furtherance of world trade and to the promotion of high level employment, production and incomes.

18. On the negative side, because the SDRs are to be allocated according to quota proportions, the small, needy developing countries will only get small amounts. Many argue that they should get more than a proportionate share; that, as it stands, the chief beneficiaries will be the dozen or so major trading countries of the world. In addition, the SDRs may allow the U.S. and U.K. to relax their efforts to improve their balance of payments position. Further, Malta or any participating country may be required to furnish in exchange for SDRs either its own currency or, if necessary, some other convertible currency in its reserves. This would tend to reduce a bit income from external assets since they will usually yield more than the 1½% to be earned on additional acquisitions of SDRs. The amounts, however, in Malta's case are so small as to be insignificant. On balance, Malta would gain from the scheme.

L-ARKIVJI NAZZJONALI TA' MALTA