INTERNATIONAL LIQUIDITY AND THE THIRD WORLD: THE DISTRIBUTION OF SPECIAL DRAWING RIGHTS

Stefaan Marijsse

On July 25th 1970, the Group of Ten[1] agreed upon the creation of Special Drawing Rights (SDR's), the function of which was to forestall the problem of future shortages in international liquidity.[2] It was arranged that over an initial period of three years, the International Monetary Fund (IMF) would create $9.5 billions in SDR's: $3.5 billions during the first, $3 billions during the second, and $3 billion during the third year. The first allocation of $3,414 millions to 104[3] of the 115 member countries of the Fund was therefore made in the year 1970. The "objective" criterion of allocation for individual countries participating in the SDR scheme[4] was 16.8 per cent of that country's quota in the IMF. Thus the 24 industrialized countries were allocated 72.02 per cent of all created international liquidity while the 80 developing countries shared in 27.98 per cent (the Group of Ten took 61.40 of all SDR's).

The object of this article is to ask whether the creation of SDR's is really based on "objective" criteria and whether it would be economically rational to link the problem of capital procurement for the developing countries to the problem of the creation of the SDR's. The existence of such a link would point to the desirability of a wider participation of the developing countries in the creation of international liquidity. This latter question is asked in view of a fact of life of international economics which is steadily growing in importance; that is the widening gap of incomes between industrial and developing countries. If this gap is to be bridged, the developing countries have, by 1975, to dispose of at least 7 billion dollars of capital and payments facilities over and above the projected capital

Table 1: Creation of Special Drawing Rights for the period 1970-1972

Group	No. of countries	A (%)	1970 B ($mls)	1970 C ($mls)	1971 (%)	1971 ($mls)	1972 (%)	1972 ($mls)
U.S.A.	1	24.26	849.10	866.88	24.26	727.80	24.26	727.08
U.K.	1	11.47	401.45	409.92	11.47	344.10	11.47	344.10
Rest of countries of the Ten Group	8	25.67	898.45	917.31	25.67	770.10	25.67	770.10
Group of Ten. Total	10	61.40	2,149.00	2,194.11	61.40	1,842.00	61.40	1,842.00
Rest of developed countries	14	10.62	371.70	379.34	10.62	418.60	10.62	418.60
Total developed countries	24	27.02	2,520.70	2,573.45	72.02	2,261.60	72.02	2,261.60
Developing countries	91 (80)	27.98	979.30	926.55	27.98	738.40	27.98	738.40
Total	115 (104)	100	3,500	3,414	100	3,000	100	3,000

Source: *International Financial Statistics*, Jan. 1970, and *Keesings Historisch Archief, o.c.*, Jan. 16. 1970.

A. If all member countries of the IMF participate in the SDR system, then the amount created would be divided among these countries following these percentages.

B. Absolute figures on the basis of participation of all countries.

C. Only 104 countries received SDR's so that $3,500 million had to be divided by 104 instead of 115 member countries. The amounts entered on this column are consonant with 16.8 per cent of the quota of 104 participate members. Formosa decided to cancel its allocation of $86 million in 1970. Thus $3,414 million's net $3,500 million were created in 1970.

inflow to these areas.[5]

The Problem of International Liquidity

What is international liquidity? The IMF, the Group of Ten, and the Bank for International Settlements (BIS) the most important international monetary authorities, define international liquidity as "all means at the disposal of the national monetary authorities to balance of payments disequilibria".[6] Usually, in this respect, a distinction is made between unconditional and conditional liquidity.

The unconditional international liquidity or monetary reserves, are those immediately available to central banks. They are the gold-stock of the monetary authority, convertible foreign exchange (mainly U.S. dollars), and the gold tranche in the IMF (25 per cent of the quota or participation of the country in IMF).

Conditional international liquidity is that which is available only under certain conditions in relation to the national economic policy of the country. Two of these conditional liquidity facilities are: the agreements between central banks to sustain a currency (in 1964, the agreement between eleven central banks and the Bank of England to back the Pound; in 1969 the Group of Ten assistance to France); and the credit tranches available to a member country of the IMF on condition that the country commits itself to measures designed to correct its balance of payments so that it will be able to repay its debt.

The importance of this definition is that international liquidity consists of facilities available to monetary authorities to cope with their balance of payments deficits. It means that international payments facilities available to private institutions are excluded, and that the euro-dollar market is left out of consideration.Euro-dollars are the dollar assets of private european residents. The importance of this limited definition of international liquidity will be clear in the following point.

The function and objective of international liquidity

is outlined in Article I of the IMF Charter. Through the balancing of balance of payments deficits, it promotes exchange stability, avoids exchange restrictions and depreciations and consequently aids the expansion and balanced growth of international trade.[7]

The problem of international liquidity. The definition and role of international liquidity shows us that such liquidity is necessary to correct balance of payments deficits. Because of this, the whole problem must be seen in the context of the theory of balance of payments disequilibria. This theory must be treated in relation to the existing monetary system, i.e. the gold exchange-standard with fixed exchange rates. If the balance on current account and on capital account of the balance of payments of a country is negative or positive, then this disequilibrium can only be corrected by a decrease or an increase in the international reserves of a country. Indeed, if there is a deficit in the balance of payments, there will be more imports of goods and services and more export of capital than imports. In such a case, the demand on the exchange market for foreign exchange will be in excess of supply of foreign exchange. As the national banks have an obligation under the Bretton Woods rule to stabilize the exchange rate in the per cent margin of par, they will have to offer foreign exchange and this means a decline in international reserves.

A balance of payments deficit cannot last for ever because the international reserves of a country are limited. A lasting surplus is also to be avoided because of the inflationary pressure it exercises. In the long run the economic authorities work on current account and the capital account of the balance of payments. There are three main possibilities for reaching a fundamental equilibrium.

1. The fundamental solution in the case of a deficit is to stimulate exports and/or to cause a sustained import of capital. In theory there is a fundamental difference between the function of capital imports and international liquidity. The latter is to solve payments difficulties in the short run, while the former is a structural solution. The developing countries do not need, in first instance, short run payments facilities but rather to import capital

goods. Their disequilibrium is not a temporary but a fundamental one, which must therefore be financed with long term capital. However international liquidity is not counted as long term capital, an outlook which is probably the base of the following pronoucement of the Group of Ten: "We have treated reserve creation as a problem distinct from the provision of capital for developing countries."[8]

2. Fundamental balance of payments disequilibria can be solved by deflationary policies. But since this is a brake on economic growth and international trade it is a policy that is usually avoided.

3. A third solution is devaluation. The positive effects of such measures (increasing export value, and a relatively smaller increase in import value) are only reached if:

- The Marshall-Lerner condition is fulfilled ($e_{f,x}+e_{h,m}$) 1; that is if price elasticites of foreign demand for exports and home demand for imports exceeds one.

- Production factors are not being employed at a maximum level because reserve capacity must be available in order to expand exports and import competing products. This condition is necessary if there is immobility of production factors. If production factors are mobile, a shift will be possible from domestic expenditure production to export and import competing production. In such a case, even under conditions of maximum employment, a devaluation might be successful.

- The government can control the domestic price level in comparison with foreign price levels in order to keep the price advantage created by devaluation. It is, however, the purpose of the Fund (Art.1) to avoid both deflation and devaluation as much as possible.

Thus, the problem of international liquidity lies in the fact that the level and the actual growth rate of international liquidity will not be sufficient to fulfill the fundamental purpose of the Fund, that is to promote a

balanced growth of international trade.[9]

If there is not sufficient international liquidity in a country, the monetary authorities of that country are unable to intervene in the exchange market and offer foreign exchange in order to cope with an excess demand in foreign exchange created by deficit. This system allows a country to have a fixed exchange rate. The alternative, if foreign exchange is lacking, is exchange restrictions, import quotas, or devaluation. But these means hamper the balanced growth of international trade.

The problem is, therefore, how to bridge a future shortage of monetary gold and U.S. dollars. We will deal with the evolution of these international liquidity assets in the next two points.

Increase of monetary gold. From 1950 till 1970 the increase of monetary gold was very small, that is 0.78 per cent (Table 2). From September 1967 till March 1969 with the pound sterling and the gold crisis, there was actually an important loss of monetary gold i.e. $1.5 billion. From September 1967 to January 1968, the gold pool countries lost $1.2 billions as a result of their intervention on the London gold market for the purpose of stabilizing the gold price at $35 per cent ounce. Therefore on March 25th 1968, because of continued monetary losses, the monetary authorities of the gold pool countries gathered in Washington and decided to stop intervention on the free gold market in London, although they would continue to sell gold among themselves at $35 per fine ounce. This was the inaugration of the two-tier system.

Deficit of the Balance of Payments of the United States As can be seen from Table 3, the increase of unconditional internal liquidity is, above all, due to the increase of the short term liabilities of the U.S. These liabilities became important from 1958 onwards due to the fact that from 1958 the U.S. balance of payments turned into a deficit.

A deficit in a key-currency means that the international liquidity of all countries increases because, on the exchange market as a whole, except the U.S. exchange market,

Table 2: Evolution of unconditional international liquidity (end of period in billion $: SDR's excluded) 1950-1970

	1951	1965	1970 2nd quarter	Increase (mln. $)	Annual increase (%)
Gold	33.9	41.9	39.1	5.2	0.8
Gold-tranche in I.M.F.	1.7	5.4	7.1	5.4	8.0
Foreign exchange	13.7	22.9	33.7	20.0	5.2
U.S. liabilities[A]	4.2	14.9	19.6		
U.K. liabilities[B]	8.2	6.7	6.9		
Difference	1.3	1.4	7.2		
Total[C]	49.3	70.2	79.9	30.6	2.1

Source: *I.M.F. Annual Report 1966*, p. 12 and *International Financial Statistics, o.c.*, Oct. 1970.
A. U.S. dollars in the reserves of non U.S. monetary authorities.
B. U.K. pound sterling in reserves of non U.K. monetary authorities.
C. U.S.S.R and China excluded.

Table 3. End of third quarter 1969: Unconditional international liquidity (in million dollars and per cent)

(Gold, foreign exchange and reserve position in the IMF)		
Rest of countries of the Group of Ten	36,117	45
U.S.A.	16,743	21
U.K.	2,434	3
Group of Ten (Total)	55,294	69
Rest of developed countries	9,631	13
Developed countries(Total)	64,925	82
Developing countries	14,640	18
Total	79,565	100

Source: *International Financial Statistics*, *o.c.*, Jan. 1970.

there is a surplus in relation to dollars. So in order to have fixed exchange rates, monetary authorities other than the U.S. treasury, intervene on the exchange markets by buying dollars and selling national currency (the system of increasing dollars in international reserves is more complicated if the euro-dollar system is taken into account).

Balancing the U.S. balance of payments means depriving the world of the most important source of increase of international liquidity. Therefore there is a dilemma. The U.S. balance of payments must be in deficit to provide the world with international liquidity but at the same time this deficit cannot last eternally. Why not? First of all a lasting U.S. deficit means a declining U.S. net reserve position[U.S. gold - U.S. liabilities (dollars in the reserves of foreign monetary authorities)]. This means that, in times of monetary crisis, if dollars are converted in the last resort into gold, the U.S. treasury would face bankruptcy as a result of an already negative net reserve position. A second reason why the U.S. cannot sustain an everlasting deficit is the misallocation of international economic resources. This means that U.S., through the very fact of a deficit, can allow itself to have more goods and services (e.g. the war in Vietnam) and invest more abroad than non key-currency countries. Indeed an non key-currency country is forced to correct its balance of payments deficits because its reserves are limited. The U.S. has a quasi unlimited possibility of running deficits because dollars

are absorped into the reserves of other countries and not subject to conversion into gold (at least not in normal periods).

The problem of international liquidity lies in the fact that there might be a future shortage of international liquidity because gold has not increase sufficiently and the supply of dollars will decline if the U.S. balance of payments deficit is balanced. However the total increase of gold and foreign exchange only increased by a total of 2.6 per cent from 1950 to 1965 and international trade by 6 per cent during the same period.[10]

It was this problem that led to the drawing up of an interim solution by the Group of Ten and the IMF. This interim solution is called Special Drawing Rights (SDR) which were created to cope with a possible future shortage of international liquidity. This nature of this new international payments facility which will partly determine the future international monetary system, and how these rights are allotted to the different countries, is the subject of the next section.

The future evolution of the international monetary system: Special Drawing Rights

The Fund decided to create a new international liquidity asset "to meet the need, as and when it arises for a supplement to existing reserve assets".[11] This initially vague general condition is elaborated in the following three conditions: Firstly, the conditions of Art. I of the Articles of Agreement must be fulfilled; secondly 85 per cent of the votes in the Fund and three-fifths of the members must agree on the creation of SDR's and finally, an international balance of payments equilibrium must be reached.

The first condition means that enough international liquidity must be available to prevent an economic recession and to avoid inflation. The second condition is that the Group of Ten which possesses 66.14 per cent of the voting rights is, in practice, the decisive factor in the creation

or cancellation of SDR's. Finally, there is the condition concerning the particular balance of payments situation of the two key-currency countries, which were still in deficit at the time of the agreement on the principle of SDR creation. Because the EEC countries feared that an additional creation of SDR's together with the deficits of the U.S. and U.K. would inflation, they claimed that the U.S. and U.K. should correct their balance of payments before the SDR's came into operation.[12] Since at the beginning of 1969, the U.S. balance of payments was in surplus, the Group of Ten decided to create $9.5 billion during the following three years.[13]

In the next paragraphs we will treat the nature, functioning and allocation of SDR's.

Definition of Special Drawing Rights. Special Drawing Rights are quasi-unconditional international liquidity, which have only to be repaid partially and whereby a country can procure for itself, via the Fund, or directly from a member country, the foreign exchange needed to correct a deficit on its balance of payments. Furthermore a country with a good balance of payments surplus, when requested,has the obligation to offer convertible exchange to a country with balance of payments difficulties.[14]

Characteristics of SDR's. SDR's are created rights,because they are allotted to country members without an equal counterpart. These rights constitute quasi unconditional international liquidity. Indeed, they may be used by any country experiencing a payments deficit, without the obligation to pursue restrictive economic policies. These rights may be drawn even if a country already exercised its right to draw on the "credit tranches" of the Fund. This is in contradiction with the gold tranche which must expire before drawing on the credit tranches is allowed. These SDR's are however quasi unconditional drawing rights because SDR's may not be used to change the structure of the reserves of a country. (e.g. Iran cannot receive dollars in exchange for SDR's if it has not a balance of payments deficit).SDR's may only be used in case of payments deficit, and even then a reasonable proportion of the other reserve assets (gold, dollars) in relation to SDR's should be used to equilibrate

the balance of payments.

SDR's must only be repaid partially. No country has to repay 70 per cent of the received SDR's. Thirty per cent is thus the minimum that every country has to reconstitute at the end of the basic period - that is after three years.[15] This characteristic is very important because the seventy per cent which is not subject to repayment can be used to correct a balance of payments deficit cost free. In particular it means that SDR's enable a country to tolerate a larger deficit on its current and capital account.

With SDR's, a country with a payments deficit can ask the Fund to give it foreign exchange in exchange for SDR's. In this way a country can respond to the increasing *demand* for foreign exchange on the exchange market caused by a payments deficits. What distinguishes SDR's from other drawing rights on the Fund, is that a country A can immediately ask country B to provide it with convertible currency in exchange for SDR's. Normally the Fund is the mediator, that is the Fund identifies a surplus country that has to provide the deficit country with the needed foreign currency in exchange for SDR's.[16]

For example, if Irān has a deficit in its balance of payments, it can ask, in 1970, the Fund or a surplus country for maximum $22 million (= 16.8 per cent of the Iranian quota in the Fund) in exchange for its complete SDR allocation for 1970.[17] How will this be booked in principle? The accounts showed below need no further explanation.

Irān (Central Bank)		Special Account of SDR			Country X (Central Bank)	
Assets	Liab.	A	IMF	L	A	L
- SDR (=22 million $)			-SDR Irān		+ SDR	
+ Foreign exch. (22 million $)			+SDR X		- F.E.	

If a country has a solid international reserve position

it has an obligation to accept SDR's from countries experiencing a deficit on their balance of payments amounting to three times its net cumulative SDR's. We can explain the last characteristic by using the following example: If Iran's international reserve position were important, and its balance of payments in surplus, then other countries may ask Iran for foreign convertible currency, immediately or via the IMF. Iran must then accept SDR's and offer convertible currency in 1970 for 22x3=$66 millions in 1971 (22+19)x3=$123 and in 1972 (22+19+19)x3=$180 millions.

[22, 19, and 19 are the Iran's allocations of SDR's, for 1970, 1971, 1972][18]

Having treated the definition and characteristics of the SDR's we shall examine in more detail how the allocation of SDR's is distributed among several countries, and on what criteria this distribution or sharing of SDR's is based. More specifically we shall focus on the sharing between developed countries and developing countries. However, before going into this topic let us be clear about the underlying assumptions. First, we assume that the total amount of SDR s created for the first basic period is adequate to cope with a future shortage of international liquidity (as a consequence of the loss of monetary gold, the adjustment tendency of the U.S. balance of payments, and a rapid expansion of world trade). Second we want to stress that the major objective of SDR's must always be a bridging of the shortage of international liquidity in the world.Finally we shall try to ommit the assumptions just mentioned above which will open a new field of investigation.

SDR's and the Third World

The problem of the Third World and the creation of SDR's can be reduced to two important questions. The first is: is the "objective" criterion on which SDR's are allotted, that is the quota in IMF, in fact objective and does it answer the need for the creation of international liquidity for the developing countries and the purposes of Article I of the IMF charter? The second is: is it realistic

and economically rational to link, in one way or another, the creation of SDR's to the need for capital and economic co-operation? When treating these two questions we shall put forward the official standpoint of the Group of Ten and the IMF before we formulate our own answer.

The criterion of allocation of SDR's and the need of international liquidity in the Third World. Art. XXIV 2b of the "Articles of Agreement of the IMF as modified by the Proposed Amendment" stipulates that SDR's will be allotted on the basis of a percentage of the quota of the member country. This percentage will be the same for all countries.[19]

On January 3rd. 1970 the Fund published this percentage that is 16.8 per cent.[20] For the Developing Countries taken as a group this means that of the $3.5 billions created in the first year, $963 millions will be their share. For the next two years this will be $826.2 millions of the $3 billions of SDR's created. This allotment leaves 27,98 per cent of the total created rights for 80 developing countries. The 24 developed countries therefore receive $2.674 million in the first year and $2.174 billions in both 1971 and 1972. From this share the United States and the United Kingdom take $1.259 million in the first year and $1.079 million in the next two years. This represents 36 per cent of total SDR's (see Table 1).

The first question we must ask is whether the developing countries share, which is 2 per cent of their total unconditional international liquidity, can be considered rational. To evaluate the rationality one has to look at the basis upon which SDR's are allotted to, and shared among, the different nations. The "objective" criterion, upon which 70 per cent of SDR's are allotted free, is the quota.[21] The word "objective" is never defined, one has to guess what it means. In a recent article Von Vangenheim has discussed the nature of the term "objective" in the creation of criteria for the allocation of SDR's.[22] The conclusion of his study was that, firstly, national income had an exaggerated impact on the determination of the quota of a country by the IMF. Secondly, that international trade was only taken into account to determine the quota instead of the whole amount

of the balance of payments of a country. That is, instead of the amount of international liquidity needed to balance disequilibria in the balance of payments, what has to be the determining factor in the setting of the quota is international trade and capital movements (i.e. current account and capital account). However, it is the whole balance of payments that must be considered in the determination of the share in the creation of international liquidity.The objective nature of the creation can thus be questioned because of the weight of national income in the determination of the quota. We can explain this exaggerated weight by the fact that quota's are based on the 1954 formula devised by the U.S. Treasury. The aim of this formula was that the U.S. should not loose control over the IMF, which would be the case if balance of payments indicators instead of national income were taken into account. It is because of the exagerated weight of G.N.P. in the creation of SDR's that a revision, as provided in Art. III, section 2, of the "Proposed Amendment" would be most useful.[24]

Only if the share in trade of developing countries,*ex-post*, were taken into account in determining the allocation of SDR's to these countries, could one say that this allocation is fair. Their share in World Trade accounted for 21 per cent in 1967, while their aggregate quota was 27.98 per cent and it is on the basis of this percentage that SDR's are allocated. We could conclude by saying that developing countries only receive a fair share in SDR's if trade *ex-post* is a valid criterion.

To prove this point we have to ask why trade *ex-post* is not a valid criterion. Second, the future and some prospects of trade and capital flows will give us an idea of the needs of international liquidity *ex-ante* of the developing countries.

Trade ex-post. The trade ex-post of the developing nations is an important understatement of what trade could have been without the restraints of international liquidity and exogenous factors. The restraint of international liquidity has the following effects. If international liquidity is inadequate a country will have to resort to import restrictions, devaluations or to one or another impingment

on the system of fixed exchange rates (multiple exchange rates, exchange restrictions). A lower level of trade is the result and thus the statistics of export trade figures are underestimated. Some data on the use of these restrictive trade measures will show overwhelmingly the relatively greater need for international liquidity in developing countries.

1. Import restrictions.[25] Because developing countries rely much more on their reserves (they find it difficult to gain access to western capital markets and do not participate in the elaborated monetary co-operation; Swap agreements, Roosa bonds, G.A.B. etc.) the ratio of reserves for imports is more significant for Third World countries. Central banks usually take measures when that ratio falls below 40 per cent. This ratio for Developing Countries as a whole fell from 64 per cent in 1951 to 31 per cent in 1968 but even this figure is influenced by the petroleum exporting countries which have high reserves. That means that all developing countries (except the petroleum exporting countries) have to apply import restrictions. These restrictions are much more important and frequent than in developing countries. If these restrictions are inadequate a country has to resort to other measures; the exchange rate system or devaluation.

2. Exchange rate practices.[26] All developed countries had by 1965 an effective par value exchange rate, they progressed from 12 countries in 1948 to all developed countries in 1968. Developing countries have only progressed slowly from 30 to 40 countries and still 35 developing country members of the IMF were not yet able to introduce a par value. From the 40 developing countries that have a par value, some are not effective and a lot of exchange restrictions do exist e.g. import surcharges and advance deposit requirements are in effect multiple exchange rates.

3. Devaluations in developing countries.[27] An article of Margaret De Vries (27) informs us that in general, developing countries, devalue more and by a larger percentage (see table 4) when import restrictions and exchange restrictions are inadequate.

These three indices, together with the deterioration

Table 4: Balance of payments of the developing countries (billion $)

	(current prices)	1975 (projections at 1960 prices)	
		low(38)	high(38)
A. CURRENT ACCOUNT			
1. Import surplus	-0.8	- 3.4	-10.0
2. Factor income payments	-4.9	-12.0	-14.2
3. Technical Assistance	-1.0	- 1.5	- 1.5
4. Trade gap (1+2+3)	-6.7	-16.9	-25.7
5. Change in reserves	-0.8	...	...
6. Discrepancies	-0.5	...	...
7. Net gap (4+5+6)	-8.0	-16.9	-25.7
B. CAPITAL ACCOUNT			
8. O.E.C.D. official aid (net)	+5.8	8.5	12.9
9. Other official aid	+0.8		
10. Total official aid (9+10)	+6.8	8.5	12.9
11. O.E.C.D. private capital	+1.8	4.0	5.0
12. Suppliers' credit	+1.0	0.4	0.4
13. Total capital inflow (10+11+12)	+9.5	12.9	18.3
14. Capital outflow	-1.5	...	...
15. Unfilled gap	...	4.0	7.4
16. Balance on capital account (14+15+16)	+8.0	16.9	25.7

Source: UNCTAD-secretariat, *Trade Prospects and Capital Needs of Developing Countries*, o.c., p.66.

of the terms of trade of developing countries, show that the demand for international liquidity has been relatively more important in the Third World than in the industrial countries. This proves that the trade of the Third World is underestimated and that trade ex-post is therefore not a valid criterion for the basis of liquidity creation. The share in the creation of SDR's let us turn to trade *ex-ante* and the other items *ex-ante* on the balance of payments of the developing countries.

Balance of Payments ex-ante. It is not only the gap on merchandise balance that is an important cause of the shortage of international liquidity in the Third World. On service account it is, above all, the item "factor income payments"[28] that caused and will cause the most important gap. (Table 4). This gap will, in the future, only be partially

bridged by a net capital inflow. Projections made by the UNCTAD secretariat[29] point out that the deficit on balance of payments of the developing countries in 1975 will range between $4 and 7.4 billions. (Table 4).

The lower deficit corresponds to a further widening gap in GNP per capita between developing and developed countries and the higher deficit corresponds to a declining gap.[30] These projected deficits correspond to a capital inflow of 1 per cent of the GNP of developed countries.So the deficits must be bridged by additional money inflow in developing countries. If not, trade will be restricted in these countries and even lower growth targets will be reached and the widening income gap will increase more and more. There are several theoretical solutions which can be combined to solve this problem.

1. The first is to focus on eliminating the most important gap on the current account: that is the investment income payments. It is especially the income out of private foreign investment which causes the gap, and this is more important than the inflow of private foreign capital over several years (Table 4). Therefore, once a country has reached a certain level of industrialization, it pays to divest. However, we cannot, within the framework of this article, enter into this very important and controversial issue.

2. An additional official capital inflow into the developing world would be another alternative to cope with the payments gap or balance of payments and consequently to avoid a shrinking growth rate through import restriction. However this solution appears to be impossible for several reasons. The official capital inflow to the developing world only reached 0.39 per cent of the GNP of developing countries in 1968 and this percentage is less than the years before (as is the absolute amount in millions of dollars). Moreover, it seems that there is no tendency for this situation to improve. The estimate of D.A.C. is that this flow is stagnating in 1969-1970. A second index is the fact that persisting inflation in the capital donating countries has a negative impact on capital procurement in the developing countries.

3. A third partial solution is a real monetary reform which would take the form of a redistribution of SDR's amongst the countries on the basis of objective needs.

If the first international policy (mentioned above under 1) is not followed, and this implies a radical change in the concepts of western economic thought, only the second and the third alternatives are left. The second alternative is however theoretical, because additional capital inflow will not to rise above 1 per cent and this cannot solve the cause of external deficit in the developing countries. However under this realistic assumption the structural balance of payments deficit in the developing countries will remain which means that the Third World must impose import-and exchange restrictions in future. This is in contradiction to the purposes of the Art. I (IV) of the IMF charter:"... the elimination of foreign exchange restrictions which hamper the growth of world trade." The IMF can now avoid this restriction by "making the Fund's resources *temporarily* available" (Art. I (IV) (of the "Proposed Amendment"). Consequently there is a dilemma. A structural long-term deficit on the balance of payments is to be financed by a long term capital inflow. However the planned long term capital is not sufficient, thus trade will decline in developing countries because of exchange restrictions. The IMF purpose is now to avoid exchange restrictions so it makes resources available but only temporarily... and not for long term purposes. As a result there is apparently no solution to the structural deficit on balance of payments unless we can say that the resources made available by IMF, in this case SDR's, are in effect long term capital procurements that can solve structural deficits.

We shall answer this question in the next point by investigating whether or not there is any link between the creation of SDR's and capital procurement in the Third World. Before we enter into this we will draw the following conclusion on the criterion of the sharing of SDR's.

1. The "objective" criterion as the basis for the creation and allocation of SDR's, that is the quota, can be questioned. The quota is over determined by a countries national income. This criterion can only with some difficulty

be called "objective" because the need for international liquidity which eliminates the disequilibrium has to be founded on the level of the current and the capital account *ex-ante*. Therefore the "objective" criterion has to be revised.

2. If the export and import of goods of the developing countries in the past (thus export) were the criterion, then the creation of SDR's in favour of the developing countries would be sufficient. If one take into account the future needs, if import and exchange restrictions are to be avoided, and if a reasonable growth target is to be realized, then a structural deficit is unavoidable. Can the financing of this disequilibrium be solved partially by SDR's or is this a distinct problem not to be confused with long term capital procurement for the Third World? We will now enter into a further analysis of whether or not there is a link between these two problems.

The link between the creation of SDR's and capital procurement for the Third World

The makers of the Special Drawing Rights declared in 1969 that the creation of international liquidity has to be separated from the question of capital procurement for the Third World.[31]

The reason of this statement is probably that international liquidity is only to be used for financing temporary deficits (as provided in the IMF articles), and therefore that SDR's are not long term capital procurements. However, SDR's are allocated 70 per cent free to all countries which are members of the Fund. A country can therefore have a larger deficit on its balance of payments and either import more goods and services or export more capital. This is financed by SDR's. These SDR's are consequently a capital donation that permits a country to use SDR's instead of dollars or gold. The accumulation of dollars and gold in the reserves represents a real cost for the country.

What, therefore, is the objective reason for giving

the U.S.A. the largest donation on the basis of her national income? The answer, perhaps, is that the U.S. will now be able to finance her balance of payments deficit without the danger of gold losses. Further, what is the objective reason of all industrial countries in awarding themselves the great majority of all these savings? These savings are due to the fact that countries have to realize a real effort, e.g. by exporting more than importing. But SDR's are allotted for 70 per cent without any real counterpart.

SDR's can be considered partly (70 per cent of the allocation) as capital procurement. Therefore they can partially finance a fundamental disequilibrium. The need of such a capital procurement is now most important in the Third World because here balance of payments difficulties are greater. These balance of payments difficulties are inherent in the stage of development.

Because of the characteristics of SDR's, and because the need for such drawing rights is relatively more important in the Third World, the basis of their creation should be founded on the following criteria: Firstly, the share of a country in the creation of SDR's should be proportional to the level of the current and capital account. Secondly they should be inversely proportional to the degree of development (=measured in GNP per capita). The latter criterion also defines disequilibrium on the balance of payments. The general presentation of this formula could be as follows:

$$T = f(B,P) \text{ where: } \frac{\delta T>0}{\delta B}; \frac{\delta T<0}{\delta P}$$

T = SDR's of a country

B = level of the balance of payments

P = GNP per capita

The consequence of this formula would be that the Third World countries, which have the most important pressure on their balance of payments because of investment income payments, import of capital goods etc., would have their share in SDR's multiplied by a number greater than one. Similarly, the allocation of SDR's to developed countries with a higher

per capita GNP would be multiplied by a number lower than one.

Such a formula would give international monetary policy a supplementary task of redistributing wealth. This is not contradictory to the purpose of the Fund. As already mentioned, it would help to avoid exchange restrictions and thus correspond to Art. I (ii)(see footnote 9). Of course such a formula and selection would be a real cost to the surplus countries, which would have to accept SDR's from the Third World. One has to remember, however, that through the creation of SDR's, industrial countries save resources. Indeed, instead of accumulating gold and dollars, paid for by an excess of goods and services exported over imports, they received now, free, a real international reserve asset without any counterpart.

The argument that international monetary policy should not be used as an instrument of real welfare, that is an international redistribution, is based on the principle that money has to be neutral. In practice every monetary policy decision, national or international, has direct or indirect influence on the redistribution of income, for example on the national level. Think only of the kind of policies used to avoid recession or excessive inflation. If money were neutral in the international field, a lot of foreign investments and expenditures, especially those of the U.S.A., would not have been possible.

However even if it were rational to revise the allocation criterion for the sharing of SDR's over developed and developing countries, it would not solve completely the gap on balance of payments of developing countries under the assumptions of a declining income gap. This is so because we have assumed that an adequate amount of SDR's were created. This assumption of course is a fundamental one. There is no agreement upon the adequacy of the level of international reserves. The amount voted for by the group of Ten and in the IMF is a political decision taken by U.K. U.S.A. on the one hand and the E.E.C. countries which had to accept the deficit of the key-currency countries on the other. However even scientifically it seems tremendously difficult to assess what the adequate level of reserve

creation would be. Therefore we have assumed that the SDR's created in these three years were adequate. If we drop this assumption and adapt the creation of SDR's to the full need of developed and developing countries what would be the theoretical consequences?

The amount of SDR's created each year would be much greater than that chosen on the basis of existing criteria. Let us explain why in the following lines. As we have seen above, an additional capital flow from the industrial to the Third World will not occur (see Balance of Payments of Developing Countries, Table 4, the gap on capital account in 1975) in future, so persisting import and exchange restrictions will be the result. To avoid this, additional international liquidity has to be created. This would make for a better international distribution of economic resources. Indeed, through the very fact that developing countries would share more in SDR's they would import more from the industrial countries and so real resources would be transferred. Why could SDR's be created as a function of both existing and future projected balance of payments needs, which would imply a higher SDR creation than that existing; about the double by 1975? Well, because the distinction between long term capital and financing facilities such as SDR's is unrealistic. Therefore the need for long term capital and financing facilities is in fact interrelated, and clearly the need for these SDR's is greater in the developing than in the developed countries so that the amount created for the first period is insufficient. There is however a classical argument that determines the amount SDR's created. Namely, if SDR's created for the first period were higher, then the inflation in Western countries would even be more marked. On the other hand if sufficient capital were to be put at the disposal of the Third World to bridge the income gap, the inflationnary pressure upon the industrial countries would be about the same as if additional SDR's for the same amount were put at the disposal of developing countries. So the argument of the Group of Ten on treating international reserve creation separately from capital procurement for the developing countries, loses its content if the economically developed countries really want to make an effort to bridge the income gap between developed and developing countries.

Conclusion

The following question, at the time of the creation of SDR's for a first period of three years, can be raised: Is the allocation criterion of SDR's in favour of the different countries objective and is the link between development co-operation and international monetary policy liable?We tackled these problems under different assumptions.

1. We assumed first that the total amount of SDR's created in the first period was adequate and concluded that this creation cannot be a complete solution to the foreign capital procurement problem for the Third World. Also we conclude that under this assumption, this problem should not be of primary concern for the creation of SDR's.

The criterion of allocation of SDR's to a country is based on the quota of this country in the IMF. Therefore it is the quota that has to be "objective". The weight of the national income in the definition of the quota is too important. This can only with difficulty be called "objective", because it is the foreign trade, services and capital movements, as well as the avoidance of exchange restrictions and devaluations in future, that must be of primary concern in defining the need of reserve creation. This means that the Third World will have to resort to more restrictive trade and exchange measure because of a structural deficiency in the balance of payments. Therefore the need of international liquidity in these countries is more important than their allocation of SDR's which is only based on their trade *ex-post*.

The fundamental payments problem of the Third World could thus partly be solved by international monetary reform that is the SDR - as one of the instruments of international economic policy. A real transfer of welfare from industrial to developing countries is justified by the fact that about three quarters of the SDR's are allocated to the industrial countries, which means a real saving for these countries, because they would otherwise have to give more goods and services than they receive in order to accumulate gold and foreign exchange in their reserves. It seems to us that this

distribution of welfare (three-quarters of the SDR's for industrial countries) generated by the cost-saving factor that is SDR's, is economically irrational because it widens the income gap in the world economy. Therefore a revision of the allocation of SDR's in favour of the developing countries, which means in fact a transfer of economic goods, is rational.

Such a revision does not endanger the essential goal of the SDR, that is implementation of international liquidity for the industrial countries. Indeed, the amount of international liquidity (SDR) that the developing countries would receive in addition of their already allotted SDR's would, in the last resort, be brought into circulation in the industrial countries because the balance of payments deficit of the developing countries is due to the transactions with the industrial countries.

The creation of SDR's under the existing creation concepts can thus not only fulfill its essential role, but also another very important goal, that is a partial redistribution of economic wealth.

2. We can also assume that the total creation of international liquidity is inadequate and has mainly be based on the needs, *ex-post*, of the industrial nations. This raises two considerations:

a. The total amount is insufficient because the very characteristic of SDR's, is a capital saving function. The capital saving factor is now scarcest in developing countries. Therefore SDR's must be seen in the context of the total needs of the World Economy. If this is done, SDR's imply a real transfer from developed to developing countries. The consequence of this is that the artificial separation in international economic theory between capital procurement and short run financing on balance of payments between autonomous and compensatory flows, between the IBRD and IMF, is raised.

b. A large amount of SDR's adapted to the full needs of the world economy is rejected by the industrial countries because it would create inflation in their economies.

This argument would be true only if the industrial countries wish to have the same growth rate in their GNP and thus if they do not really want to contribute to the bridging of the widening income gap in the world economy. So,SDR's are a manifestation of how international economics is not really international, where the rationality of a balanced international growth is subordinate to the self-sustaining power structure in the international economy.

Notes

1. The Group of Ten consist of the following countries: Belgium, Canada, France, Italy, Japan, Netherlands, U.K., U.S., Western-Germany and Sweden.
2. P. Fabra, *Le Monde*, Paris, Julay 26th 1969, P.1 and 18.
3. Formosa decided not to participate in the S.D.R. creation, so that out of $3,5 billion $86 million have not been created.
4. *Keesings Historisch Archief*, January 16th 1970, p. 19.
5. The UNCTAD secretariat made projections for 1975 under minimum and maximum assumptions. Under minimum assumptions the annual increase of G.N.P. per capita for Developing Countries will be 28 per cent and in the industrial countries 3.1 per cent, thus still a widening gap: the capital gap of the Developing Countries projected under these assumptions is $4 billions.Under the maximum assumptions the annual increase of G.N.P. per capita for developing countries will be 3.7 per cent and for the industrial countries 3.6 per cent, thus a declining gap: under these assumptions the capital gap is $7 billions (see Table 4).
   UNCTAD secretariat, *Trade Prospects and Capital Needs of Developing Countries*, New York, 1968, U.N. p. 3-45.

6.a. *International Liquidity, IMF. Annual Report of the Executive Directors for the Fiscal Year ended April 30, 1964*, Washington D.C. 1964, p. 25-26.

b. *Les liquidites internationales*, Banque des Reglements Internationaux, Trente-sixieme Rapport Annuel, Basel, 13 June 1966, p.156-157.

c. *Ministrial Statement of the Group of Ten and Annex prepared by Deputies*, 1964, p.6.

7. *Articles of Agreement of the International Monetary Fund as modified by the Proposed Amendment*, Washington D.C. 1968, p. 1 en 2 (iii.).
8. Group of Ten, *Communique of Ministers and Governors and Report of Deputies*, July 1966, p.3.
9. Proposed Amendment, *o.c.*, p.1.
10. *IMF Annual Report 1966*, Washington D.C., 1966, p.12.
11. *IMF Annual Report 1968*, Washington D.C., 1968, p. 134 and p. 137.
12. This objective was reached by raising the minimum vote required in the IMF. for decisions such as the creation SDR's from 80 per cent to 85 per cent.Consequently the E.E.C. countries with 16,7 per cent of the voting rights have a veto right.
13. P. Fabra, *Le Monde*, July 26 1969, p.1 and 18.
14. Definition based on:
a. I.M.F. *Annual Report*, 1968, *o.c.*, p. 14 and 15.
b. R. Ossola, "Deliberate Reserve Creation: an Interim Solution", *Banca Nazionale del Lavoro*, Rome,Sept.1966, p. 253-254.
c. P. Fabra, Le monde de l'economie, *Le Monde*,Paris,Sept. 23 1969, p. I and IV.
15. *Proposed Amendment*, *o.c.*, Art. XXV section 6.
16. Proposed Amendment, *o.c.*, Art. XXV, section 2,3,4,5.
17. *International Financial Statistics*, IMF Washington D.C., Oct. 1970.
18. This data has been deduced from the definition of S.D.R. and data of Table 1 and International Financial Statistics.
19. Proposed Amendment, *o.c.*, p.43.
20. *Keesings Historisch Archief*, *o.c.*, p.19.
21. Group of Ten, *Communique of Ministers and Governors Report of Deputies*, July p. 2, "On the basis of IMF quota's or simular objective criteria".
22. E. Von Wangenheim, *Developing Countries and Monetary Reform*, Weltwirtschaftliches Archiv, Heft 1, 1969, p.95-105.
23. The formula adopted to define the quota of a country in IMF is the beginning of the fund and which still is relevant, is the following.
90% of {2% of the G.N.P. + 5% of the gold and dollar balances July 1963 = (=R) + 10% of maximum variations of exports during the years 1934-1938 ($=\P_x^2$) + 10% of

average imports (=$\bar{M}$) }, this must be increased for the country in the same ratio as average exports 1934-1938 bore to national income (=X/GNP).In short q=f {G.N.P., R, σ_x^2, $\bar{M}$, $\frac{\bar{X}}{GNP}$}.

Source:*The International Monetary Fund 1945-1965:*Twenty years of International Monetary Co-operation, Vol. II: Analysis, IMF, Washington D.C., 1969, p. 311.

24. Proposed Amendment, *o.c.*, p.3.
25. "International Liquidity and Reserve Creation", *IMF. Annual Report of the Executive Directors ended for the fiscal year April 30, 1966*, p. 15 and *International Financial Statistics*, Jan. 1970.
26. *The International Monetary Fund, 1945-1965, Twenty years of International Monetary cooperation*,Volume II: Analysis, Washington D.C., p. 116-21.
27. M. De Vries, "The Magnitudes of Exchange Devaluation", *Finance and Development*, No.2, 1968, p.10.
28. "Factor income payments gap" are the earnins of all investments and loans paid to foreign nations.
29. UNCTAD secretariat, *Trade Prospects and Capital Needs of Developing Countries*, New York, 1968, p. 3, 48 and 67.
30. See footnote (5) and table 4.
31. Group of Ten, *Communique of the Ministers and Governors and Report of Deputies*, July 1966, n°3.