NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/23

3:00 p.m., February 13, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
J. de Groote	H. G. Schneider
	X. Blandin
	R. J. J. Costa, Temporary
	M. K. Bush
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	H. A. Arias, Temporary
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	
	A. A. Scholten, Temporary
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	S. M. Hassan, Temporary
	E. Portas, Temporary
J. Tvedt	
	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present

R. M. Ezeife, Principal Secretary in the Ministry of Finance of Nigeria. African Department: J. B. Zulu, Director; A. I. Abdi, P. A. Acquah, E. A. Calamitsis, M. Diari, C. N. Egwim, M. Sidibe, E. van der Mensbrugghe. Asian Department: S. P. O. Itam, H. C. Kim, R. J. Niebuhr. Exchange and Trade Relations Department: S. Kanesa-Thasan. External Relations Department: P. de Fontnouvelle, L. R. Fidel. Fiscal Affairs Department: R. van Til. Legal Department: G. P. Nicoletopoulos, Director; J. K. Oh, S. A. Silard. Middle Eastern Department: F. Drees. Treasurer's Department: D. Williams, Deputy Treasurer; W. J. Byrne, W. L. Coats, Jr., D. S. Cutler, D. Gupta, A. F. Moustapha. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. J. Batliwalla, S. El-Khouri, W. Moerke, G. E. L. Nguyen, Y. Okubo, I. R. Panday, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, R. L. Bernardo, J. Bulloch, M. B. Chatah, L. E. J. M. Coene, M. Eran, G. Ercel, C. Flamant, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, A. K. Juusela, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, M. Rasyid, J. Reddy, D. J. Robinson, S. Sornyanyontr, J. C. Williams, A. Yasseri.

1. NIGERIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/84/22, 2/13/84) their consideration of the staff report for the 1983 Article IV consultation with Nigeria (SM/84/17, 1/12/84; and Sup. 1, 2/7/84). They also had before them a report on recent economic developments in Nigeria (SM/83/250, 12/15/83).

Mr. R. M. Ezeife, Principal Secretary in the Ministry of Finance of Nigeria, was present at the meeting.

The staff representative from the Exchange and Trade Relations Department recalled that several Directors had emphasized the need for a comprehensive and integrated structural adjustment program with close collaboration between the Fund and the World Bank. Cooperation between the two institutions thus far had been exemplary, extending over a long period of time and covering a wide range of policy areas, and the detailed policy prescription presented in the staff report was the result of that collaborative effort. The staffs of the Fund and Bank were agreed that it was important to implement a substantial part of the policy prescription at an early stage.

There were three main reasons why the staff felt that an early and substantial exchange rate adjustment was needed, the staff representative continued. First, detailed World Bank sectoral studies on the structure of costs and prices showed that a substantial exchange rate adjustment was needed to reactivate the agricultural and industrial sectors. Second, the implementation of the necessary structural and supply-oriented reforms would be greatly inhibited without an exchange rate adjustment; in particular, it would be difficult to effect a realignment of domestic prices, a liberalization of import and exchange restrictions, and tariff reform. Third, a major adjustment would help to generate revenue from the oil sector and so reduce the fiscal deficit; it would also be a means of reducing real expenditures in line with the diminished real resources currently available to Nigeria. It would, of course, be important for any exchange rate adjustment to be supported by other appropriate demand and supply policies.

The acute shortage of foreign exchange and supplies in the Nigerian economy had already resulted in the emergence of parallel markets for foreign exchange and a number of products, reflecting their scarcity value, the staff representative commented. Recent information suggested that the exchange rate in the parallel market was about three or four times the official rate; in the circumstances, a modest adjustment in the exchange rate, as a first step, would not be appropriate. As had been observed by several Directors, the imbalances and price distortions in the economy were too large and too deep seated for a moderate exchange rate change to generate the desired amount of confidence, both domestically and externally, in the Nigerian adjustment program.

Mr. Zhang wondered whether a devaluation, insofar as it applied to oil revenues, would create new money in terms of local currency.

The staff representative from the Exchange and Trade Relations Department replied that, while the foreign exchange earnings from oil would not change, a devaluation would lead to an increase in the domestic currency resources available to the budget and, if expenditures were tightly controlled, would generate forced savings or, at least, reduce the dissaving that had been taking place in the economy. In that way, a different pattern of use of the available foreign exchange, more suited to Nigeria's circumstances, would be achieved.

The staff representative from the African Department added that the heart of the issue was expenditure restraint. It was important to reduce the underlying fiscal imbalance and to use appropriate credit policies for sterilizing the increased liquidity that would result from the devaluation; at the same time, an attempt should be made to bring about the needed correction in the internal terms of trade.

Mr. Malhotra said that, as he understood it, the subsidization of oil did not arise only because of the exchange rate. If a domestic pricing issue were involved, it might be preferable to increase domestic prices as a way of soaking up liquidity in the system while helping the budget. The tendency of late seemed to be to justify a devaluation by citing the benefits that it would bring to the budget, but such benefits might not occur in all cases, particularly given the different regimes followed by various member countries. If the staff felt that the exchange rate in Nigeria was out of line, that was one thing; a devaluation should not be justified only on the grounds that it might benefit the budget when there were surer and more effective ways of achieving that goal.

The staff representative from the African Department remarked that the staff was not counting on the fiscal gains from the devaluation; rather, it was relying on expenditure restraint and a restructuring of government spending away from nontraded services and goods to traded services and goods. The fiscal impact of the devaluation in Nigeria's case, for example, could be troublesome if there were no expenditure restraint, precisely because of the increase in the local currency counterpart of government oil revenues. Mr. Zhang seemed to be suggesting that the increase in local currency stemming from a devaluation should not be a source of budgetary laxity. In fact, the objective of the fiscal policy proposed by the staff was to avoid such laxity through the application of monetary and fiscal expenditure restraints. The fiscal effects of a strong devaluation were complex. One effect, of course, was the generation of new resources, particularly from oil exports; nonetheless, other elements--for example debt servicing--were costly for the budget.

Mr. Nimatallah inquired about the expected impact of the devaluation on the external sector, particularly on exports.

The staff representative from the African Department replied that the matter should be viewed in a longer-run perspective, particularly in terms of the incentive that the devaluation would provide for import substitution. In the shorter run, the adjustment package was designed to deal not only with the exchange rate but also with the rationalization of tariff rates, which would be reduced significantly. The lower tariff rates would tend to divert economic activity from nonofficial channels to official channels; in other words, they would result in trade diversion into the official channels. The crux of the problem in Nigeria was the existence of an overvalued currency, which generated expectations of an even higher appreciation in the currency that might require exchange controls and very strict allocation of foreign exchange earnings. Such a development would not be sustainable. In order to rationalize the situation, the staff was proposing a general reduction in tariff rates as well as demand management policies that would tend to constrain import demand to sustainable levels through the corrective effect of the exchange rate adjustment on domestic production.

Mr. Nimatallah observed that the developments mentioned by the staff representative would occur over the medium term; he was more interested in the immediate effect of a devaluation, which would seem to make imports much more expensive and would thus reduce their volume but not necessarily their value in foreign currency.

The staff representative from the African Department responded that the efficiency of the use of imports would also be increased by the devaluation in combination with a tightly managed expenditure control mechanism.

The Chairman reminded Directors that imports in Nigeria were currently constrained not by cost but by import controls and the lack of foreign exchange. He understood why a number of Directors were advocating a less drastic devaluation; however, a gradual approach was not always applicable, especially in a situation in which the exchange rate had become strongly overvalued. It was important to break expectations and to provide a clear signal that the rate was going to move in the other direction. The gradual or smaller-step devaluation might encourage the market to take a wait-and-see attitude and would not provide the sort of movement toward the export sector and toward the surrendering of the proceeds of exports on the market that should be occurring. In general, it was not certain that a major change in the incentive mechanism could be effected through modest steps, which would not serve to break expectations.

Mr. Nimatallah considered that it might be better to look toward a reasonable initial devaluation--one that was neither too small nor too substantial--as Nigeria began its efforts to adjust. Then, depending upon the results of that devaluation, another step might be taken in, say, a year's time. The danger of a once-for-all substantial devaluation was that it might result in more harm than good; a somewhat more gradual, or "stepped," approach would allow for movement in the appropriate direction without so great a risk of harmful effects. Following a review of the effects of the initial adjustment, a decision could be taken about whether or at what pace to devalue again.

The Chairman said that staff and management were worried that beginning a new program with an inadequate level of competitiveness would result in failure. The staff had conducted a comprehensive study of the situation in Nigeria and felt strongly that a substantial devaluation was necessary.

Mr. Zhang noted that the Nigerian economy was quite rigid and that expectations might not be broken quickly, even with a substantial devaluation. He would appreciate further clarifications from the staff on the particular sectors and industries that would benefit from the move that was proposed. It would be helpful, for example, to know more about what was hampering export manufacturing or agricultural activities and about the profit positions of companies that might wish to engage in import substitution activities.

The staff representative from the African Department replied that the World Bank had completed a detailed study on various sectors of the economy, including the industrial sector by manufacturing categories and the agricultural sector. The indications were that, given the present exchange rate, a large segment of those sectors was experiencing negative rates of protection of between 35 percent and 50 percent. It was also clear that the agricultural sector had not been responsive to even the current heavy subsidization of inputs, because the prices for imported grains were such that it was more profitable to import grains than to produce them domestically. If Executive Directors were interested in further details of the World Bank study, he would be happy to circulate the text.

Mr. Malhotra said that he understood the staff to be suggesting that one of the benefits of the devaluation was that it would provide an opportunity to rationalize the import tariff structure, which presumably meant that duties would have to be reduced. It was of course possible that tariffs could be so structured or managed as to provide incentives to export industries or import substitution industries, but he was curious about the overall impact on imports that was envisaged. Assuming that the idea was not to increase import restrictions, and given that non-oil exports at present constituted about 2-5 percent of total exports and that the quantity of imports was not particularly elastic, then, apart from the beneficial effect of a devaluation on the effort to rationalize the tariff structure, the emphasis on a major devaluation might well be misplaced and might serve to delay the overall adjustment of the economy. What he and some other Directors were suggesting was that the emphasis should be less on a substantial devaluation than on needed improvements in other areas of the economy. He could accept an initial devaluation of reasonable size so long as the focus of the program was more properly placed on specific areas requiring improvement.

Mr. Mtei observed that, under the new Administration in Nigeria, there was a greater awareness of the need to manage the economy as a unit and to pursue--at both the federal and the state levels--policies that were consistent with the overall national goals. As he had stated in his introductory remarks, the previous Administration had budgeted to reduce 1984 expenditures by 29 percent; the new Administration had gone even further and envisaged that total expenditures in 1984 would be considerably less than the limit recommended by the World Bank. Under the new Administration, the states, local governments, and parastatal enterprises received directives from the Central Government and would be carrying out those directives more effectively than in the past. It was also recognized that financial discipline in expenditure was important at the federal level and, as had been reported in the press, drastic pruning measures had been implemented over the past few weeks, affecting both the current and capital budgets. In addition, the authorities were generally in agreement with the staff on the question of broadening the revenue base. The specific issue of subsidies and pricing of public utilities was under review.

On monetary policy, the bulk of credit expansion had been directed toward financing the government deficits, Mr. Mtei continued. Since the deficits were being brought under stricter control, credit expansion should slow. In addition, the rate of growth of credit to the private sector would be held to 15 percent in 1984, and the authorities had narrowed the spread between deposit and lending rates. They were also working to improve the financial infrastructure in order to enhance the resource mobilization role of interest rates.

In commenting on the external sector, Executive Directors had stressed the exchange rate issue, trade policy, and the debt service problem, including import payments arrears, Mr. Mtei recalled. With regard to the exchange rate, the authorities recognized that the naira was somewhat overvalued and had taken some steps to redress the situation. However, they remained concerned about the effects of a massive devaluation on the economic and social environment. And a number of Executive Directors--Mr. Nimatallah, Mr. Joyce, Mr. Alhaimus, Mr. Lovato, and Mr. Malhotra--had shown some appreciation of those apprehensions. He tended to agree with Mr. Nimatallah that the Nigerian situation raised doubts about the efficacy of a large exchange rate adjustment; the traditional export sector was very small, and most of what used to be traditional exports were currently domestic inputs for the new import-substitution industries. He could not agree that those industries were running at a loss because of the overvaluation of the exchange rate; the problem was rather a lack of raw materials and spare parts. In that connection, he wished to echo a point stressed by Mr. Zhang: in attempting to establish the magnitude of the required devaluation--and the authorities were not challenging the need for some devaluation--detailed and adequate analysis should be employed.

Turning to trade restrictions, Mr. Mtei said that his authorities agreed that the restrictions were only temporary palliatives; however, they could not be abruptly removed in the absence of adequate financial flows. Indeed, the authorities had pointed out that there was an apparent contradiction in that the country was critically short of foreign exchange and was accumulating payments arrears, yet was being urged to embark on an open-door policy toward imports. On external debt issues, Nigeria was current on the repayment of all debts except those with respect to import payments arrears. The authorities were vigorously pursuing the possibility of refinancing.

He welcomed the emphasis that Executive Directors had placed on the need for collaboration between the Fund and the World Bank in the effort to evolve a workable adjustment program for Nigeria, Mr. Mtei commented. As he had noted in his introductory statement, the authorities' intention was to request an extended arrangement with the Fund that would work in tandem with the structural adjustment loan that the authorities were currently negotiating with the World Bank.

In conclusion, Mr. Mtei remarked, he would like to make two specific points. First, the staff's statement that "the economic measures introduced in 1982 and 1983 were proving to be disruptive to efficiency in resource allocation, production, employment and trade, and, more importantly...[were] not suited to dealing with the fundamentals of the economic and financial crisis" had not been agreed with the Nigerian authorities as claimed on page 8 in the staff report. Second, in response to a comment by Mr. Blandin, although Nigeria might have had its share of economic difficulties in the recent past, the situation at present was not as serious as that obtaining in Ghana or Zaïre; hence, the extent of adjustment required in Nigeria could not be comparable to that which was required in those countries.

The Chairman made the following summing up:

Executive Directors expressed broad agreement with the staff's analysis of Nigeria's economic problems and with the general thrust of the analyses and appraisal in the report on the 1983 Article IV consultation. Directors noted that the authorities were confronted with serious fiscal and external payments difficulties, including the virtual depletion of official reserves and an accumulation of large import payments arrears. The public finances of the Federal Government and the state governments had deteriorated sharply; the overall budgetary deficit of the Federal Government alone had exceeded the equivalent of 16 percent of GDP in 1983, putting further strains on the external payments position and fueling domestic inflationary pressures. Meanwhile, economic activity had declined, with the emergence of widespread underutilization of productive capacity caused by a growing shortage of foreign exchange for imports. All Directors stressed that such a situation was most worrisome and unsustainable.

Directors agreed that an important factor in the major turnaround of Nigeria's economic and financial performance had been the sharp and sudden drop in oil revenues on which Nigeria has over the years grown heavily dependent or perhaps, some Directors said, overdependent. But they stressed that the growing difficulties also reflected major structural weaknesses and distortions rooted deep in past economic policies. Directors recalled that, in the wake of the oil boom, the authorities had resorted to generally expansionary fiscal and monetary policies, supported by increasing reliance on a system of complex administrative import controls and industrial regulations, to promote accelerated development and industrial diversification, while the exchange rate had been allowed to appreciate consistently. As a result, Directors noted, Nigeria had experienced a pattern of sectorally uneven growth, a disappointing agricultural sector performance, a considerable shrinkage of non-oil exports, the emergence of high-cost, import-intensive consumer goods industries behind high protective tariffs, a heightened dependence on imports, and an increased vulnerability to adverse fluctuations in the oil market.

Directors pointed out that the emergency fiscal and restrictive trade measures introduced by the authorities since 1982 had not been effective in dealing with the real cause of the external payments and fiscal crisis; rather, they said, the measures could only compound the longer-term adjustment problems through their distorting impact on relative prices, economic incentives, and resource allocation. Serious concern was also expressed about the additional restrictions imposed early in 1984 by Nigeria on trade and payments and about the general trend toward insulating the Nigerian economy from international trade. While noting that trade liberalization would depend, inter alia, on the availability of adequate external financing, Directors urged the authorities to remove the restrictions as soon as possible and to follow appropriate adjustment policies.

Directors urged the authorities to shift from ad hoc administrative controls to the introduction of fundamental changes in economic policies, including the use of a rational policy on prices, as part of a comprehensive medium-term program for economic stabilization and structural adjustment. Directors welcomed the fact that the authorities generally agreed with the staff on the nature of the problems and the thrust of the corrective actions needed. Only such an adjustment effort, Directors felt, could create the basis for achieving broad-based noninflationary growth, reduced dependence on oil, and a viable external payments position.

It was observed that fiscal data were not current and were inadequate, and the suggestion was made that technical assistance from the Fund in this field would be helpful. Directors also expressed serious concern regarding the financial situation of the states, which played a large fiscal role in Nigeria. The need to get the state governments to contain their expenditure in a way consistent with the overall fiscal targets was stressed. Similarly, considerable improvement was called for in the performance and discipline of public enterprises, areas where strong coordinated action by the Fund and the World Bank would be needed.

Directors stressed the urgent need for a decisive move toward a comprehensive and strong adjustment strategy. Most Directors considered that the policies described by the staff in the report provided a sound basis for policy actions. The required program should feature much needed tightening in demand management policies centered on strong fiscal adjustment at all levels of government together with vigorous monetary and credit policy measures, including the pursuit of a more flexible interest rate policy. The adjustment program should also envisage necessary structural changes in several areas, notably those directed toward a subtantial improvement in state government finances and reform of public enterprises; the re-establishment of appropriate cost-price relations, especially in oil product prices, where strong readjustments are needed; and a balanced structure of incentives to promote supply. A number of Directors stressed the need to take steps toward a broadly based sales tax, and they urged the authorities to implement at an early stage the recommendations of the task force on public corporations.

As regards exchange rate policy, while a number of Directors stressed the need to take carefully into account all the consequences of a devaluation and to adopt a gradual approach, a broader view was that a substantial initial adjustment in the exchange rate to be followed by a continuing flexible exchange rate policy should be central to the needed rationalization of external sector policies and a viable adjustment process, in which diversification away from heavy reliance on oil would take place. In this connection, Directors underscored the need for a reform of the customs tariff, to make it a simplified and more uniform one for effective industrial protection, and the crucial role of a progressive liberalization of imports and exchange restrictions. It was considered by many Directors that an appropriate program of structural adjustments should be placed in a medium-term framework and should be a matter for active and close collaboration between the Fund and the World Bank.

Directors noted that, even with appropriate adjustment policies, Nigeria would be faced with sizable external financing gaps over the next three years, due in large part to the bunching of debt service payments on public and publicly guaranteed external debt and the massive stock of import payments arrears that would have to be settled. Directors urged the authorities to follow a coordinated multilateral approach in the negotiations with their creditors to reschedule these payments, and to use debt relief or new external financing obtained to support a fundamental economic adjustment.

It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

--

The Executive Board then turned to the proposed decision concluding the 1983 Article XIV consultation with Nigeria.

The staff representative from the African Department proposed that the words "and SM/84/17 and Supplement 1" should be incorporated in paragraph 2 of the decision after the reference to "SM/83/250." As shown in the SM/84/17, Supplement 1, dealing with changes in the exchange system since January 1, 1984, no substantive changes warranting modifications in the decision had taken place; in general, the proposed addition would serve to introduce a reference to the most recent documents available.

The Executive Board accepted the proposal by the staff and adopted the decision as amended.

The decision was:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Nigeria's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Nigeria, in the light of the 1983 Article IV consultation with Nigeria conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Nigeria continues to maintain several restrictions on payments and transfers for current international transactions, as described in SM/83/250 and SM/84/17 and Supplement 1. Since the previous Article IV consultation, Nigeria has increased the restrictiveness of its exchange system and has accumulated payments arrears on imports. It also continues to maintain a non-interest-bearing advance deposit on the opening of letters of credit, which was introduced on April 21, 1982, giving rise to a multiple currency practice subject to Article VIII, Section 3. The Fund notes that this measure was introduced for balance of payments reasons and maintained temporarily for the purposes of monetary control; the Fund encourages the authorities to remove it, as well as the other restrictions, including the payments arrears, as soon as possible.

Decision No. 7625-(84/23), adopted
February 13, 1984

2. LEVEL OF FUND SDR HOLDINGS - REVIEW; AND USE OF CURRENCIES UNDER OPERATIONAL BUDGET

The Executive Directors considered staff papers reviewing the level of the Fund's SDR holdings (SM/84/24, 1/19/84) and setting forth certain issues arising in relation to the use of currencies under the operational budget (SM/84/23, 1/19/84).

The staff representative from the Treasurer's Department drew the attention of Executive Directors to the suggestion in SM/84/24 that the Fund's holdings of SDRs would probably be about SDR 6.4 billion by end-February or early March 1984. In fact, some expected purchases had not materialized, which meant that the transfers of SDRs under the existing budget would be less than expected earlier. As a result, the Fund's holdings of SDRs would be about SDR 6.8 billion at the beginning of the next budget period, which would necessitate sales of SDRs over the next five budgets of something in excess of SDR 4 billion, rather than SDR 3.9 billion as had been projected in the paper.

The paper on the use of currencies under the operational budget (SM/84/23) contained no specific recommendations, the staff representative observed. The staff's preference was to continue with the current practice of making ad hoc adjustments for a few members with relatively small quotas in relation to reserves, but the staff would of course be guided by the views of the Executive Board.

Mr. Nimatallah remarked that the staff paper reviewing the level of the Fund's SDR holdings was well balanced and convincing, and he could support the proposed decision. Determining the appropriate level of the Fund's SDR holdings was largely a matter of judgment: on the one hand, the institution should hold a reasonable amount of SDRs to meet its operational needs and for liquidity considerations; on the other hand, since SDRs had been created as reserves for members, the Fund should do all that it could to promote the SDR as a means of payment and as a reserve asset by using SDRs in the operational budget. Hence, it might not be reasonable for the Fund to hold too large a proportion of the total SDRs allocated.

At present, following the recent quota increases, the Fund's holdings of SDRs were clearly well above operational requirements and represented a large proportion--about 30 percent--of total allocations, Mr. Nimatallah continued. However, the Fund had to be prudent in disposing of its liquid assets, in view of its already large and growing liquid liabilities. On balance, there appeared to be a need for a steady and orderly reduction in the Fund's SDR holdings in the period ahead. The staff's proposal to reduce the holdings to about SDR 4 billion by May 1985 was appropriate, as was the proposed review of the policy before April 1985. At that time, the Executive Board should be in a better position to judge whether further reductions would be needed.

The paper on the use of currencies under the operational budget (SM/84/23) raised an important issue of principle with regard to the method by which the Fund allocated currencies for use in the operational budget, Mr. Nimatallah remarked. Specifically, the Executive Board was being asked to consider the desirability of continuing with ad hoc limitations on the use of currencies of certain members with small quotas. As previous discussions had shown, there was no easy answer to the question. The Fund of course needed to have a clear and uniform principle for allocating sales of currencies among members in order to ensure that the costs and benefits of lending to the Fund were distributed in a rational and equitable manner; it was essential to avoid discriminatory treatment that could make members reluctant to lend their currencies to the Fund. At the same time, it was important to ensure that the principle on which currencies were allocated was one that best served the Fund's liquidity needs over time. Traditionally, those considerations had led the Fund to use members' currencies in relation to their gold and foreign exchange holdings, an approach that had been confirmed by the Executive Board in September 1979 and again in March 1981. He could fully support the approach, because it was both sensible and fair that members' contributions to the financing of Fund operations should be related to the resources that members had available for that purpose.

On the other hand, as earlier papers on the subject had indicated, the Fund had maintained flexibility in adapting its procedures for allocating currency sales to the needs and circumstances of individual members, Mr. Nimatallah continued. The importance of such flexibility had been specifically recognized in the March 1981 decision, and he did not feel that the intention had been to apply the Fund's traditional approach without taking other relevant factors into account. The level of the Fund's holdings of a particular currency in relation to the member's quota was one such consideration; and a limitation on the Fund's use of members' currencies based on that consideration had been employed after 1979. Although the limitation had been removed in March 1981, in anticipation of an expansion in Fund credit, it had been recognized at the time that ad hoc methods for adjusting the allocation for one or more currencies could, on occasion, be necessary.

Turning to the issue at hand, Mr. Nimatallah noted that the Fund had an agreed and appropriate method for allocating currency sales. However, that method had resulted on occasion in sales of certain currencies in amounts that were two or three times the average in relation to quotas, something that had caused difficulties for some members. As the staff had pointed out, those difficulties were likely to persist. One solution to the problem might be to continue to apply the present ad hoc limitations on the use of some members' currencies, when necessary. While he could agree to such an approach, he would emphasize the words "only when necessary." The Fund had taken account of the special circumstances of members with small quotas in the past, but very few countries had been involved, and the amounts had been small. Still, the procedure ran the risk of turning ad hoc exceptions into something of a more permanent character, which would not be consistent with the principle that members' rights and obligations should be uniform. In the circumstances, he wondered whether it might not be preferable to establish a more general rule or understanding that would combine uniform treatment with the flexibility necessary to take account of the real concerns of members with small quotas. Such a general understanding would be one way of resolving the problem--which was otherwise likely to arise with each operational budget--in a manner that would avoid discriminatory treatment of members. The understanding could of course be reviewed regularly in the light of developments in the Fund's liquidity position.

Mr. Clark stated that, on the question of the Fund's SDR holdings, he was in agreement with the views expressed by Mr. Nimatallah. The high proportion of SDRs currently held by the Fund did not help preserve the reserve-asset function of the SDR, and he could therefore endorse the objective of reducing the Fund's holdings of SDRs to about SDR 4 billion by end-May 1985; he hoped to see a substantial further rundown by the end of the following financial year.

On the use of currencies under the operational budget, the position of his chair was well known, Mr. Clark continued. His authorities would prefer to see the elimination of ad hoc restrictions on the use of currencies and the full implementation of the principle of uniformity of treatment. Short of that, however, they would prefer that the execution of the operational budget should mitigate informally the use of particular currencies rather than that the Board should adopt any general rule relating the use of a currency to the level of the Fund's holdings of that currency.

Mr. Tvedt observed from SM/84/24 that the Fund's holdings of SDRs, following the Eighth General Review of Quotas, had been increased by January 1984 to about SDR 7 billion, an amount equal to 30 percent of total SDR allocations. In order not to limit the role of the SDR in the international monetary system, it was important that the required holdings should be channeled back to members over a reasonable period. Of course, he recognized that the Fund needed to hold some SDRs for operational reasons and that, at present, the holdings of SDRs had a beneficial effect on the Fund's net income position. However, consideration of the Fund's income position should not be a primary factor in determining the level of the Fund's SDR holdings.

The staff's proposal to reduce those holdings to SDR 4 billion by end-May 1985 seemed reasonable, as did the suggestion to reduce them further to SDR 1.5 billion over a period of two and one-half to three years, Mr. Tvedt continued. The latter target should, however, be reviewed before May 1985 in order to accommodate possible changes in operational needs linked to further quantitative or qualitative developments relating to SDRs.

On the use of currencies under the operational budget, Mr. Tvedt said that he shared the view that the Fund should continue to use members' reserves as the main criterion in distributing amounts of currencies to be sold under the operational budget. The Fund should of course adhere to as uniform a method as possible, and the use of ad hoc adjustments should therefore be limited to those situations in which the holdings of a country's currency would be reduced to a substantially lower level than the average. With that proviso, however, he could accept a continuation of the present practice.

Mr. Schneider stated that, in principle, he had no difficulty with the staff's recommendations regarding the level of the Fund's SDR holdings, although he would have preferred a bolder approach that would promote a more active use of the SDR through a faster rundown of those holdings. The proposal to reduce the Fund's holdings of SDRs to SDR 4 billion by end-May 1985 would, if implemented, mean that almost 19 percent of cumulative allocations would still be held by the Fund. A more active use of SDRs would result in a smaller buildup of reserve positions and, within the legal obligations, there appeared to be ample room for a somewhat larger absorption of SDRs by countries judged sufficiently strong to accept them. In general, the Fund should place greater emphasis on promoting the use of SDRs among participants rather than on keeping a large proportion of allocated SDRs in its own portfolio. If the Fund were to increase the amount sold under each operational budget by about SDR 200 million, the Fund's holdings could be reduced to some SDR 3 billion by May 1985, a pace that he did not find excessive.

With regard to the paper on the use of currencies under the operational budget, Mr. Schneider said that his views were similar to those of Mr. Clark. There were only four countries with relatively small quotas that were likely to be affected by ad hoc adjustments in future. However, a comparison of members' reserve tranche positions with their quotas or their holdings of foreign exchange showed that all four countries were below the average. Hence, beyond his belief in the principle of the uniform treatment of members, he would prefer discontinuing ad hoc adjustments for those few countries whose quotas were small in relation to their reserves.

Mr. Grosche said that his chair could support an early and substantial reduction in the currently record high level of the Fund's SDR holdings. While his authorities could go along with the proposed decision in SM/84/24, they wished to record their view that the proposed average transfer of SDR 800 million in each of the next five operational budgets should be regarded as a minimum. Their view had been strengthened by the introductory remarks of the staff, in which the estimates of the Fund's holdings of SDRs by the beginning of the next budget period had been updated. In general, a reduction below the target of SDR 4 billion by end-May 1985 seemed both feasible and desirable.

The view of his authorities was based on a number of considerations, Mr. Grosche noted. First, SDRs were primarily reserve instruments and should facilitate certain transactions between member countries and the Fund. Second, the Fund's income should continue to be a subsidiary factor in decisions on the level of the Fund's SDR holdings. On page 5 of the paper, the staff had implicitly put forward the idea that the shrinking gap between the SDR interest rate and the rate of remuneration should be offset by higher SDR holdings in order to obtain the same amount of revenue from that source. In his view, that line of reasoning carried less weight than other considerations that spoke in favor of a reduction. Finally, the argument for holding a certain amount of SDRs for the operational needs of the Fund had some merit, although an amount of SDR 1 billion should suffice, considering that a stronger use of SDRs within the operational budget would reduce the need to include freely usable currencies. In that respect, the overall liquidity position of the Fund would not be affected, and a particularly high level of SDRs for working balances would not seem to be necessary.

On the matter of the adjustments made by the staff in distributing amounts of currencies to be sold by the Fund under operational budgets, Mr. Grosche considered that the current practice should be maintained, especially as the staff had presented no new arguments that would make a strong case for a change. The Fund's liquidity would continue to be best served by relating the use of currencies to members' reserves. However, in determining the currencies to be used, the Fund should maintain flexibility; hence, he was not in favor of a general rule under which the distribution of currencies in the operational budget would have to take some account of the Fund's holdings of currencies. He could go along with a procedure that provided special treatment for a few countries on an ad hoc basis. The adjustments should not be regarded as a permanent feature of operational budgets; otherwise, they might violate the principle of uniform treatment of members.

On another matter, Mr. Grosche commented on the final sentence on page 4 of SM/84/24, wherein the staff had hinted at the possibility of using "a certain amount of flexibility in the execution of the operational budget so as to moderate the speed with which the Fund's holdings of currencies would be reduced in the event that some currencies were being sold at a rate considerably in excess of the average percentage reduction of holdings." He was not in favor of such a provision, which would run the risk of allowing changes in already agreed upon operational budgets and might be interpreted as a general rule that could hamper the necessary flexibility that the Fund should employ in conducting its business.

Mr. Lovato supported the staff's view that the Fund's holdings of SDRs should be reduced in the coming months by a substantial amount, at least as large as that mentioned in the proposed decision. The aim of enhancing the importance of the SDR as a reserve instrument in the international monetary system could be achieved only if SDR holdings outside the Fund increased at a steady rate that was perhaps faster than the rate of increase of overall reserve assets. Excessive holdings by the Fund that were not justifiable on the grounds that they were needed for transactions or, to a limited extent, for liquidity considerations, might adversely affect the role of the SDR as a means of official payment in the international community. If the Fund considered that role important, it should not be undermined by emphasis on other considerations.

Taking up the staff paper on the use of currencies under the operational budget, Mr. Lovato agreed with the staff's assessment of the problem and with the solutions suggested for the short run. In the past, ad hoc adjustments had been employed to meet the concerns of some small member countries on the use of their currencies, which appeared excessive in relation to their quotas; there was no compelling reason at present to suggest that those countries' concerns should not continue to be met. As he favored flexibility, he could agree that no strong justification existed for the adoption of general rules to limit the use of currencies by the Fund.

The apparently "small" problem described by the staff was actually a manifestation of the more general problem concerning the adequacy of quotas in relation to countries' relative participation in the Fund and in the world economy, Mr. Lovato commented. All countries for which ad hoc adjustments were likely to be necessary in the next four operational budgets appeared to have calculated quotas that were substantially higher than their actual quotas. It was frequently also true for larger countries that the Fund's use of currencies was substantially and systematically out of balance in relation to quota shares. In providing the general guidelines for the use of the Fund's resources, the Articles of Agreement explicitly mentioned the "desirability of promoting balanced positions in the Fund." While that principle was related in particular to the selection of currencies under Article V, it was questionable whether a meaningful balance in countries' positions in the Fund could actually be achieved if substantial discrepancies persisted in members' quotas in relation to their reserves or in relation to the use of their currencies by the Fund. The notion of a "balanced position in the Fund" should be understood in a broad sense, and a more careful consideration of the role that different currencies played in the Fund's operations could help to improve that balance.

Mr. Hirao remarked that the present level of SDR holdings by the Fund was rather high, and that it would be desirable to reduce it fairly quickly. However, taking into account the current level of the Fund's liquid liabilities, he could accept the proposal to reduce the Fund's SDR holdings to about SDR 4 billion by end-May 1985.

As a basic principle, it had been agreed that the level of a member's reserves should provide the basis for determining the amounts of its currency to be sold under the operational budgets, Mr. Hirao recalled. That principle should be maintained because it was consistent with the provisions of the Articles and helped to achieve harmonization of members' positions in the Fund in relation to their reserves. It might be necessary to continue the practice of making ad hoc adjustments in the cases of certain members whose quotas were small in relation to their reserves, but that should be exceptional. Despite his reservations about the ad hoc adjustments, he could not support the alternative of adopting a general rule to take into account the Fund's holdings of currencies in framing the operational budgets. The present practice of making ad hoc adjustments to limit the use of certain currencies had worked fairly well; given that the amounts involved had been relatively small, he saw no reason to modify the practice.

Mr. Costa stated that, in light of the decision adopted in May 1983 and the developments described in SM/84/24, he had no objection to the proposed reduction in the Fund's holdings of SDRs in the period through end-May 1985. The pace of the reduction should perhaps be even faster than that proposed, particularly in light of the staff's view that the operational needs of the Fund could be adequately met by working balances of the order of only SDR 1 billion. However, circumstances might change from time to time that could affect the Fund's liquidity and its operational needs, and it was a difficult matter of judgment to establish a specific optimal level of SDR holdings. In the circumstances, he could support the proposed decision as it stood.

Commenting on the issues arising in relation to the use of currencies under the operational budget, Mr. Costa noted that the staff seemed to be implying that a moderate divergence from present practice would not create any significant problems either for the countries concerned or for the Fund. Hence, he could go along with either of the first two alternatives mentioned on page 3 of SM/84/23, if those were acceptable to the majority of the Board.

Mr. Polak stated that, like others, he could support the proposed decision to reduce the Fund's holdings of SDRs to about SDR 4 billion by May 31, 1985. With regard to the issues in SM/84/23, he felt that, in principle, it would be wrong to deviate from the practice of using currencies in proportion to members' reserves. As a practical matter, however, he had no difficulty with the ad hoc proposals to limit the pace at which the Fund reduced its holdings of the currencies of certain small-quota members. Finally, like Mr. Grosche, he was not in favor of the solution proposed in the final sentence on page 4 of SM/84/24, which seemed to suggest that the Fund would draw up a currency budget on the basis of an established rule but, depending on circumstances, would execute it somewhat differently.

Mr. Alhaimus remarked that he could support the proposed decision on the level of the Fund's SDR holdings. It was important to decrease those holdings at a gradual pace while keeping in mind the high and rising levels of the Fund's liquid liabilities. In deciding on the amount by which the SDR holdings were to be reduced over a given period, some attention should be paid to the impact of such a reduction on the Fund's income position and on the rate of charge to borrowers. It was possible, as shown in the staff paper, that a fast pace of reduction could increase the pressures on the Fund's net income that would arise from the increase in the rate of remuneration resulting from the recent decision to bring that rate closer to the interest rate on the SDR.

On the issues concerning the use of currencies under the operational budget, Mr. Alhaimus agreed with the staff that considerations regarding adjustments in currency sales of some members whose quotas were small both in absolute terms and in relation to their reserves would continue to be valid, at least for the next four quarterly budgets. Without such adjustments, the method of determining currency sales--which had been adopted in March 1981--would result in sales of a number of currencies exceeding the average sales as a percentage of quota by a wide margin. Having reviewed the alternative approaches outlined on page 3 of SM/84/23, he could support the maintenance of present practice rather than the second alternative. As he understood it, the flexibility in executing operational budgets that the staff had in mind under the second alternative would result in the same distribution of currencies as under present practice. However, shifting the adjustment to the execution stage might have certain drawbacks, one of which was the possible misinterpretation by members whose currencies were being used of what the amounts proposed in the budgets really meant. Another drawback was that the approach might require the inflation of proposed budgets in order to compensate for adjustments in the amount of relevant currencies or, alternatively, a greater use of other currencies than had been proposed in the budget. In light of those considerations, he favored the maintenance of present practice, and he could go along with limiting the net use of the relevant currencies to 5 percent of quota, which was the average for the next four quarters.

Mr. Joyce commented that he had no difficulty with the staff recommendation that the Fund should reduce its holdings of SDRs to about SDR 4 billion over the period until end-May 1985. That level appeared to be more than adequate to meet the Fund's liquidity and operational needs. With regard to the issues in SM/84/23, he had some sympathy for those countries that occasionally experienced problems because their quotas were small in relation to their reserves. He could therefore support a continuation of the present practice of making adjustments to limit the speed at which the Fund reduced its holdings of the currencies of such members. He did not believe that a general rule was needed.

Ms. Bush took note of the indication by the staff that potential liquidity needs caused by larger reserve tranche positions following the latest quota increase would seem to support a high level of SDR holdings; on the other hand, it could easily be argued that a lower level would be more appropriate. The staff had pointed out, for example, that the proposed level of holdings of SDR 4 billion at end-May 1985 was far higher than what was required as a working balance; moreover, that level was equivalent to about 4.4 percent of quotas, whereas the targeted December 1983 level of SDR 1.5 billion was equivalent to only 2.4 percent of quotas. Despite those two considerations, in view of the potential liquidity needs of the Fund she could go along with the targeted reduction to SDR 4 billion by end-May 1985, provided that a review of the situation was conducted prior to that date.

On the issues arising in relation to the use of currencies under the operational budget, Ms. Bush considered that the concerns expressed by small-quota countries reflected an underlying problem related to the issue of the rate of remuneration. It was not surprising that small-quota countries were reluctant to have their currencies used when the rate paid on the unremunerated reserve tranche positions was not competitive. The situation could of course be resolved by setting the rate of remuneration equal to the interest rate on the SDR, and progress toward that end had begun. Until parity was reached, however, she had some sympathy for those countries for which the budgeted use of their currency was high in relation to their quotas; and she could go along with a continuation of the practice of making ad hoc adjustments in certain cases. Still, the staff and the Executive Board should keep in mind the desirability of avoiding the perception that small-quota countries did not have a responsibility for helping with the financing of the Fund.

Mr. Ismael noted that, prior to the recent quota increase, the level of the Fund's SDR holdings had been appropriate; the additional inflow of SDR 5 billion in the form of payments by members contributing to the Eighth Quota Review subscription had made the level higher than necessary. In his view, an appropriate level for the Fund's SDR holdings would be equivalent to approximately 25 percent of all SDRs allocated; however, he could be flexible on that amount in view of the absence of any new allocations over the past several years, despite continued calls for a supplement to global reserves. In that connection, he would appreciate an explanation of why the Fund's holdings of SDRs had in the past been related to allocations, since the criteria referred to in paragraph (iii) on page 5 of SM/84/24 seemed adequate to ensure that the Fund could meet its operational requirements and obligations. In spite of the currently high SDR holdings, he could see advantages in a gradual reduction along the lines mentioned by the staff, and he could therefore support the proposed decision.

With regard to the second item under discussion, Mr. Ismael considered that there were two main shortcomings in the present method of determining amounts of currencies to be used under operational budgets. First, members' rights and obligations in the Fund were defined in terms of Fund quotas, and there seemed to be no logical reason for using a different yardstick to define members' obligations for allowing their currencies to be used in the operational budget. Second, a number of countries had a policy of holding large reserves--sometimes through borrowing--for various reasons, inter alia, to meet unforeseen needs or to create and maintain confidence in their ability to meet existing or potential foreign exchange liabilities. In that respect, it was undesirable to include members' currencies in the operational budget solely on the basis of their reserves. On balance, he could support the continuation of the present method of making ad hoc adjustments for countries whose quotas were small in relation to their reserves. Such adjustments would likely be for only small amounts and would involve very few members; their impact on the additional use of other members' currencies included in the budget would continue to be small in relation to their gold and foreign exchange holdings.

Mr. Malhotra said that he too could go along with the proposal for reducing the Fund's SDR holdings to SDR 4 billion by end-May 1985. The current level was too high and should be reduced, although the pace of reduction should be gradual; although the Fund's income position should not be the sole guiding factor in determining an appropriate level for the Fund's holdings of SDRs, it should not be completely ignored. In that connection, the end target of SDR 1.5 billion should perhaps be reconsidered during the 1985 review. His own feeling was that the target might have to be increased rather than reduced. Finally, with regard to the issues outlined in SM/84/23, he was in favor of maintaining the use of ad hoc adjustments to limit the sales of some currencies under the Fund's operational budget.

Mr. Morrell stated that, like others, he could support the staff's recommendation to reduce the Fund's holdings of SDRs to about SDR 4 billion by May 31, 1985, a target that seemed reasonable in view of the uncertainties about future SDR allocations and the Fund's liquidity position. He also agreed with those who felt that the level of the Fund's income should not be a major factor in determining the level of the Fund's holdings of SDRs.

With regard to the use of currencies under the operational budget, Mr. Morrell said that he tended toward the position of Mr. Clark and others who felt that the use of currencies should be based on the strength of countries' reserves. However, he could agree to continue the practice of making ad hoc adjustments in special cases.

Mr. Zhang commented that he could support the proposed decision on the level of the Fund's SDR holdings and accept the proposal to continue making ad hoc adjustments in the sale of currencies--for the purposes of the operational budget--of those countries with relatively small quotas and high reserves.

Mr. Hassan considered that the amount of SDRs to be transferred in purchases under the operational budget should continue to be determined on the basis of a longer-term view of the appropriate level of the Fund's SDR holdings. Staff analysis showed that the present level of the Fund's holdings of SDRs--SDR 6.4 billion--was higher than might be necessary, and he could support the proposed decision to reduce that level to SDR 4 billion by end-May 1985. With regard to the use of currencies under the operational budget, the principle of relating the use of members' currencies to the level of their reserves should be maintained, and he could support the continuation of the present practice of making ad hoc adjustments in certain cases.

Mr. Salehkhou noted that the level of SDR holdings in the General Department was a function of the inflows and outflows taking place in a given period. The level had risen rapidly in recent months--because of subscription payments under the Eighth General Review of Quotas--and should be reduced. However, prudential considerations called for a reduction that should not be too large or too fast; unbudgeted or unpredicted needs might arise in the future that could demand larger SDR holdings by the Fund. While most available economic forecasts for 1984 and 1985 were sanguine, the Fund's liquid liabilities were quite large and would seem not to warrant a sizable reduction in the level of the Fund's SDR holdings. Moreover, large changes might develop in the usability of the currencies of individual members, which would enhance the argument for maintaining the Fund's SDR holdings at an appropriate level.

Commenting on the effect of the Fund's SDR holdings on net income, Mr. Salehkhou noted that, with the recent Board decision to increase the rate of remuneration gradually to equal the SDR interest rate, the impact of the Fund's average holdings of SDRs on net income would decrease accordingly. While it should not be the primary consideration in determining the level of SDRs held by the Fund, it was reasonable to pay some attention to the impact on net income, at least until parity between the rate of remuneration and the SDR interest rate was reached. For fiscal year 1984, revised net income estimates showed a considerable decline from original projections, and any inappropriate reduction in the level of SDRs held by the Fund could have adverse consequences for the Fund's income as well as for the rate of charge. The recent decision to increase the rate of remuneration had already created a situation in which pressure could soon mount for an upward adjustment in the rate of charge. On balance, the target figure for the Fund's SDR holdings of SDR 4 billion by end-May 1985 seemed appropriate in present circumstances, and he could support the proposed decision.

The issues arising in relation to the use of currencies under the operational budget had been discussed at various times by the Executive Board over the past few years, and a compromise had been implemented since early 1982, Mr. Salehkhou recalled. Article V, Section 3(d) of the Fund's Articles of Agreement provided that, in adopting policies and procedures for operational budgets, the Fund should be cognizant of both the balance of payments and reserve positions of members and should take account of developments in the exchange markets as well as the desirability of promoting balanced positions in the Fund. The observance of the criterion of maintaining balanced positions meant that special adjustments could be made for those countries with relatively small quotas whose currencies were sold at a relatively higher ratio to their quotas than was the case for other members. It had been agreed, therefore, that operational budgets should include ad hoc proposals to maintain some balance in those instances. The overall experience with the ad hoc procedure had been satisfactory, even though in recent budgets, there had been a somewhat higher average use of currencies of small-quota members relative to the average for all members whose currencies were sold under the operational budgets. Moreover, the net effect on other members had not been disruptive. While he sympathized with those small-quota countries that found themselves out of line with the average trend, the ad hoc adjustments made thus far seemed to have eased the pressure on those countries and had helped to maintain a certain amount of flexibility in the Fund's operations.

One of the alternative methods described by the staff was to work out a general rule to distribute the currencies in the operational budget based partly on the Fund's general holdings of currencies, Mr. Salehkhou noted. That approach did not meet with the staff's approval, because, at present, the Fund's liquidity was not under strain; however, it was acknowledged that the level of the Fund's holdings of currencies at a time of liquidity constraint, or when the level of holdings of certain currencies was too low, might be a factor for consideration. If so, then the alternative method as outlined could become acceptable in future. He would appreciate staff comment on that matter as well as some elaboration on the possibility of using currencies in broad proportion to the amounts included in the operational budget. In the meantime, he could go along with the proposal to continue with the present method--which was flexible and appropriate in current circumstances--of using ad hoc adjustments.

Mr. Portas stated that, like others, he could support the proposed decision on the level of the Fund's SDR holdings and that he favored the continuation of current practice with regard to the use of currencies under the operational budget.

Mr. Orleans-Lindsay said that, in view of the high proportion of SDRs held by the Fund at present, he too could support the aim to reduce the Fund's holdings gradually to SDR 4 billion by end-May 1985. Of course, the Fund's liquidity position should not be ignored, and he hoped that the scheduled review in 1985 would take that element into account. On the use of currencies under the operational budget, he could support the present practice of making ad hoc adjustments.

The staff representative from the Treasurer's Department, responding first to comments on the level of the Fund's holdings of SDRs, considered that Executive Directors should perhaps not focus too much on the amount of SDRs that the Fund should sell in each operational budget, because those amounts might change depending upon unforeseen developments in the Fund's holdings. It would be preferable to focus on the overall target for end-May 1985.

On the criteria used by the staff in determining an appropriate level for the Fund's SDR holdings, the staff representative noted that an appropriate ratio of holdings to total SDRs allocated was largely a matter of judgment. The staff was inclined to feel that holdings of one third of total allocations was probably too high, but it was difficult to come to any firmer view. It was clear that a level of at least SDR 1 billion would be needed to fulfill the purely operational requirements, but liquidity considerations would seem to call for a somewhat higher figure. In current circumstances, the staff had felt that the end target might be somewhat higher than the SDR 1.5 billion minimum agreed upon on the previous occasion.

Taking up the issues arising in connection with the use of currencies under the operational budget, the staff representative remarked that the current procedures appeared to work well. In response to a point raised by Mr. Salehkhou, he agreed that the time might well come when the Fund's holdings of certain currencies were so depleted that there would be strong reasons for conserving holdings of those currencies for specific operational reasons. For example, under borrowing agreements, there were certain currencies that the Fund was able to use to make repayment of borrowing, while other currencies could not be used for that purpose. However, the situation at present did not seem to warrant any general understanding on the approach that should be taken in such circumstances.

The Chairman, summing up the discussion, observed that the Executive Board was apparently in agreement with the proposed decision on the level of the Fund's holdings of SDRs and could accept, for the time being, the continuation of the practice of making ad hoc adjustments on the sale of members' currencies under the operational budget.

The Executive Board then adopted the following decision:

In determining the amounts of SDRs to be transferred in purchases under the operational budgets, the Fund will be guided by the aim of reducing the Fund's SDR holdings to a level of approximately SDR 4 billion by May 31, 1985. Prior to April 30, 1985, the Fund will review the level of its SDR holdings to determine whether and to what extent they should be further reduced.

Decision No. 7626-(84/23) S, adopted
February 13, 1984

APPROVED: August 6, 1984

JOSEPH W. LANG, JR.
Acting Secretary