



FUND FINANCIAL OPERATIONS AND POLICIES

New commitments of Fund resources under stand-by, extended, and SAF/ESAF arrangements rose to a record level of SDR 19.7 billion in 1995/96, mainly reflecting augmentation of access under Mexico's stand-by arrangement and approval of an extended arrangement for Russia. Members' purchases from the General Resources Account (GRA) plus SAF and ESAF loans amounted to SDR 12.3 billion, also a record. And total Fund credit outstanding, including under the SAF and ESAF, increased by SDR 5.2 billion to SDR 42.0 billion as of the end of 1995/96, surpassing the previous record set more than a decade earlier. The Fund's liquidity position in 1995/96 was affected by the high level of demand for Fund resources, and the liquidity ratio registered a significant decrease. The Board continued to work on issues related to Fund quotas under the Eleventh General Review of Quotas, in particular on the size and distribution of an overall increase in quotas. In May 1996, the Group of Ten countries and a number of other countries with the financial capacity to support the international monetary system reached agreement on the main features of new borrowing arrangements to provide supplementary resources to the Fund. The Fund's net income for 1995/96 of SDR 89 million was added to its reserves, which rose to SDR 1.88 billion as of the end of the financial year. The level of overdue financial obligations to the Fund declined sharply to SDR 2.2 billion during 1995/96, and the number of countries in arrears by six months or more decreased from eight to six. The valuation basket of the SDR was revised effective January 1, 1996. At SDR 27.4 billion, the volume of SDR transfers in 1995/96 reached a record.

Membership

During 1995/96 the membership of the Fund increased from 179 to 181. Brunei Darussalam became a member on October 10, 1995, with a quota of SDR 150 million, and on December 20, 1995 the Board determined that Bosnia and Herzegovina had

fulfilled the necessary conditions to succeed to the membership of the former Socialist Federal Republic of Yugoslavia. Bosnia and Herzegovina's quota in the Fund is SDR 121.2 million. The Federal Republic of Yugoslavia (Serbia/Montenegro) has not yet completed arrangements for succession to membership in the Fund.

Quotas

During 1995/96 the Board continued work on Fund quotas as part of the Eleventh General Review of Quotas. In July 1995 issues relating to the share in Fund quotas of the developing countries were discussed. The main conclusions of the Board's deliberations were (1) that the quota formulas were working broadly as intended; (2) that there was a small group of countries that had experienced above-average rates of long-term growth that had not been fully captured in the quota calculations because of the conversion of GDP from national currency units into SDR equivalents at market exchange rates; and (3) that these countries could be considered on a case-by-case basis. In August 1995 the Committee of the Whole for the Eleventh General Review of Quotas was established. The Committee considered preliminary quota calculations based on the same formulas used in the Eighth and Ninth General Reviews and on data covering the period through 1993. The Committee confirmed that the quota formulas were working broadly as intended. In light of the large amount of estimation the staff was required to undertake to prepare the database for the calculations, the Committee encouraged members to submit complete and accurate data on a timely basis.

The Committee of the Whole met again in December 1995 to consider techniques for distributing quota increases. Most members of the Committee expressed the view that the choice of method used to distribute the selective element (that is, that part of the quota increase not distributed equiproportionally) should depend on (1) the size of the quota increase and

(2) the size of the equiproportional element. Some Committee members were of the view that the illustrative methods under consideration did not go far enough in raising the quota shares of countries with actual quotas that were significantly out of line with their quotas calculated according to the usual formulas. In January 1996 the Committee considered the traditional quantitative factors bearing on the size of an increase in quotas—namely, changes in the scale of the world economy since the last increase in quotas and projections of possible demand for Fund resources in the coming period. Committee members also discussed the adequacy of Fund quotas in the context of the globalized economy.

In February 1996 the Committee of the Whole met to consider quota calculations based on revised data (through 1993) and issues related to the number of basic votes allocated to each country. The Committee noted that the revised data primarily reflected members' official data, and the amount of staff estimation had been reduced to almost negligible proportions. In view of the sharp decline in the relative importance of basic votes in the Fund's voting structure, many members of the Committee felt it would be appropriate to revise the number of basic votes for each country. A number of other members considered that the issue of basic votes was not a high priority, and that the position of developing countries should be protected more by appropriate increases in their quota shares. They noted that the Fund had already taken other measures to ensure appropriate quota shares for the smallest members. Because an amendment of the Articles of Agreement would be required, Committee members were of the view that this issue should not slow down consideration of other aspects of the quota review and that it could be revisited in the event that other amendments to the Articles would be considered.

In March 1996 the Committee again reviewed issues concerning the size and distribution of an overall increase in quotas. In this connection, many Committee members felt that the projected sharp drop in the Fund's liquidity ratio through 1997 and early 1998 highlighted the need for a substantial increase in Fund quotas and the necessity of reviewing the Fund's borrowing arrangements. While acknowledging the need to review borrowing arrangements, other members considered that the Fund's financial position remained strong. The Committee agreed that its work program would continue to focus on the size of the quota increase and its distribution among the membership. The Committee also agreed to consider (1) a number of technical issues relating to ad hoc quota adjustments for those members whose current quotas were significantly out of line with their relative positions in the world economy; and (2) alternative approaches to addressing the issue of those few members that have

had relatively fast long-term growth rates but declining shares in calculated quotas.

Fund's Liquidity, Access Policy, and Borrowing

The Fund's liquidity position in 1995/96 was affected by the record high level of demand for Fund resources for the second year in a row, and the liquidity ratio declined further from the historically high level reached at the end of 1993/94. Large purchases were made during the year by Russia and Mexico, under their respective stand-by arrangements, and a substantial additional commitment of resources was made to Russia later in the year under an extended Fund facility (EFF) arrangement.

The liquid resources of the Fund consist of usable currencies and SDRs held in the GRA. Usable currencies, the largest component of liquid resources, are the currencies of members whose balance of payments and reserve positions are considered sufficiently strong to warrant the inclusion of their currencies in the operational budget for use in the financing of Fund operations and transactions (see Box 10). The Fund's liquid resources declined to SDR 56.4 billion at the end of April 1996 from SDR 61.6 billion a year earlier, primarily reflecting the high level of purchases under arrangements.

In assessing the adequacy of the Fund's liquidity, the stock of usable currencies and SDRs held in the GRA is reduced by the amount of resources committed under arrangements and expected to be drawn, and is reduced further to take account of the staff's assessment of the need to maintain working balances of currencies and the possibility that the currencies of some members in relatively weak external positions could become unusable in financing Fund operations and transactions. After these adjustments were made, the Fund's uncommitted and adjusted usable resources totaled SDR 33.5 billion as of April 30, 1996, compared with SDR 42.5 billion a year earlier.

The Fund's liquid liabilities as of the end of April 1996 amounted to SDR 37.3 billion, consisting entirely of reserve tranche positions, as the Fund had no outstanding borrowing for the first time since 1973/74. By comparison, liquid liabilities at the end of April 1995 had amounted to SDR 33.7 billion, consisting of SDR 31.7 billion in reserve tranche positions and SDR 2.0 billion in outstanding borrowing. The ratio of the Fund's uncommitted and adjusted usable resources to its liquid liabilities—the liquidity ratio—decreased from 126.1 percent at the end of April 1995 to 89.8 percent at the end of April 1996. (The evolution of the liquidity ratio since calendar year 1982 is shown in Chart 7.) Projections based on current access policies and limits indicate that the demand for Fund resources will remain relatively high over the next few

Box 10

OPERATIONAL BUDGET

In accordance with principles laid out in the Fund's Articles of Agreement, the Board adopts for each upcoming quarterly period an operational budget specifying the amounts of SDRs and selected members' currencies to be used in purchases, repurchases, and other Fund financial operations and transactions expected to take place during that period.

Assessment of Members' External Positions

An important element of each quarterly operational budget is the selection of those members with sufficiently strong external positions to warrant the inclusion of their currencies for use in outward transfers under the operational budget. The currencies of these members are then made available for purchase by members experiencing balance of payments difficulties. In proposing a member country for inclusion in the operational budget and designation plan (see Box 12), the Fund takes into account recent and prospective movements in the member's gross reserves, developments in its balance of payments, the relationship of the member's gross reserves to its imports and Fund quota, and developments in exchange markets; recent movements in the member's net reserves are also taken into account, to the extent that

the necessary data are available. The balance of payments and gross reserve positions of a country are considered jointly, and strength in one element may compensate for moderate weakness in the other. In practice, the assessment of a member's combined balance of payments and reserve position involves a significant element of judgment.

Convertibility

The members whose currencies have been proposed for use in transfers by the Fund are obliged to convert them into one of the five freely usable currencies at the request of purchasing members. In exchange for the use of their currencies in transfers, "strong members" receive a claim on the Fund in the form of an increase in their reserve tranche position that can be drawn without challenge in the case of balance of payments need.

Guidelines on the Use of Currencies

The Board has established a set of guidelines governing the allocation of the amounts of currencies to be used in both transfers and receipts under the Fund's operational budget. The present guidelines call for the use of currencies on the *transfers side* of the budget (that is, the currencies that finance extensions of Fund credit) to

be determined in proportion to members' holdings of gold and foreign exchange reserves. A limit is, however, placed on the use of a member's currency in transfers, so that the Fund's holdings of that currency do not fall below two thirds of the Fund's average holdings, expressed in percent of quota, of members' currencies included in the budget. The guidelines specify that transfers of U.S. dollars be made on the basis of ad hoc proposals, with the aim of maintaining, to the extent possible, and in relation to quotas, the Fund's holdings of U.S. dollars close to the average level of the Fund's holdings of other members' currencies included in the budget. On the *receipts side* (that is, the currencies used primarily to service past extensions of Fund credit), the guidelines call for the allocation of currencies to be determined in relation to members' reserve tranche positions in the Fund. The Board reviews the guidelines governing the allocation of currencies under the operational budget periodically to ensure that the objective of promoting "balanced positions" in the Fund over time is achieved. On the occasion of the last review, in February 1995, it was decided to continue to apply the present guidelines until the end of December 1996.

years, so that the decline in the liquidity ratio is likely to continue, albeit at a slower pace than during the last two years. In light of the prospective evolution of the Fund's liquidity position, in April 1996 the Interim Committee requested the Board to pursue work on quota issues with a view to reaching a conclusion as soon as possible.

The Fund currently has no outstanding borrowing, having repaid all its remaining debt to lenders by end-March 1996. However, the Fund can borrow under the General Arrangements to Borrow (GAB) (up to SDR 17.0 billion) and under an agreement with the Saudi Arabian Monetary Agency in association with the GAB (SDR 1.5 billion) when supplementary resources are needed to forestall or to cope with an impairment of the international monetary system. The doubling of resources currently available to the Fund under the GAB, under consideration by the Group of Ten coun-

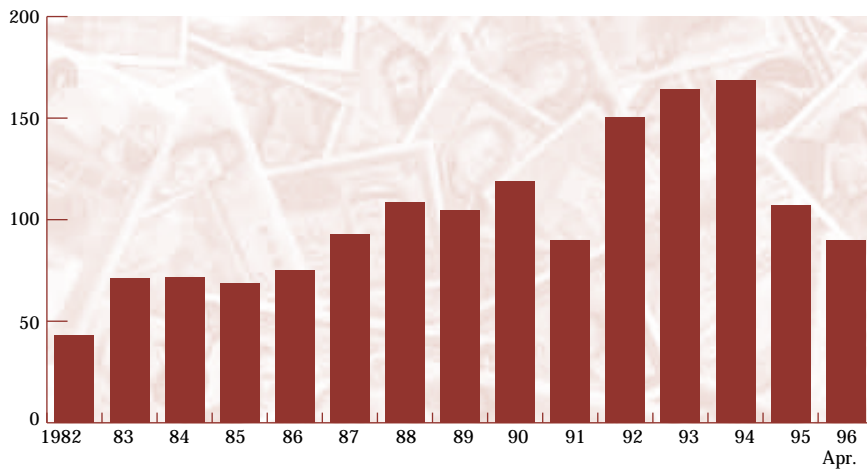
tries and other countries with the capacity to support the international financial system, would provide a means of strengthening the Fund complementary to an increase in quotas.

At their meeting in Paris on May 23, 1996, the representatives of the Group of Ten countries and a number of other countries with the financial capacity to support the international monetary system reached agreement both on the broad principles and on the key substantive points for new arrangements to increase the resources available to the Fund to deal with international financial emergencies. The new arrangements, which will double the resources now available under the GAB, will be the first and principal resources in the event of a need to provide supplementary resources to the Fund. The GAB will continue to exist, but the combined amount drawn under the two arrangements will at no time exceed SDR 34 billion. It was agreed

Chart 7

FUND'S LIQUIDITY RATIO, 1982-96

(In percent; end of December)



that individual country commitments would be based on relative economic strength as measured by actual Fund quotas as a predominant criterion. Countries will participate on an equal footing, with rights and responsibilities commensurate with their commitments. The aim is to finalize details and reach final agreement by the time of the 1996 Annual Meetings.

When policies on access to Fund resources and access limits were reviewed in 1994, the Board decided to raise, for a period of three years, the annual limit on access to the Fund's general resources under the credit tranches and extended arrangements from 68 percent to 100 percent of quota, subject to regular annual reviews. The Board again reviewed access policies and limits in October 1995 and decided to maintain the annual access limit under the credit tranches and extended arrangements at 100 percent of quota and the cumulative access limit at 300 percent of quota. The annual reviews take account of all relevant factors, including the magnitude of members' payments problems and developments in the Fund's liquidity. The access limits may be exceeded in exceptional circumstances, as the Board may decide.

Members' Use of Fund Resources and Credit Outstanding

In 1995/96 members' purchases from the GRA, excluding reserve tranche purchases,¹³ amounted to SDR 10.8 billion, slightly more than the 1994/95

¹³Reserve tranche purchases were made by three members in 1995/96 and amounted to less than SDR 50 million, about the same level as in 1994/95. Reserve tranche purchases represent members' use of their own Fund-related assets and not use of Fund credit.

level of SDR 10.6 billion. Purchases plus SAF and ESAF loans amounted to SDR 12.3 billion, the largest volume of credit provided in any financial year in the history of the Fund (Table 39; see also Appendix II, Table II.7). Purchases during 1995/96 consisted of SDR 8.4 billion under stand-by arrangements (compared with SDR 7.6 billion in 1994/95), SDR 1.6 billion under extended arrangements (SDR 1.6 billion in 1994/95), SDR 0.7 billion in two outright purchases, and SDR 0.1 billion under the systemic transformation facility (SDR 1.1 billion in 1994/95). In addition, the Fund provided compensatory financing in the amount of SDR 9 million (SDR 0.3 billion in 1994/95).

Russia was the largest user of Fund resources in 1995/96, drawing a total of SDR 3.8 billion (about 100 percent of its quota) in monthly purchases, first under a stand-by arrangement and then an extended arrangement (Appendix II, Table II.8). Mexico continued to draw under its stand-by arrangement, making three purchases totaling SDR 3.5 billion. Other large purchases were made by Argentina (SDR 0.8 billion); Zambia (SDR 0.7 billion in an outright purchase following the clearance of its arrears to the Fund and prior to the disbursement of an ESAF loan—see below, under Overdue Financial Obligations); Ukraine (SDR 0.5 billion); and Algeria (SDR 0.4 billion). Broken down according to region, purchases by countries of the former Soviet Union and central and eastern European countries in 1995/96 amounted to SDR 5.0 billion; Latin American countries purchased SDR 4.4 billion; African countries purchased SDR 1.1 billion; Asian countries purchased SDR 0.2 billion; and purchases by Middle Eastern countries amounted to SDR 0.1 billion.

Repurchases in the GRA during 1995/96 totaled SDR 6.7 billion, compared with SDR 4.0 billion in the previous financial year (Appendix II, Table II.9). The actual level of repurchases in 1995/96 was higher than the scheduled level of about SDR 4.4 billion, owing to voluntary advance repurchases made by Chile (SDR 142 million), Hungary (SDR 392 million), and Poland (SDR 640 million), and repurchases of overdue amounts by Zambia (SDR 542 million) and Bosnia and Herzegovina (SDR 18 million). Zambia's prompt repurchase of its outright purchase of SDR 652 million also increased the overall level of repurchases in 1995/96. Scheduled repurchases will generally increase over the next several years, reflecting the

Table 39
SELECTED FINANCIAL INDICATORS
(In millions of SDRs)

	Financial Year Ended April 30							
	1989	1990	1991	1992	1993	1994	1995	1996
	<i>During period</i>							
Total disbursements	2,682	5,266	6,823	5,903	5,877	5,903	11,178	12,303
Purchases by facility (GRA) ¹	2,128	4,440	6,248	5,294	5,284	5,241	10,592	10,826
Stand-by and first credit tranche	1,702	1,183	1,975	2,343	2,940	1,052	7,587	9,127
Extended Fund facility	188	2,449	2,146	1,571	2,254	746	1,595	1,554
Compensatory and contingency financing facility	238	808	2,127	1,381	90	718	287	9
Systemic transformation facility	—	—	—	—	—	2,725	1,123	136
Loans under SAF/ESAF arrangements	554	826	575	608	593	662	587	1,477
Special Disbursement Account resources	380	584	180	138	49	68	19	185
ESAF Trust resources	174	242	395	470	544	594	568	1,292
By region	2,682	5,267	6,823	5,903	5,877	5,903	11,178	12,303
Africa	701	1,289	577	740	377	1,185	1,022	2,324
Asia	469	525	1,714	1,476	1,806	690	383	367
Europe	338	268	1,960	1,516	1,343	3,258	2,896	5,046
Middle East	—	66	—	333	26	11	76	129
Western Hemisphere	1,174	3,119	2,572	1,838	2,325	758	6,801	4,437
Repurchases and repayments	6,705	6,399	5,608	4,770	4,117	4,509	4,231	7,100
Repurchases	6,258	6,042	5,440	4,768	4,081	4,343	3,984	6,698
Trust Fund and SAF/ESAF loan repayments	447	357	168	2	36	166	247	402
	<i>End of period</i>							
Total outstanding credit provided by Fund	25,520	24,388	25,603	26,736	28,496	29,889	36,837	42,040
Of which:								
General Resources Account	23,700	22,098	22,906	23,432	24,635	25,533	32,140	36,268
Special Disbursement Account	965	1,549	1,729	1,865	1,879	1,835	1,651	1,545
Administered accounts								
Trust Fund	682	326	158	158	158	105	102	95
ESAF Trust ²	174	416	811	1,281	1,824	2,416	2,944	4,132
Percentage change in total outstanding credit	-14	-4	5	4	7	5	19	12
Number of indebted countries	83	87	81	82	90	93	99	97

¹Excludes reserve tranche purchases.

²Includes Saudi Fund for Development associated loans.

recent rise in the use of Fund resources and the revolving nature and medium-term maturity of the Fund's balance of payments assistance (Chart 8).

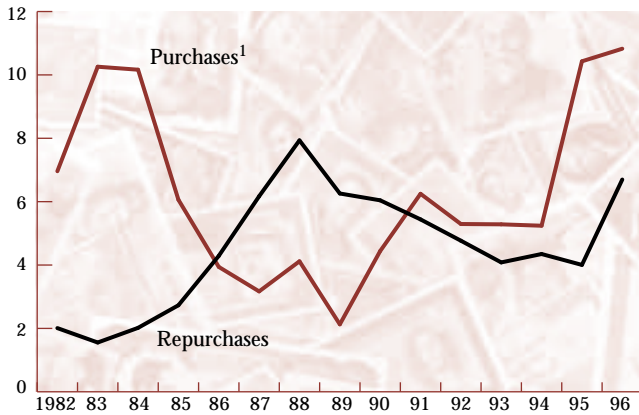
Taking into account both purchases and repurchases, Fund credit outstanding in the GRA increased by SDR 4.2 billion in 1995/96, from SDR 32.1 billion as of April 30, 1995 to SDR 36.3 billion as of April 30, 1996. (Details are provided in Appendix II, Table II.10.) If net disbursements under the SAF and ESAF are also included (see below), Fund credit outstanding under all facilities increased by SDR 5.2 billion in 1995/96, from SDR 36.8 billion on April 30, 1995 to SDR 42.0 billion on April 30, 1996 (Chart 9). With the projected strong demand for use of the Fund's

general and ESAF Trust resources, total Fund credit outstanding is expected to continue to rise in the period immediately ahead.

Stand-By and Extended Arrangements

Commitments under stand-by arrangements totaling SDR 9.6 billion were approved in 1995/96, including commitments under new arrangements for 19 countries and augmentation of access under existing arrangements for two other countries (Appendix II, Table II.1). Noteworthy among these commitments was the augmentation of the stand-by arrangement with Mexico. This arrangement, totaling SDR 12.1 billion, which had been approved in February 1995 with

Chart 8
**GENERAL RESOURCES PURCHASES
 AND REPURCHASES, FINANCIAL YEARS
 ENDED APRIL 30, 1982-96**
(In billions of SDRs)



¹ Excluding reserve tranche purchases.

an initial purchase amount of SDR 5.3 billion (300 percent of quota), was augmented by SDR 6.8 billion (388 percent of quota) following a review at the end of June 1995. Stand-by arrangements for five other Latin American countries (Argentina, Costa Rica, El Salvador, Panama, and Uruguay) totaling SDR 1.0 billion were approved in 1995/96. Access under Panama's arrangement was subsequently augmented for debt- and debt-service-reduction operations. Eight stand-by arrangements totaling SDR 1.0 billion were approved for countries of the former Soviet Union and central and eastern European countries (Armenia, Azerbaijan, Belarus, Georgia, Hungary, Kazakhstan, the former Yugoslav Republic of Macedonia, and Uzbekistan). The arrangements with Armenia and Georgia were later canceled and replaced by ESAF arrangements. Also, the Board approved augmentation of access under the existing stand-by arrangement with Romania (SDR 0.2 billion). Three stand-by arrangements totaling SDR 0.6 billion were approved for Asian and Middle Eastern countries (Pakistan, following cancellation of its EFF/ESAF arrangement, Papua New Guinea, and Yemen), and three arrangements totaling SDR 0.1 billion were approved for African countries (Cameroon, Djibouti, and Lesotho). As of April 30, 1996, 21 countries had stand-by arrangements with the Fund, with total commitments of SDR 15.0 billion and undrawn balances of SDR 5.5 billion (Appendix II, Tables II.2 and II.3).

During 1995/96 four extended arrangements totaling SDR 8.4 billion were approved for Algeria, Gabon,

Jordan, and Russia. The arrangement for Russia for SDR 6.9 billion (equivalent to 160 percent of Russia's quota), which was approved in late March 1996, is the largest extended arrangement in the history of the Fund. As of April 30, 1996, seven countries had extended arrangements, with commitments totaling SDR 9.4 billion and undrawn balances of SDR 8.6 billion (Appendix II, Table II.4).

New commitments of Fund resources under stand-by and extended arrangements increased significantly in 1995/96 to reach SDR 18.0 billion, exceeding the level of SDR 14.1 billion committed in 1982/83 at the height of the debt crisis. The record high level of commitments in 1995/96 was mainly attributable to the augmentation of Mexico's stand-by arrangement and the extended arrangement for Russia, which together amounted to SDR 13.7 billion. Commitments to other countries amounted to SDR 4.3 billion, a substantial share of which was approved for the economies in transition, reflecting their progress in formulating macroeconomic and structural reform programs that could be supported under stand-by or extended arrangements.

Special Facilities

The Fund's special facilities consist of the compensatory and contingency financing facility (CCFF) and the buffer stock financing facility, which has not been utilized since 1983; the systemic transformation facility (STF) ceased to be in effect as of end-December 1995.

Only one country, Rwanda, made use of the CCFF during 1995/96, with a drawing of SDR 9 million, compared with drawings totaling SDR 0.3 billion in 1994/95. From the inception of the STF in April 1993 to its expiration at the end of 1995, 20 countries purchased a total of SDR 4.0 billion under the facility, including 17 countries that made two drawings each. Purchases under the STF totaled SDR 136 million in 1995/96, compared with SDR 2.7 billion in 1994/95, and were made by four countries of the former Soviet Union (Armenia, Azerbaijan, Georgia, and Uzbekistan) and one central European country (former Yugoslav Republic of Macedonia).

SAF and ESAF

During 1995/96 the Fund continued to provide concessional financial support to low-income countries under the SAF and ESAF. As of April 30, 1996, 1 SAF arrangement and 28 ESAF arrangements were in effect. A one-year SAF arrangement for SDR 0.2 billion, together with a three-year ESAF arrangement for SDR 0.7 billion, was approved in 1995/96 for Zambia, following the successful completion of a rights accumulation program and clearance of Zambia's arrears to the Fund. Seven other new ESAF arrangements totaling SDR 0.7 billion were approved in

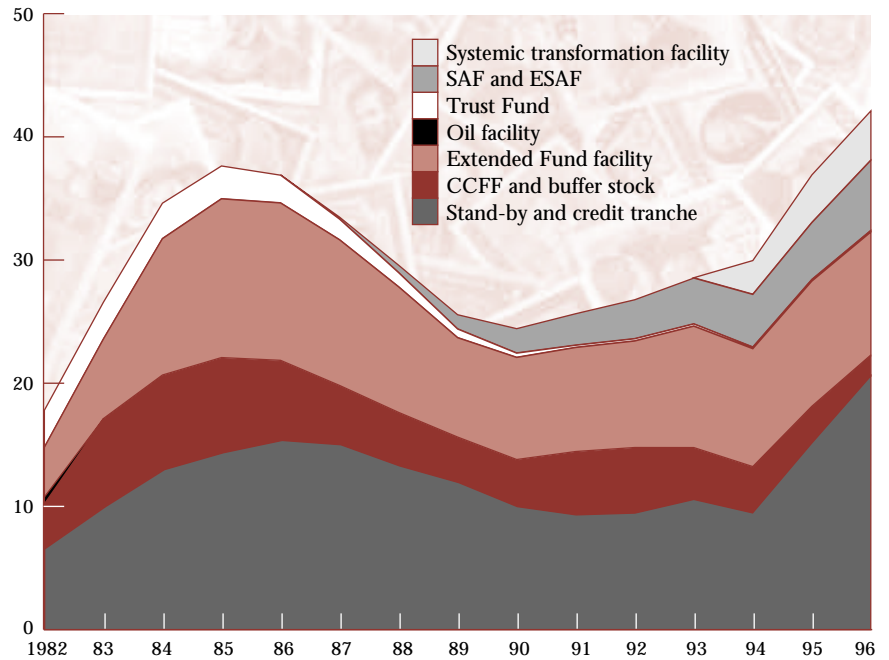
1995/96 for Armenia, Chad, Georgia, Ghana, Kenya, Malawi, and Mali, along with increased access under the existing ESAF arrangements with Burkina Faso, the Kyrgyz Republic, and Sierra Leone. Cumulative commitments under all approved SAF and ESAF arrangements (excluding undisbursed amounts under expired and canceled arrangements) totaled SDR 8.0 billion as of April 30, 1996, compared with SDR 6.9 billion a year earlier (Appendix II, Tables II.5 and II.6). SAF and ESAF disbursements during 1995/96 totaled SDR 1.5 billion, compared with SDR 0.6 billion in 1994/95, bringing cumulative disbursements through April 30, 1996 to SDR 6.5 billion.

The ESAF has been financed mainly from contributions in the form of loans and grants by member countries to the ESAF Trust, which is administered by the Fund, and also from SAF resources in the Special Disbursement Account (SDA). SAF resources were made available in conjunction with loans from the ESAF Trust until February 1994, when the Board decided to cease approving new commitments of SAF resources under ESAF arrangements. All resources available for SAF arrangements were fully utilized as of December 1995. As of April 30, 1996, total disbursements of SDA resources under SAF and ESAF arrangements amounted to SDR 2.2 billion.

The enlargement and extension of the ESAF Trust, which is targeted to approximately double its total lending capacity to SDR 10.1 billion, became effective on February 23, 1994, and is being financed by a broad cross-section of the Fund's membership. In the period since the enlargement became effective, the Board has approved borrowing agreements amounting to SDR 4.6 billion with 11 countries, 3 of which are developing countries, and with the OPEC Fund for International Development; one of the borrowing agreements, amounting to SDR 0.2 billion, is still subject to legislative approval. As of April 30, 1996, total loan commitments by lenders to the ESAF Trust under agreements approved by the Board amounted to SDR 9.7 billion, with additional loan commitments of SDR 449 million needed to reach the target amount of SDR 10.1 billion.

The commitment period for ESAF Trust loans to eligible members currently extends to December 31, 1996, with disbursements to be made through the end

Chart 9
TOTAL FUND CREDIT OUTSTANDING TO MEMBERS (INCLUDING TRUST FUND, SAF, AND ESAF), FINANCIAL YEARS ENDED APRIL 30, 1982-96
(In billions of SDRs; end of period)



of 1999. As discussed in the section on Fund Support of Member Countries, above, proposals for a continuation of ESAF operations, and for the continued financing and adaptation of the ESAF, have been the subject of extensive discussions in the Board.

Contributions to the Subsidy Account enable loans from the ESAF Trust to be provided at a highly concessional rate of interest (currently 0.5 percent a year). Under the arrangements for enlarging the ESAF Trust, 43 members have agreed to make contributions to the Subsidy Account in the form of direct grants and deposits or investments at concessional interest rates. About half the contributors are developing countries, which are providing almost 20 percent of the total contributions. The modalities of most contributions have been agreed and payments are being received by the ESAF Trust, while a few contributions will start to be paid when domestic legislative procedures have been completed. The total value of bilateral subsidy contributions for the enlargement is estimated at about SDR 1.4 billion, bringing to SDR 3.8 billion the value of bilateral subsidy contributions committed both for the enlargement and before it. In addition to these bilateral contributions, the Board transferred SDR 0.4 billion from the SDA to the ESAF Trust Subsidy Account in early 1994. The value of this contribution by the Fund, once interest that will accrue is taken into account, is about SDR 0.6 billion.

The availability of resources in the Subsidy Account, net of subsidies already paid, rose from SDR 1,330 million as of April 30, 1995 to SDR 1,425 million as of April 30, 1996. The ESAF Trust made interest payments of SDR 126 million to lenders in 1995/96, of which SDR 17 million was financed by payments of interest by borrowers from the Trust and the balance of SDR 109 million was drawn from the resources of the Subsidy Account.

Details of SAF and ESAF arrangements, and borrowing agreements and subsidy contributions for the ESAF Trust, are provided in Appendix II (Tables II.5, II.6, and II.11).

Fund Income, Charges, and Burden Sharing

At the beginning of the financial year, the Fund sets the rate of charge on the use of its resources as a proportion of the weekly SDR interest rate, in order to achieve a target amount of net income for the financial year to add to its reserves. This method of fixing the rate of charge ensures that the Fund's operational income closely reflects its operational costs, which depend largely on the SDR interest rate, and thus minimizes the need for discretionary changes in the rate of charge.

For 1995/96 the proportion of the rate of charge to the SDR interest rate was set at 102.5 percent and aimed at achieving a net income target equal to 5 percent of reserves at the beginning of the financial year. Any income in excess of the target was to be used to reduce retroactively the proportion of the rate of charge for the financial year. After taking into account net income in excess of the target amounting to SDR 12 million that was refunded to members that paid charges during the year, the proportion of the rate of charge to the SDR interest rate for 1995/96 was reduced to 101.7 percent. The average rate of charge on the use of Fund resources in 1995/96 was 4.31 percent before adjustments for burden sharing, which are discussed below (Appendix II, Table II.14).

The Fund pays remuneration to a member country on the amount by which its norm for remuneration exceeds the Fund's holdings of its currency, excluding holdings that reflect the member's use of Fund credit. For each member, the norm is calculated as the sum of 75 percent of the member's quota on April 1, 1978, plus any increases in quota consented to and paid after that date. For members joining the Fund after April 1, 1978, the norm is calculated as the sum of a percentage of quota determined by the weighted average of the norms of all existing members relative to quota on the date of admission, plus any increases in the member's quota consented to and paid after that date. The rate of remuneration, before the adjustments under the burden-sharing mechanisms discussed below, is set at 100 percent of the SDR

interest rate, which averaged 4.25 percent in 1995/96.

The measures taken in recent years to strengthen the Fund's financial position in light of the existence of overdue obligations were continued in 1995/96. First, a target amount of net income is determined each year to be added to the Fund's reserves. Second, the financial costs of overdue obligations are shared by debtor and creditor members: one half each of the cost of deferred charges and of the allocation to the Special Contingent Account (SCA-1) of 5 percent of reserves at the beginning of the year is borne by members paying charges on the use of the Fund's resources and by members receiving remuneration through adjustments to the rates of charge and remuneration, except that the adjustment to the rate of remuneration cannot reduce that rate to less than 85 percent of the SDR interest rate. These burden-sharing procedures have been extended by the Board through 1996/97.

As part of the strengthened cooperative strategy to resolve the problem of protracted overdue obligations to the Fund, further adjustments (extended burden sharing) are made to the rate of charge and to the rate of remuneration (subject to the floor of 80 percent of the SDR interest rate stipulated in the Articles of Agreement). The resources so generated are placed in a second Special Contingent Account (SCA-2) and are intended to protect the Fund against risks associated with credit extended by the GRA for the encashment of rights earned in the context of rights accumulation programs and to provide additional liquidity to finance those encashments. The extended burden-sharing procedures were adopted in July 1990 and will remain in effect until the target level of resources of SDR 1 billion has been accumulated in the SCA-2. The adjustment to the rate of remuneration is set so as to yield three times the amount of resources generated by the adjustment to the rate of charge, subject to the floor to the rate of remuneration mentioned above.

When deferred overdue charges are settled, an equivalent amount is refunded to members that paid higher charges or received lower remuneration under burden sharing. Settlements of deferred charges amounted to SDR 333 million in 1995/96, bringing total cumulative refunds to SDR 959 million as of April 30, 1996. Balances in the SCA-1, which amounted to SDR 692 million as of April 30, 1996, will be returned to contributors when there are no more overdue obligations, or at such earlier time as the Fund may decide. Balances in the SCA-2, which amounted to SDR 942 million as of April 30, 1996, will be returned to members that paid additional charges or received reduced remuneration when all outstanding purchases related to the encashment of rights have been repurchased, or at such earlier time as the Fund may decide.

Box 11

THE FUND'S HOLDINGS OF GOLD

As of April 30, 1996, the Fund held about 103.4 million fine ounces of gold at four designated depositories, valued in the Fund's financial statements at SDR 3.6 billion on the basis of SDR 35 per fine ounce (except for a minor amount acquired in 1992 in partial settlement of a member's overdue obligations, and valued at the then-prevailing market price).¹ These holdings represent the balance of the Fund's stock of gold after the gold auctions to finance the Trust Fund, a concessional facility for eligible low-income countries, and the restitution of gold to members in the period 1976–80.

Following the Second Amendment of the Articles of Agreement in April 1978, the monetary role of gold was eliminated from the Articles. Among other changes, the Second Amendment eliminated gold as the basis of the value of the SDR, abolished the official price of gold (0.888671 gram of fine gold per SDR), removed the limits to the price at which members may deal in gold, ended restrictions on dealings in gold among member countries, and required the Fund to be guided by the objective of avoiding the management of the price, or the establishment of a fixed price, in the gold market. In addition, the Second Amendment eliminated the obligatory use of gold as a means of payment to and by the Fund and also barred the

¹On the basis of the market price prevailing on April 30, 1996, the Fund's holdings would be valued at US\$40.3 billion (SDR 27.8 billion).

use of gold as a currency peg by members of the Fund. Any use of gold in payments must be acceptable to both the Fund and the members using it. The Fund can accept gold in settlement of obligations only if approved by members holding 85 percent of the total voting power.

While gold is reflected as an asset in the Fund's balance sheet and financial statements, it is not used in the Fund's operations and transactions, and any disposal of the remaining stock of the Fund's gold requires approval by an 85 percent majority of the total voting power. The Fund may sell gold but may not engage in such gold transactions as loans, leases, or swaps, and may not use gold as collateral. Even after sale, the use of the proceeds is subject to specific provisions of the Fund's Articles.

In 1995 the Executive Board reviewed the role of gold in the Fund. The Board concluded that use of the Fund's gold must take account of the overriding need to maintain and, where possible, strengthen the Fund's financial base. In this regard, there was broad agreement that the Fund's policy on gold should be governed by the following principles:

- As an undervalued asset held by the Fund, gold provides a fundamental strength to the Fund's balance sheet. Thus, any mobilization of the Fund's gold should avoid weakening the Fund's overall financial position.
- The Fund's gold holdings provide the Fund with operational maneuverability both as regards its policies on the use of its resources and through

adding credibility to the level of the Fund's precautionary balances. In these respects, the benefits of the Fund's gold holdings are passed on to the membership at large, to both creditors and debtors.

- The Fund should continue to hold a relatively large amount of gold among its assets, not only for prudential reasons, but also to meet unforeseen contingencies.

- The Fund has a systemic responsibility, given that it is the second-largest official holder of gold in the world, with about 10 percent of total official gold stocks of member countries. The Fund must take great care to avoid causing disruptions that would have an adverse impact on all gold holders and gold producers, as well as on the functioning of the gold market.

- The importance attached to the view that a sale of gold by the Fund must not weaken its financial position, and if possible should strengthen it, means in practice that the capital profits of any sale of gold should be retained and only the income deriving from the investment of those profits used for any current operations that might be agreed.

Also in the course of 1995/96, in the context of discussions on the modalities of financing a self-sustained ESAF, Directors considered the possibility of use of a modest amount of the Fund's gold. While there was general agreement that any such mobilization should reflect the principles outlined above, the necessary 85 percent voting majority required for a sale of gold has not been forthcoming.

For 1995/96 the target amount of net income to be added to reserves and the amount to be placed in the SCA-1 were each set at SDR 89 million. Unpaid charges due by members in protracted arrears and contributions to the SCA-1 resulted in adjustments to the basic rate of charge of 24 basis points, and in adjustments to the rate of remuneration of 28 basis points. Adjustments for extended burden sharing further increased the basic rate of charge by 4 basis points and further reduced the rate of remuneration by 57 basis points to 80 percent of the average SDR interest rate. Shortfalls in the amounts placed in the SCA-2, owing

to the 80 percent floor of the rate of remuneration having been reached, totaled SDR 14 million cumulatively at the end of 1995/96; these shortfalls will be recouped when the adjusted rate of remuneration does not reach that floor. For 1995/96 the adjusted rate of charge on the use of Fund resources averaged 4.59 percent and the adjusted rate of remuneration averaged 3.40 percent.

After the retroactive reduction of charges amounting to SDR 12 million, net income for 1995/96 equaled the target amount of SDR 89 million and was added to the Fund's reserves, which increased to

Table 40

ARREARS TO THE FUND OF COUNTRIES WITH OBLIGATIONS OVERDUE BY SIX MONTHS OR MORE
(In millions of SDRs; end of period)

	Financial Year Ended April 30					
	1991	1992	1993	1994	1995	1996
Amount of overdue obligations	3,377.7	3,496.0	3,006.4	2,911.3	2,982.6	2,174.9
Number of countries	9	10	12	9	8	6
Of which:						
General Department	3,171.7	3,274.1	2,768.3	2,729.5	2,809.1	2,001.6
Number of countries	9	10	12	9	8	6
SDR Department	27.3	37.5	49.9	51.4	46.3	53.1
Number of countries	6	7	9	8	5	4
Trust Fund	178.7	184.3	188.3	130.4	127.2	120.2
Number of countries	6	6	6	4	4	3
Number of ineligible members	8	8	7	5	5	4

SDR 1.88 billion as of April 30, 1996 from SDR 1.79 billion a year earlier. The Board established a net income target of SDR 94 million for 1996/97 and set the proportion for the rate of charge at 109.4 percent of the SDR interest rate.

Total precautionary balances (reserves plus the balances in the SCA-1 and the SCA-2) amounted to SDR 3.5 billion as of April 30, 1996, equivalent to 9.7 percent of total Fund credit outstanding. Precautionary balances generally available to protect the Fund's financial position against the consequences of overdue repurchases in the GRA (reserves plus the balance in the SCA-1) totaled SDR 2.6 billion, which was equivalent to 236 percent of credit outstanding to countries in arrears to the Fund by six months or more (SDR 1.1 billion). (For a discussion of the Fund's gold holdings, see Box 11 on preceding page.)

The level and adequacy of the Fund's precautionary balances were considered by the Board in April 1996. In reaching a judgment on the adequacy and appropriate rate of accumulation of precautionary balances, Directors are guided by two general principles. First, precautionary balances should fully cover credit outstanding to members in protracted arrears to the Fund; and second, precautionary balances should also include a margin for the potential exposure to risk related to credit outstanding to members currently meeting obligations on a timely basis. After taking into account the expansion of outstanding credit and such qualitative factors as the strength and perseverance of members' adjustment efforts and their progress toward medium-term balance of payments viability, Directors agreed to set the net income target

for 1996/97 and the contribution to the SCA-1, respectively, at 5 percent of reserves at the beginning of the year.

Overdue Financial Obligations

The level of outstanding overdue financial obligations to the Fund declined significantly in 1995/96 from SDR 3.0 billion on April 30, 1995 to SDR 2.2 billion on April 30, 1996. This decrease resulted largely from the clearance of arrears by Zambia (SDR 830 million) and Bosnia and Herzegovina (SDR 25 million) in December 1995.

There were no new cases of protracted overdue obligations to the Fund in 1995/96, and the number of countries in arrears to the Fund by six months or more decreased from eight to six. Of the six countries in protracted arrears as of April 30, 1996, all were in arrears to the GRA; four to the SDR Department; three to the Trust Fund; and two were in arrears on SAF obligations. Selected data on arrears to the Fund are shown in Table 40, and further information on countries' overdue obligations by type and duration is shown in Table 41.

As of April 30, 1996, four countries remained ineligible to use the general resources of the Fund, pursuant to declarations under Article XXVI, Section 2(a)—Liberia, Somalia, Sudan, and Zaïre. These four countries accounted for 96 percent of total overdue obligations to the Fund on that date. Declarations of noncooperation remained in effect with respect to three countries: Liberia (issued March 30, 1990), Sudan (September 14, 1990), and Zaïre (February 14, 1992).

Table 41

ARREARS TO THE FUND OF COUNTRIES WITH OBLIGATIONS OVERDUE BY SIX MONTHS OR MORE, BY TYPE AND DURATION, AS OF APRIL 30, 1996
(In millions of SDRs)

	Total	By Type			By Duration			
		General Dept. (incl. SAF)	SDR Dept.	Trust Fund	Less than one year	1–2 years	2–3 years	3 years or more
Iraq	25.2	0.1	25.1	—	3.0	4.9	3.8	13.5
Liberia	433.6	389.4	13.5	30.7	11.1	11.9	13.3	397.3
Somalia	181.3	169.0	4.6	7.7	7.2	8.1	10.2	155.8
Sudan	1,183.3	1,101.5	—	81.8	29.2	30.3	35.3	1,088.5
Yugoslavia, Federal Republic of (Serbia/Montenegro)	72.0	62.1	9.9	—	8.9	14.3	23.8	25.0
Zaire	279.6	279.6	—	—	29.5	50.9	67.3	131.9
Total	2,174.9	2,001.6	53.1	120.2	88.9	120.4	153.7	1,812.0

Progress Under the Strengthened Cooperative Strategy

The strengthened cooperative strategy to resolve the problem of protracted overdue obligations to the Fund was formulated in early 1990 and was endorsed by the Interim Committee in May of that year. The three key elements of the strategy—prevention, intensified collaboration, and remedial measures—continued to be implemented in 1995/96, in order to assist overdue countries in finding solutions to their arrears problems and to prevent the emergence of new arrears.

Prevention

Preventive measures to keep new cases of arrears from emerging or becoming protracted remain the key first element of the Fund's arrears strategy. These measures comprise four components—the conditionality associated with the use of Fund resources; assessments of borrowing countries' medium-term balance of payments viability and capacity to repay; cooperation with donors and other official creditors to ensure that adjustment programs supported by the Fund are adequately financed; and technical assistance in the formulation and implementation of appropriate adjustment programs. During the past year, two developments have reinforced the Fund's ability to assess a member's capacity to repay and to identify potential problems in the period while Fund resources remain outstanding—the introduction of debt-sustainability analyses prepared jointly by the staffs of the Fund and the World Bank for the heavily indebted poor countries, and the strengthening of surveillance.

Over the past year, the Fund and Bank staffs have intensified their collaboration in analyzing the prospects for debt sustainability of heavily indebted poor countries. More comprehensive analyses of countries' overall external debt situations and medium-term

sustainability have been undertaken, including in the context of work on Fund-supported programs, policy framework papers, Article IV consultations, and the Bank's country assistance strategies. Some of the results of these efforts include highlighting the issue of countries' capacity to repay and helping to ensure that the volume and terms of new lending are consistent with that capacity.

In the aftermath of the Mexican crisis of late 1994 and early 1995, it was agreed that surveillance practices should be strengthened to better enable the Fund to identify emerging financial tensions at an early stage. The efforts to strengthen Fund surveillance include improving the availability and quality of economic data and introducing a more continuous surveillance process, including for countries where the Fund's exposure is large.

Intensified Collaboration and the Rights Approach

The Fund continued to work closely during 1995/96 with countries in arrears in order to resolve the problem of their overdue financial obligations. Intensified collaboration was designed as a means of coordinating efforts in this regard. It provides a framework for countries in arrears to establish a track record of policy and payments performance, to mobilize resources from international creditors and donors, and to normalize relations with the Fund, including the clearance of overdue obligations. A country's economic policies might be formulated in the context of a rights accumulation program, or a Fund- or staff-monitored program.

The availability of the rights approach is limited to the 11 countries in protracted arrears to the Fund at the end of 1989. To avail themselves of this approach, these countries must enter into a medium-term rights

accumulation program by a certain deadline, which has been extended into 1997. A rights accumulation program, which shares many of the features of a regular Fund-supported macroeconomic stabilization and structural reform program, allows a country in protracted arrears to accumulate rights to future drawings of Fund resources in accordance with a phased schedule, and in amounts up to the level of arrears outstanding at the beginning of the program. Disbursements are made, however, only after the clearance of arrears and are conditional upon satisfactory conclusion of the rights program and approval by the Fund of a successor arrangement or arrangements.

Five of the original 11 eligible countries—Cambodia, Guyana, Honduras, Panama, and Vietnam—cleared their arrears to the Fund without recourse to the rights approach. Three other eligible members—Peru, Sierra Leone, and Zambia—adopted rights accumulation programs. All three countries have successfully completed those programs, cleared their arrears to the Fund—Peru in March 1993, Sierra Leone in March 1994, and most recently Zambia in December 1995—and have remained current with the Fund following their arrears clearance.

The clearance of Zambia's arrears, the largest arrears settlement to date, took place on December 6, 1995, with the help of bridge loans from several members. Following the clearance and the lifting of Zambia's ineligibility to use the Fund's resources, the Board approved successor SAF and ESAF arrangements totaling SDR 883 million, of which SDR 833 million was disbursed immediately. For the three other countries in protracted arrears at the end of 1989—Liberia, Somalia, and Sudan—the rights approach remains available, although progress has been hindered by a number of factors.

On December 20, 1995, Bosnia and Herzegovina cleared its arrears to the Fund (SDR 25 million) with the help of a bridge loan from another member and succeeded to membership in the Fund. On the same day, the Board approved a drawing of SDR 30 million (25 percent of quota) under the policy on emergency assistance to post-conflict countries to support the country's economic program for 1996. The settlement of arrears by Bosnia and Herzegovina was part of an intensive multilateral collaborative effort to normalize the country's relations with the international community and to lay the foundations for economic reconstruction and development.

Remedial Measures

The preventive and collaborative elements of the arrears strategy are complemented by remedial measures that seek to protect the Fund's resources from further use by a member in arrears, and to set in motion a concerted effort to resolve the problems of

the member concerned. These measures consist of specific actions to be taken on the basis of a timetable agreed by the Board in early 1990. The timetable sets a framework for the Board's consideration of various measures, which are then implemented if the Board considers that the member is not cooperating with the Fund in addressing the problem of its overdue obligations, taking into account the particular circumstances of the individual member.

In accordance with the timetable, three notifications were issued to the Board at the one-month stage of arrears during 1995/96. In one of these cases, following consultation with the Board, communications were sent to selected Governors after the member had been in arrears for more than six weeks. In another case, consultation about the sending of such communications took place, but in light of arrangements that had been made by the member for settlement of the arrears, the communications to selected Governors were deemed not to be necessary. In two of the three cases, the arrears were cleared before a complaint was issued to the Board. In the third, a report and complaint under Rule S-1 (that is, with respect to arrears in the SDR Department) were issued to the Board on February 27, 1996.

Under the timetable of remedial measures, the voting rights in the Fund of two countries have been suspended: Sudan, effective August 9, 1993, and Zaïre, effective June 2, 1994. In the case of Zaïre, the Board reviewed this decision on two occasions during 1995/96. Taking into account the increased payments made by Zaïre and the fact that the authorities had elaborated an economic program for 1996, which was being informally monitored by the Fund staff, the Board decided at its most recent review on March 1, 1996 to postpone again consideration of the initiation of the procedure for compulsory withdrawal until the time of the next review, scheduled to take place within six months.

Compulsory withdrawal is the final and most severe sanction in the timetable of remedial measures. In the case of Sudan, which is the largest and most protracted case involving overdue obligations to the Fund, the procedure for compulsory withdrawal was initiated on April 8, 1994 by the issuance of a complaint by the Managing Director. The Board considered that complaint on three occasions during 1995/96. At the most recent review, on February 13, 1996, the Board noted Sudan's commitments concerning economic policies and increased payments to the Fund and encouraged Sudan to strengthen its adjustment effort by adopting a comprehensive program of financial and structural measures. In the event that Sudan did not improve its cooperation with the Fund by August 2, 1996, the Board noted that it would expect to recommend to the Board of Gover-

nors that Sudan be required to withdraw from the Fund.

SDR Transactions and Operations

Allocations of SDRs, the international reserve asset created by the Fund to supplement existing reserve assets, have totaled SDR 21.4 billion since January 1970.

These are held largely by Fund member countries, all of which are participants in the SDR Department, with the balance held by the Fund's GRA and by official entities prescribed by the Fund to hold SDRs. Prescribed holders do not receive SDR allocations, but they can acquire and use SDRs in transactions and operations with participants in the SDR Department and with other prescribed holders under the same terms and conditions as participants. During 1995/96 the number of prescribed holders remained unchanged at 15.¹⁴ In response to a request by the Interim Committee in April 1995, the Fund has embarked on a broad review, with the involvement of outside experts, of the role and functions of the SDR in light of changes in the world financial system (see the section on the Present and Future Role of the SDR, above).

The SDR is the unit of account for Fund operations and transactions and is also used as a unit of account, or the basis for a unit of account, by a number of other international and regional organizations and international conventions. In addition, to a very limited extent the SDR has been used to denominate financial instruments created outside the Fund by the private sector (private SDRs). At the end of 1995/96, the currencies of three member countries were pegged to the SDR.

SDR Valuation and Interest Rate Basket

Since January 1, 1981 the value of and interest rate on the SDR have been determined on the basis of a unified basket of five currencies. The valuation of the SDR was reviewed by the Board in September 1995 and the valuation basket was revised effective January 1, 1996. The currencies included in the basket, which are those of the five member countries with the largest exports of goods and services during the five-year period ending one year prior to the date of the revision, remained unchanged. However, the initial weights of these currencies were modified to reflect changes from 1985–89 to 1990–94 in their relative importance in international

¹⁴These prescribed holders of SDRs are the African Development Bank, African Development Fund, Arab Monetary Fund, Asian Development Bank, Bank of Central African States, Bank for International Settlements, Central Bank of West African States, East African Development Bank, Eastern Caribbean Central Bank, International Bank for Reconstruction and Development, International Development Association, International Fund for Agricultural Development, Islamic Development Bank, Latin American Reserve Fund, and Nordic Investment Bank.

Table 42

CHANGE IN SDR VALUATION BASKET
(Initial percentage weights; amounts of currency units in parentheses)

Currency	January 1, 1996	January 1, 1991
U.S. dollar	39 (0.582)	40 (0.572)
Deutsche mark	21 (0.446)	21 (0.453)
Japanese yen	18 (27.2)	17 (31.8)
French franc	11 (0.813)	11 (0.800)
Pound sterling	11 (0.105)	11 (0.0812)

trade and reserves, as measured by the value of exports of goods and services of the countries issuing the currencies and the balances of the currencies held as reserves by members of the Fund. The currency weights were translated into currency amounts in such a manner as to ensure that the value of the SDR was the same on December 29, 1995 (the last business day of 1995) under both the revised and previous baskets. The initial weights and the corresponding amounts of each of the five currencies in the revised and previous baskets are shown in Table 42. The revised basket will be in effect until December 31, 2000.

Since August 1, 1983 the SDR interest rate has been calculated weekly as a weighted average of interest rates on selected short-term instruments in the five countries whose currencies are included in the valuation basket. In September 1995 the Board also reviewed the financial instruments included in the SDR interest rate basket and decided that those instruments would remain unchanged. The interest rates and instruments are the market yield on three-month treasury bills in the United States, the three-month interbank deposit rate in Germany, the three-month rate on certificates of deposit in Japan, the three-month rate on treasury bills in France, and the market yield on three-month treasury bills in the United Kingdom.

SDR Transfers

A sharp increase in the use of SDRs by member countries to discharge their financial obligations to the Fund in 1995/96 was combined with a substantial growth in transfers among participants and prescribed holders as well as a very high level of transfers from the GRA to participants. Total transfers of SDRs in 1995/96 rose to a new record level of SDR 27.4 billion, surpassing the previous record level of SDR 20.3 billion set in 1994/95. Summary data on transfers of SDRs by participants, the GRA, and prescribed holders are presented in Table 43 (see also Appendix II, Table II.12).

Table 43

TRANSFERS OF SDRs
(In millions of SDRs)

	Annual Averages ¹					Financial Years Ended			1/1/70- 4/30/96
	1/1/70- 4/30/78	5/1/78- 4/30/81	5/1/81- 4/30/83	5/1/83- 4/30/87	5/1/87- 4/30/93	April 30			
	1994	1995	1996						
Transfers among participants and prescribed holders									
Transactions with designation									
From own holdings	221	294	815	165	—	—	—	—	5,016
From purchase of SDRs from Fund	43	1,150	1,479	1,744	164	—	—	—	14,727
Transactions by agreement	439	771	1,262	3,121	6,023	3,122	8,987	8,931	78,155
Prescribed operations	—	—	277	520	1,453	406	124	1,951	13,835
Fund-related operations	—	—	—	43	203	436	301	704	2,829
Net interest on SDRs	42	161	259	285	410	121	174	319	5,564
Total	744	2,377	4,092	5,878	8,254	4,085	9,586	11,905	120,126
Transfers from participants to General Resources Account									
Repurchases	306	809	702	991	1,956	642	1,181	5,572	29,474
Charges	259	620	1,233	2,574	1,887	1,425	1,386	1,985	32,893
Quota payments	24	1,703	175	1,591	2,151	71	24	70	25,097
Interest received on General Resources Account holdings	16	135	551	307	81	336	262	53	4,007
Assessments	1	1	2	4	4	4	4	4	67
Total	606	3,269	2,662	5,466	6,079	2,478	2,857	7,683	91,538
Transfers from General Resources Account to participants and prescribed holders									
Purchases	208	1,474	2,227	2,554	2,067	2,676	5,970	6,460	48,325
Repayments of Fund borrowings	—	88	86	614	1,261	300	862	—	11,620
Interest on Fund borrowings	4	27	183	443	295	162	97	—	4,286
In exchange for other members' currencies									
Acquisitions to pay charges	—	3	95	896	388	166	99	49	6,422
Acquisitions to make quota payments	—	114	—	—	—	—	—	—	341
Reconstitution	175	33	—	—	—	—	—	—	1,555
Remuneration	26	165	604	1,536	1,021	958	815	1,092	17,058
Other	29	7	22	17	53	108	51	259	1,109
Total	442	1,911	3,217	6,059	5,085	4,370	7,894	7,859	90,716
Total transfers	1,792	7,556	9,971	17,404	19,418	10,933	20,336	27,448	302,379
General Resources Account holdings at end of period	1,371	5,445	4,335	1,960	7,930	6,038	1,001	825	825

¹The first column covers the period from the creation of the SDR until the Second Amendment to the Articles of Agreement; the second column covers the period of the SDR allocations in the third basic period and the Seventh General Review quota increases; after an intervening period represented by the third column, the fourth column covers the period of the Eighth General Review quota increases and before the introduction of the two-way arrangements to facilitate transactions by agreement; and the fifth column covers, except for the three most recent financial years, the period since the designation mechanism became of a precautionary nature.

Transfers of SDRs from participants to the GRA more than doubled from SDR 2.9 billion in 1994/95 to SDR 7.7 billion in 1995/96, reflecting mainly a jump in use of SDRs for repurchases from SDR 1.2 billion in 1994/95 to SDR 5.6 billion in 1995/96, when repurchases in SDRs represented more than 80 percent

of total repurchases. With the growth in outstanding Fund credit, charges paid in SDRs increased to SDR 2.0 billion in 1995/96, despite a decline in the average rate of charge. Other transfers to the GRA totaling SDR 0.1 billion consisted of small amounts for quota payments, interest on the SDR holdings of the

Box 12

DESIGNATION PLAN

Article XIX of the Fund's Articles of Agreement provides for a designation mechanism under which participants whose balance of payments and reserve positions are deemed sufficiently strong are obliged, when designated by the Fund, to provide freely usable currencies in exchange for SDRs up to specified amounts. The designation mechanism ensures that in case of need participants can use SDRs to obtain foreign exchange reserves at short notice. The participant wishing to sell its SDRs in transactions with designation is required to make a representation to the Fund that it has a need to use its SDRs. While a request to sell SDRs through designation cannot be challenged at the time of use, the Fund examines recent developments in the participant's combined balance of payments and reserve position immediately afterward to determine that the requirement of need has been met, that is, the use of SDRs was in accordance with Article XIX, Section 3(a). If, in

the judgment of the Fund, the transaction was not in accordance with that Article, the participant may be designated to receive SDRs in order to offset the effect of the previous use. Adherence to the principle of this Article ensures that SDRs are not used under designation for the sole purpose of changing the composition of reserves.

The designation mechanism is executed through quarterly designation plans, approved by the Board, which list participants subject to designation and set maximum limits on the amounts of SDRs they can be designated to receive during the quarter. Apart from a participant being "sufficiently strong" for designation, the amounts of designation for individual participants are determined in a manner that promotes over time equality in the "excess holdings ratios" of participants (that is, SDR holdings above or below allocations as a proportion of participants' official gold and foreign exchange reserves). A participant will

therefore be subject to designation if its excess holdings ratio is below the projected common ratio used in calculating the proposed plan. A participant's obligation to provide currency against SDRs in designation is limited, however, to twice the level of its net cumulative allocations, unless the participant and the Fund agree to a higher limit.

Since September 1987 there have been no transactions with designation as potential exchanges of SDRs for currencies have been accommodated through voluntary transactions by agreement with other participants, primarily the 12 participants that have established with the Fund standing arrangements to buy or sell SDRs for one or more freely usable currencies at any time, provided that their SDR holdings remain within a certain range. These "two-way" arrangements have helped accommodate members' desires to both buy and sell SDRs and have facilitated the circulation of SDRs in the system.

GRA, and reimbursements to the GRA for the cost of conducting the business of the SDR Department.

Despite a relatively low level of holdings of SDR 1 billion at the beginning of 1995/96, the substantial amounts of SDRs received by the GRA during the year enabled the Fund to transfer to participants SDR 7.9 billion, exceeding the record level of such transfers reached in 1994/95. Members' purchases from the Fund during 1995/96 of SDR 6.5 billion represented the largest category of transfers from the GRA, followed by remuneration and other payments of SDR 1.4 billion to members. Acquisitions of SDRs by member countries for the payment of charges declined to a very small amount, reflecting generally higher holdings of SDRs by debtor countries and the larger supply of SDRs available through transactions by agreement.¹⁵

Transfers among participants and prescribed holders increased from SDR 9.6 billion in 1994/95 to SDR 11.9 billion in 1995/96, largely due to a record volume of prescribed operations, which rose to SDR 2.0 billion in 1995/96 from SDR 0.1 billion in

1994/95. A large portion of these operations consisted of bridge operations used by two countries to clear their arrears to the Fund and pay the reserve asset portion of their quota increases. In comparison, prescribed operations in 1994/95 consisted mainly of settlements of financial obligations among participants and prescribed holders. Countries continued to acquire substantial amounts of SDRs in transactions by agreement during 1995/96, in order to discharge their financial obligations to the Fund and to build up their holdings of SDRs. Transactions by agreement continued to be conducted for the most part with the assistance of 12 countries that have established standing arrangements with the Fund to buy or sell SDRs for one or more freely usable currencies at any time provided that their SDR holdings remain within certain limits. These so-called two-way arrangements have proved to be resilient in accommodating desired acquisitions of SDRs and a very substantial proportion of desired sales of SDRs, obviating recourse to the designation mechanism (see Box 12). Transactions by agreement totaled SDR 8.9 billion during 1995/96, only marginally less than the record level of 1994/95. To help satisfy desired acquisitions of SDRs that could not be met from countries with two-way arrangements, or from other countries wishing to sell SDRs, the Fund

¹⁵Members could only acquire from the GRA the amount of SDRs needed for the payment of charges within 30 days of the due date of charges.

requested two countries with relatively large SDR holdings to consider additional sales; those countries subsequently provided an additional SDR 0.5 billion for sale in 1995/96. Despite the high level of transactions during 1995/96, requests for acquisitions totaling SDR 0.8 billion by a number of countries could not be met as of the end of the financial year.

Fund-related operations, representing use of SDRs in connection with the SAF, ESAF, Trust Fund, and Supplementary Financing Facility Subsidy Account, more than doubled to SDR 0.7 billion in 1995/96 from SDR 0.3 billion in 1994/95. Part of this increase was due to operations related to Zambia's clearance of its arrears to the Fund in December 1995. Net interest on SDRs rose to SDR 0.3 billion because of higher average holdings of SDRs by prescribed holders and participants with holdings in excess of their net cumulative allocations.

Pattern of SDR Holdings

Transfers of SDRs during 1995/96 resulted in a further redistribution of SDR holdings among the various groups of holders, with the Fund playing the major role in the circulation and redistribution of SDRs. In making transfers of SDRs under the quarterly operational budgets, the Fund has been guided since early 1993 by the aim of reducing its SDR holdings to a range of SDR 1.0–1.5 billion by the end of 1995. After having reduced its SDR holdings to SDR 1 billion at the end of 1994/95, in order to maintain its holdings

near that level, the Fund generally transferred the SDRs it received during a quarter to debtor members in connection with purchases and to creditors in the payment of remuneration. As of April 30, 1996, the holdings of the GRA amounted to SDR 0.8 billion, slightly below the level a year earlier.

While debtor members sold a substantial portion of the SDRs they received from the GRA to members with two-way arrangements in order to obtain freely usable currencies and used SDRs to meet their financial obligations to the Fund, they retained some of the SDRs thus received, with the result that their SDR holdings rose relative to their net cumulative allocations (Appendix II, Table II.13). In terms of net cumulative allocations, the SDR holdings of the developing countries increased from 60.4 percent to 67.9 percent during 1995/96, reflecting their preference to hold larger amounts of SDRs and their ability to do so after having received them in purchases from the GRA. In contrast, the SDR holdings of the industrial countries declined from 105.1 percent to 102.4 percent of net cumulative allocations, mainly because the amount of SDRs they sold in transactions by agreement was greater than the amount they acquired during the year. The SDR holdings of prescribed holders increased slightly to SDR 1.1 billion as of April 30, 1996, representing largely the Fund's investments of SAF and ESAF resources in official SDRs maintained with the Bank for International Settlements (BIS).

