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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/51

3:00 p.m., April 2, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	H. G. Schneider
	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	M. K. Bush
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	
	L. Leonard
	G. W. K. Pickering, Temporary
A. Kafka	
	G. Grosche
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
J. Tvedt	
N. Wicks	T. A. Clark
	Wang E.

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: S. Ishii. European Department: S. Kashiwagi. Exchange and Trade Relations Department: H. W. Gerhard. IMF Institute: C. Tognetti. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. S. Cutler, D. Gupta, Q. Md. Hafiz, T. B. C. Leddy, D. V. Pritchett, G. Wittich, B. B. Zavoico. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. El-Khouri, Y. Okubo. Assistants to Executive Directors: E. M. Ainley, J. R. N. Almeida, J. Bulloch, M. Camara, Chen J., D. Hammann, A. K. Juusela, H. Kobayashi, A. Koné, A. A. Scholten, S. Sornyanyontr.

1. LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors continued from the previous meeting (EBM/84/50, 4/2/84) their consideration of a report on the Fund's current and prospective liquidity and its financing needs for 1984 (EBS/84/44, 3/7/84).

Mr. Wicks commented that some of the staff assumptions regarding use of Fund resources seemed conservative; thus, the resulting estimates of the financing requirements set out in the paper were perhaps on the high side. He recalled that Mr. Prowse had observed at the previous meeting that the financing requirements would be considerably different if there were marginal changes in the assumptions. The staff was right to be cautious, but he concluded from the paper that the figures for the financing requirements represented close to the heaviest drain on resources, barring unforeseen shocks and recognizing that no explicit provision was made for reserve tranche use.

Commenting on Part V of the paper, Mr. Wicks said that he agreed with the broad thrust of the assessment of the overall position. The Fund's ordinary resources had been restored to a comfortable level and were likely to remain so for the foreseeable future. With regard to borrowed resources, there was still some uncertainty in his mind whether a commitment gap would emerge in the second half of the year. Given that uncertainty, it was too soon to talk about financing a possible gap. However, he remained committed to the principle that the Fund should seek assurance in advance that adequate finance was available to support decisions on the use of Fund resources. Therefore he agreed that, if necessary, the Board should address the matter in a few months.

By the next half-yearly review of the Fund's liquidity, Mr. Wicks continued, he would appreciate it if the staff could present assessments of the effects on the Fund's liquidity of various access limits under the enlarged access policy, of varying the mix of ordinary and borrowed resources, of the scope for switching between ordinary resources and borrowed resources, and perhaps of ending the rule about separating ordinary and borrowed resources. The examination of those aspects could take place either in the next liquidity review or in a separate paper, but before the discussion of access for 1985.

Mr. Pickering commented that he was pleased to note the considerable improvement that had occurred in the Fund's liquidity position since the previous report. The sizable quota increases under the Eighth General Review, as well as the increased number of usable currencies, had raised the amount of ordinary resources. A new SDR 6 billion borrowing package had been agreed in principle and, he hoped, would be finalized soon. Despite new and increased estimates of commitments of borrowed resources for 1984, the commitment gap was considerably less than had been expected in October 1983. In fact, given that staff projections of commitments in the past had tended to be on the high side, it was possible that there would be little or no commitment gap by year-end. He could therefore agree with the staff that consideration of future measures to finance the potential commitment gap could be deferred until the next half-yearly liquidity review unless there were large unexpected demands. In that case, a special liquidity examination could be undertaken to update projections.

Mr. Blandin recalled that a few months previously his chair had commented that staff estimates had been perhaps on the pessimistic side. He was therefore pleased to see the favorable evolution in the consideration of the Fund's financing and liquidity needs for 1984 and 1985. With regard to ordinary resources, quota increases under the Eighth General Review had increased those resources substantially and provided appreciable room for maneuver.

With regard to borrowed resources, Mr. Blandin continued, the staff estimated that they would be sufficient in terms of drawings, with a slight gap of SDR 0.8 billion at the end of 1984. However, the commitment gap could reach SDR 4.05-5.05 billion at the end of 1985 and, in the staff's view, called for the Fund to arrange for new borrowed resources to meet its commitment to lend. That approach was not justified at the present stage because, first, world recovery should strengthen in 1985 and alleviate the Fund's burden, and, second, the staff's assumptions were conservative. For example, as noted by many Directors, the staff envisaged SDR 2 billion in commitments for small industrial countries, but it stated on page 13 of EBS/84/44 that there were no indications of possible use of the Fund's resources by any of the industrial countries. In any case, the activation of the General Arrangements to Borrow (GAB) could also provide the necessary flexibility to deal with a worsening of the situation.

He shared the concern expressed by many Directors about the second and third paragraphs of page 6 of the staff report, Mr. Blandin concluded. In particular, he had been surprised that two thirds of the new arrangements would be in the range of 30-60 percent of quotas, while no arrangements in the range of 102-125 percent of quota were currently envisaged. He looked forward to another opportunity to discuss that point. On another matter, he supported Mr. Nimatallah's suggestion to have selected ratios distributed on a quarterly basis.

Mr. Kafka remarked that although he had no problems with the paper, like other speakers he was puzzled by the relatively low percentages of access in relation to quota forecast by the staff, and he invited comment. Like others, he believed that the Fund's lending policy should be prudent but not niggardly. The assumptions for demand for Fund assistance were based on expectations of continued recovery, which could be prejudiced by excessively restrictive, rather than reasonable, lending policies.

Mr. Schneider noted that the improvement in the Fund's liquidity position was welcome because a number of member countries followed changes in the Fund's position closely. Therefore, the Fund should continue its prudent approach by keeping a reasonable ratio between usable resources and its total liabilities, including reserve tranche positions. He did not expect a commitment gap in 1984, but it was more difficult to assess precisely developments in 1985. A number of uncertainties--for example, the evolution of the economic recovery in the United States and elsewhere and the speed of adjustment--played a decisive role. Nevertheless, it was important to avoid the emergence of a sizable commitment gap, and it would be prudent to ascertain the readiness of potential lenders to extend further credits to the Fund. Finally, could the staff say when the SDR 6 billion borrowing agreements would come into effect?

Mr. Hirao commented that the staff estimates were cautious and broadly reasonable, although he shared to some extent the views expressed by Mr. Prowse and Mr. Wicks. The Fund's position had been strengthened significantly in recent months through a number of measures, including the increase in quotas, but the staff paper indicated that the use of resources would also remain substantial in the coming years and that a commitment gap of borrowed resources was expected to loom large toward the end of 1984. It was important to monitor closely the liquidity position of the Fund in view of the uncertainties related to the timing and amounts of the prospective use of Fund resources. He supported the staff suggestion that the discussion of financing the commitment gap be taken up later, when firmer estimates on the use of Fund resources became available.

Mr. Alhaimus noted that, as expected, the Fund's liquidity had improved considerably with the increase in quotas and the agreements to strengthen the Fund's borrowing potential. Usable ordinary resources, in particular, were expected to remain at reasonably high levels through 1985. He agreed with the staff that such a comfortable position should not lead to any accelerated depletion of the Fund's ordinary resources, given the expected demand for Fund credit and what the staff called the continuing "dangers that the international debt problem poses for the instability of the international monetary system." It was the expectation, however, that in case such dangers arose, the new GAB arrangements would be particularly relevant.

The main problem with respect to the Fund's finances in the coming period would continue to be the commitment gap of borrowed resources, Mr. Alhaimus remarked. The gap was expected to emerge again later in 1984 and might continue to widen thereafter. The paper proposed that the financing of the commitment gap be considered during the next liquidity review at the latest; but no matter when Board discussion was scheduled, the problem would remain particularly difficult, as the short-term credit line totaling SDR 6 billion was only currently being finalized.

Mr. Erb said that he agreed with the staff analysis and conclusions.

Mr. Lovato stated that, assuming the conclusion of the SDR 6 billion borrowing agreements, the Fund's liquidity position had improved considerably. In light of the world economic situation and potential demand, the Fund's liquidity gave no cause for concern in 1984, although staff estimates of SDR 7.5 billion in Fund support under stand-by and extended arrangements and under special facilities in 1984 indicated a problem for borrowed resources. However, taking into account the Fund's ordinary resources and the conservative criteria used for Fund credit, he could accept a possible commitment gap of borrowed resources of SDR 0.75-1.75 billion in the second half of 1984. According to Table 3 on changes in the Fund's resources on a cash flow basis, SDR 5.2 billion would be available under borrowing agreements at the end of 1984. Therefore, under present assumptions, the Fund's liquidity position for 1984 was comfortable. Therefore, the discussion of the commitment gap of borrowed resources could be postponed until September.

Mr. Delgadillo recalled that when the previous report on the Fund's liquidity and financing needs had been discussed, the Board had been concerned about the ability of the Fund to meet the growing demand for financing from a large segment of its member countries. Fortunately, in recent months developments had enhanced the Fund's liquidity position; increased quotas under the Eighth General Review, the expansion of the GAB, and preliminary agreements with borrowers had been particularly important in enabling the Fund to continue to meet demands for Fund credit and to maintain a sound financial position. The rapid depletion of ordinary resources should be avoided, and sizable commitment gaps should not be allowed to develop. Should any gap arise earlier than expected, management should adopt the necessary steps to arrange for its financing. Also, if unfavorable developments should take place before the next half-yearly review, an earlier date for that review would be desirable.

Important progress had been made in strengthening the liquidity position of the Fund, Mr. Delgadillo stated. That progress had involved long and difficult negotiations by management and staff and the political will of all interested parties. At present, the Fund should continue to provide badly needed financing in a flexible manner to help restore economic and financial health to the system as a whole. Finally, he shared the concerns expressed by Mr. Senior and others regarding the assumptions on the levels of access included in the staff paper.

Mr. Kabbaj said that he broadly concurred with the analysis of the Fund's liquidity position and the assessment of its financing needs in 1984 and 1985. He also supported the course of action proposed in Section V of the staff paper and agreed that the financing of the commitment gap currently foreseen for the second half of 1984 could be better considered in the next half-yearly review of the Fund's liquidity and financing needs. The staff and the Board would then be in a better position to assess the estimates for 1984 and the financial prospects of potential users in the medium term.

Since the Executive Board's previous examination of the issue, Mr. Kabbaj continued, the Fund's liquidity position had strengthened markedly after a period of considerable strain. That improvement was due to a large extent to the putting in place of a financial plan that included, on one hand, obtaining additional ordinary resources through the Eighth General Review of Quotas, and on the other, undertaking new borrowings from countries in surplus external positions to assure the continuation of the policy of enlarged access. Nevertheless, such a strengthening of Fund resources had also entailed a significant reduction in deficit countries' potential annual and maximum access to Fund resources, despite the intensification of their external difficulties. He would not elaborate on the appropriateness of that curtailment, as the issue had been thoroughly examined by the Executive Board. However, referring to the understanding that had emerged from the Board's extensive discussion in December 1983 and January 1984, he asked the staff to what extent its estimates of demand for Fund resources corresponded to the Board's decision, particularly with respect to the amount of individual programs.

The staff had projected that two thirds of the new arrangements would be for amounts at annual access rates falling between 30 percent and 60 percent of quota and that the remainder would fall in the 71-102 percent range, Mr. Kabbaj remarked. Those projections seemed to indicate a too restrictive interpretation by the staff of the compromise reached earlier in 1984 of a two-tier system allowing for access of 102 percent to 125 percent of quota. Should that interpretation prevail, the pace of adjustment in countries seeking Fund assistance would be forced further and might endanger the successful implementation of those programs.

Other factors that had affected positively the prospective liquidity position of the Fund, although to a lesser degree, included the decision by the Indian authorities to forgo a significant portion of their extended arrangement with the Fund, the cancellation or inoperativeness of a number of arrangements, and the decisions by a few members previously considered potential users not to request Fund assistance, Mr. Kabbaj observed. He invited the staff to comment on whether those decisions reflected unsuccessful negotiations or an improvement in the external situation of the members concerned.

With respect to the projected commitment gap, Mr. Kabbaj commented that the Fund's approach, which aimed at avoiding the development of wide borrowing gaps, was sound and strengthened the credibility of the institution. While supporting the proposed course of action in dealing with that issue in 1984 and 1985, he also believed that it was necessary to avoid situations similar to that of 1983, when unprecedented and potentially damaging emergency action had had to be taken. Those developments had been extraordinary but clearly indicated that some caution was justified.

Mr. Mtei noted that the staff projections for demand and supply of Fund resources for 1984 indicated that the short-term liquidity position had benefited from the quota increases under the Eighth General Review. With borrowing arrangements currently being completed with the BIS, two industrial countries, and the Saudi Arabian Monetary Agency, the Fund should be able to meet the demand projected by the staff. Therefore, the anticipated commitment gap in the course of 1984 should be considered in the context of the mid-year review. At that time he hoped that firm projections for 1985 could be provided to explain the rise in the commitment gap for that year. However, it was important to point out that the short-run liquidity situation should not be allowed to mask the long-run need for expanding the Fund's own resources. His chair had, on previous occasions, called for a substantial increase in quotas under the Eighth General Review. With the less than desirable outcome under that review, it would be necessary to monitor constantly long-term liquidity needs. He realized that the uncertainty surrounding the staff's projections could render such an exercise difficult at the present stage; nevertheless, a long-term perspective at an early stage could be useful in looking at the Ninth General Review of Quotas, which should not be unduly delayed.

The medium-term assessments that the Board had recently requested in reviewing economic developments in member countries, either under Fund-supported programs or under Article IV consultations, could form a reasonable basis for medium-term projections of the use of Fund resources, Mr. Mtei observed. He invited the staff to comment.

The staff report had broadly outlined the distribution of arrangements between short-term and medium-term arrangements and in terms of access limits, Mr. Mtei remarked. With regard to new arrangements that were likely to be considered during the course of 1984, the area departments should have a reasonable idea of how negotiations for possible Fund support would evolve over the year. He could therefore take the 1984 estimates as a fair indication of the outturn for the year. However, on previous occasions his chair had been concerned about the preponderance of short-term arrangements, which gave the impression that there was a preference for such arrangements. He hoped that that was not the case, as the present estimates provided for one third of the total to be in the form of extended arrangements. His concerns stemmed from the fact that the problems facing many developing countries, particularly those in Africa, were structural in nature. When the Board had concluded the review under the extended arrangement for Malawi, only a few weeks previously, Mr. Sangare had expressed regret that the program was the only medium-term arrangement for the whole of Africa, even though the countries in that area had the greatest need for medium-term support. He did not deny that there were practical difficulties in designing such programs, but if the Board intended to be more supportive of medium-term approaches to adjustment, the staff should explore ways of surmounting the problems related to program preparation and implementation.

Although there had been an overall increase in total new arrangements for 1984 from the figure estimated in October 1983, Mr. Mtei noted, the shift of two relatively large arrangements from 1983 to the current year had overwhelmed the reductions that had occurred for those countries with smaller quotas. He pointed out that each time the Board considered the Fund's liquidity position, there appeared to be a downward adjustment in the estimates regarding new arrangements for members with small quotas.

His chair had expressed a similar concern when the Board had discussed Fund liquidity the previous year, Mr. Mtei continued. In explaining the reductions, the staff had noted that some programs had become inoperative. He wondered whether efforts were being made either to resuscitate some of the programs or to negotiate new programs in their place. Either action would be important because the situation in most of those countries had actually worsened. He also believed that to estimate annual access limits of only 30-60 percent of quota for two thirds of the stand-by and extended arrangements amounted to ignoring that many developing countries' balance of payments positions were bad and that the prospects for their improvement in the near future were not bright. He was therefore disturbed to note that arrangements for annual access limits above 102 percent of quota had not been envisaged. He wondered whether that omission was symptomatic of the Fund's despair that many members would not be able to adopt strong programs, or whether the staff believed that the balance of payments problems of those countries would be solved promptly.

Mr. de Vries noted that the Fund's liquidity position had improved, although it was difficult to determine that position precisely because of the inconsistency in the presentation of the statistics. The periods, methodology, and figures were rarely comparable, and he would welcome a more steady base for the presentation; in the past, he had suggested some elements for that base.

It appeared that demand could be covered in 1984, Mr. de Vries observed; in 1985, if present access policies were continued unchanged, the financing needs would have to be considered. The commitment gap should be monitored in order to avoid the situation that had developed in 1983, when the amount of access had prompted the Fund to find additional financing. He requested that tables be prepared, on a consistent basis, that set out the effect on Fund liquidity of various access limits and, more particularly, the results of different mixes of the Fund's own and borrowed resources. He recalled that it had been explained that the mix did not determine the need to borrow but, on the contrary, that the Fund resources determined the mix. He was therefore struck by the presentation in Table 2 indicating that, although it was Fund policy that quotas should be the prime element of Fund financing, the use of borrowed resources was larger than the use of ordinary resources. Although that situation arose from earlier Board decisions, it seemed odd in the light of the Fund's main policy approach.

He agreed with the conclusions of the staff paper, Mr. de Vries remarked. Although the present discussion did not concern access policies, many comments had been made on the percentages of access forecast by the staff. In the absence of additional information, he gathered that the percentages were the result of the implementation of the policy decided by the Board previously.

Mr. Jayawardena recalled that when the Executive Board had last discussed the Fund's liquidity position and financing needs, there had been concern that the liquidity position would come under increasing strain with a growing commitment gap, a perception that had greatly contributed to the reduction in access to the Fund's resources. The current paper indicated that the liquidity position had improved substantially since that time. He welcomed that evolution insofar as it had emerged from improvements on the resource side, but he remained concerned about the contribution to that situation of the virtually negative effect of the Eighth Quota Review on access to Fund resources for most countries and practically all potential users of Fund resources.

Although prudence in financial management should be a cardinal principle in guiding the operations of an institution such as the Fund, it had to be matched with the need to fulfill the Fund's responsibilities to perform an increasing role in the present difficult times, Mr. Jayawardena observed. He was therefore concerned by the statement in the staff report that area departments had indicated that the majority of new arrangements in 1984 were likely to be in the form of stand-by arrangements and that about one third would be committed under extended arrangements. At present, when large-scale adjustments of a structural longer-term nature were called for, he would have expected the extended type of arrangement to predominate. Moreover, the same departments reported that about two thirds of the new arrangements would be for annual access of 30-60 percent of quotas, about one sixth for 71-90 percent, one sixth for 91-102 percent, and none for 102-125 percent. He was intrigued by the gap between the 30-60 percent and 71-90 percent ranges. More important, he wondered how the various departments had made that assessment, and whether the actual balance of payments needs were in those ranges or whether the degree of adjustment contemplated had led to the determination of such needs within those ranges. Had any calibration between the strength of adjustment and access to resources been worked out to yield those estimates, or were they the result of departments' deciding that a rationing of resources had to be made to conserve the Fund's liquidity? If those levels of access reflected the degree of adjustment, however that might be measured, he would like to know the mechanics of how that was accomplished, and whether the lack of programs in the 102-125 percent range indicated a Fund perception that adjustment around the world in the foreseeable future would be very weak.

His questions raised an important issue about the role of the Fund, Mr. Jayawardena explained. The Fund was an institution of international cooperation, and, as such, it should first assess the global needs for financing and adjustment and then find the ways and means to meet those needs. Recalling the World Economic Outlook discussion, he wished to be assured that the need for funds had not been underestimated or that access for Fund members had not been made more stringent, which would accomplish nothing but a diminishing role for the Fund.

With regard to the staff paper's presentation, he requested that, in future reports, tables be provided indicating past estimates and actual outturn for at least two periods for comparison, Mr. Jayawardena concluded. Thus, Executive Directors could analyze historical trends and reach more informed decisions.

Mr. Alfidja said that he welcomed the staff paper, which indicated a change in the Fund's liquidity position. The strains upon the Fund's position seemed to have disappeared, and it was encouraging that the Fund's liquidity position was strong at present because of the various actions described in Part V of the paper. The commitment gap, which had been expanding and had been projected to reach SDR 6 billion at the end of 1983, was estimated at present at SDR 2.8 billion and to decrease further to SDR 0.75-1.75 billion in the second half of 1984. Those developments were in line with the need to ensure that any emerging commitment gap should be small and temporary.

For 1984, a satisfactory liquidity position for the Fund seemed assured, Mr. Alfidja noted, and he commended the Managing Director for his efforts in securing additional resources. He had no doubt that the Fund would continue to pursue a policy of prudent financial management by keeping its commitments in line with available resources.

A substantial demand for the use of Fund resources had been projected for 1984, Mr. Alfidja observed. In dealing with the distribution of arrangements for 1984, the staff had stated that about one third of the total would be covered by extended arrangements, and about two thirds would be for annual access rates falling between 30 percent and 60 percent of quota. He was concerned about those annual access rates for developing countries, and he asked the staff for further elaboration, because the implications seemed to confirm his fears about the limited size of Fund resources to be made available to some of the countries in his constituency in the future.

There were uncertainties about the projections of the Fund's liquidity position in 1985, Mr. Alfidja continued, and the staff had indicated that a commitment gap could arise. He reiterated his position that quotas should remain the primary resource of the Fund and that action on the Ninth Quota Review should be initiated. The Eighth Quota Review had not resulted in substantial resources relative to the potential needs of the members. The Fund might continue to engage in borrowing, but only from official sources, and recourse to the private markets should be considered only as a last resort. Finally, he encouraged the Managing Director to continue his efforts in arranging lines of credit, and he commended those countries that had agreed to lend to the Fund to enable it to play its role in the international financial system.

The Treasurer recalled that several Executive Directors had inquired about the status of the SDR 6 billion borrowing agreements with the Saudi Arabian Monetary Agency (SAMA), the BIS, Japan, and the National Bank of Belgium. The various components were each contingent upon the completion of others before entering into effect. Negotiations with SAMA were close to conclusion, and therefore there would not be much delay in bringing the package into force. It might be necessary to amend the BIS agreement because it had been assumed that it would be in force before the end of March; the drawdown period of one year had been expected to begin on March 30, and it would now be necessary to move it forward somewhat to avoid losing part of the drawdown period. The staff was confident that no material issue stood in the way of a positive conclusion of the SDR 6 billion borrowing package.

On the timing of consideration of new borrowing, the commitment gap envisaged for 1984 was not large, especially if the staff assumption of the total use of about SDR 2 billion by smaller industrial countries was merely precautionary, the Treasurer went on. It was unlikely that any commitment gap would appear before the summer, assuming the conclusion of the SDR 6 billion borrowing agreements, but if there were unexpected demands, a special review by the Executive Board would be indicated. It was clear from the present discussion that a sizable commitment gap should not be allowed to develop and that during 1984 there should be some discussion of additional borrowing, either at the time of the next review or earlier.

With regard to the demand for Fund resources during 1984, a few Directors had questioned the inclusion of SDR 2 billion for the smaller industrial countries, the Treasurer noted. The position of some of those countries was relatively weak, and the staff had followed past practice of providing a shadow figure or upper range to avoid the impression that their borrowing needs could be negligible. Although the developing countries had a greater need for Fund assistance because they had limited access to the market or other sources, the staff had wanted to indicate that the smaller industrial countries should be able to rely on the Fund as a source of balance of payments support, as indeed should other industrial countries. He would not propose to reveal their identity, in line with the usual practice, and because none of the smaller industrial countries had approached the Fund for credit at the present time. The total quotas of the smaller industrial countries in weaker positions amounted to SDR 2 billion, which illustrated the additional demands that could arise in the coming months.

The statement in the staff report that two thirds of the expected demand from developing countries would fall in the range of 30-60 percent of quota had been the subject of several comments by Executive Directors, the Treasurer remarked. Some Directors were concerned that it might reflect an overly restrictive interpretation by the staff of the guidelines on access. The figures reflected the staff's interpretation of the various elements of the guidelines: there must be a balance of payments need, the Fund's role should be catalytic in appropriate cases, and the amount of resources provided by the Fund must be in line with the adjustment effort.

He did not expect a diminution of balance of payments need, the Treasurer commented. It had been asked whether the inoperative arrangements, amounting to SDR 450 million, were being canceled, resuscitated, or renegotiated. In almost all cases, the objectives of the inoperative arrangements had not been achieved, and the arrangements were being renegotiated. In a few instances, the fact that the arrangement did not represent a large proportion of the access ceiling--50 or 60 percent--reflected cumulative access limits applying to countries that had approached the Fund in the past and were expected to do so in 1985. He did not believe that the staff's interpretation of the guidelines was too restrictive or that they did not fit the agreed criteria; Executive Directors would have the opportunity to review each program when it came before the Board.

The use that might be made of reserve tranche positions in the period ahead had not been deducted from ordinary resources, the Treasurer said. It was difficult to estimate that demand, as each country decided which part of its reserves it would use. It was clear that there would be reserve tranche purchases, and they should be kept in mind when judging the contention that the demand for Fund resources had been overestimated.

The staff assumed that when the Board reviewed access policy later in 1984, it would also be necessary to review the effects of any changes in that policy on the Fund's liquidity, the Treasurer remarked. The specific items mentioned by Executive Directors, which had been covered in the previous year's review of the liquidity of the Fund, could usefully be discussed at that time, when the outlook for demands on the Fund in 1985 would be clearer. The mixing policy decided by the Board in January 1984 had not been included in the present half-yearly liquidity review but could be considered in conjunction with the new access policy. At present, the Fund had sufficient ordinary resources, but it was questionable whether that condition would prevail. The mixing policy should not be changed on short notice, but should be as steady as practicable. Nevertheless, Directors could decide to change it if that were considered desirable.

A comment had been made by Mr. Prowse about the criteria for inclusion in the operational budget of currencies of countries that had weakening balance of payments positions, the Treasurer recalled. First, the operational budget was decided quarterly, and the amounts that became usable were much more limited than total holdings. Second, in selecting a country for inclusion in the operational budget or designation plan, the staff took into account its balance of payments position and its reserve position for the quarter ahead, though if the situation worsened further over the medium term, not all of the Fund's holdings of the member's currency would be usable. Moreover, if a country decided that for balance of payments reasons it wished to encash its reserve tranche position, that country could be excluded from the currency budget for a period. Therefore, he thought the present policies for selecting countries for inclusion in the operational budget and designation plan were not inconsistent with the judgment that not all of the holdings of those currencies would be usable over the medium-term horizon. He did not believe that there was a need to review the criteria.

Interest had been expressed by some Directors in the various ratios, the Treasurer concluded, and he pointed out that the ratios were reported quarterly in the operational budget and half-yearly in the liquidity reviews. Although the shorter staff paper had been praised by the Board, the staff would consider how to present time series of past estimates and actual figures in order to provide a broader background for the Board's appraisal.

The staff representative from the Treasurer's Department explained that although reserve tranche positions had not been included in the projections, the staff had indicated that members holding approximately SDR 5 billion of reserve tranche positions were in current account deficit in 1983 or 1984, as projected in the recent World Economic Outlook exercise. Of that amount, SDR 2 billion was held by GAB participants, and in certain circumstances those positions could be financed by use of the GAB. A further SDR 1 billion of reserve tranche positions was held by eight smaller industrial countries, and the remaining SDR 2 billion was held by developing members. Other than the possible use by GAB participants, the remainder would be financed with ordinary resources. In the past three years, use of reserve tranche positions had averaged about SDR 1 billion a year. It was difficult to forecast use in the period ahead, and the extent of such use would largely depend on decisions taken by a handful of members that held large amounts of reserve tranche positions and had possible needs for financing. Reserve tranche purchases in the first three months of 1984, not including those associated with the quota payments, had amounted to about SDR 200 million.

Mr. Kafka thanked the Treasurer for his explanation of the proportion of access in relation to quota as stated in the staff paper. Would it be possible to provide the Board with a table showing the preponderant reasons for the number of countries and the amounts involved that resulted in the staff classification of those countries with potential access of 30-60 percent? He recalled that the Treasurer had mentioned three reasons: first, balance of payments need; second, weak programs; and third, use approaching the overall limit, which could be 375 percent or 500 percent.

The Chairman said that another factor--the time frame of the adjustment--should be added. If countries had to undertake a long process of adjustment, the Fund should be cautious in providing the maximum cumulative limits because of the numerous actions that would be required over time. He recalled that in the discussions on the way to pitch the Fund's resources in individual cases, the Executive Board had devoted special attention to that factor. Therefore, it was the combination of the criteria cited by the Treasurer that had produced the range that Executive Directors had focused on during the present meeting. The Treasurer was not trying to modify the policy but had presented the area departments' estimates of the use of Fund resources, and the resulting breakdown was consistent with Board policy on the amount of access in individual cases. Of course, when the Board considered each program, the staff and management would explain why an amount had been proposed. The Board could then provide guidance on the implementation of the agreed guidelines in individual cases.

It appeared at present that there would be no new arrangements falling in the 102-125 percent range, the Chairman observed. The staff would not bend access rules for the sake of liquidity estimates, but would follow the guidelines reached by the Board on access limits. He understood that not all Directors had been completely satisfied by that understanding because it was a compromise, and some Directors believed that the Fund was erring on the conservative side. Meanwhile, others believed that in some cases the access limits were high in terms of the protracted use of Fund resources without a demonstration of the medium-term viability of the balance of payments. The staff was striving to reach the correct balance.

Mr. Prowse explained that he had wondered why the staff had adjusted the usable currencies amount downward by 25 percent on the present occasion, rather than by 20 percent as in previous cases. He presumed the figure had been reached after taking into consideration the particular countries included, but there must be a point where the adjustment factor could be too large. Obviously, 50 percent would suggest that too many countries with weak balance of payments positions had been included.

The Treasurer replied that the highest adjustment factor employed in the liquidity reviews had been one third, while in other cases adjustments of one fourth and one fifth had been used. The adjustment factor proposed for the current review had been increased from one fifth to one fourth because those countries whose overall balance of payments position might not be completely secure were a large and significantly increasing proportion of the members whose currencies were considered usable. The holdings of that group had increased significantly since the previous review of the Fund's liquidity, and, on the basis of experience, the staff could have suggested to the Board a somewhat higher adjustment. It was a question of judgment and because the Fund's overall liquidity position was strong at present there was no need for fine-tuning, but it was appropriate to reassert the principle.

The staff representative from the Treasurer's Department, replying to a question by the Chairman, said that none of the currencies of industrial countries included in the SDR 2 billion estimate for possible use of Fund resources were also included among the currencies considered usable and for which a reduction in holdings of one fifth instead of one fourth had been made.

Mr. Nimatallah noted that the Appendix included three ratios: quota, liquidity, and asset, which was in effect a solvency ratio. He wondered whether the asset ratio could be expanded and improved to include a set of ratios along with explanatory notes describing future possible changes and the reasons for them. He was aware that some information was provided in the operational budget, but he was requesting a different set of ratios to be distributed quarterly or, preferably, monthly.

The Treasurer said that perhaps following consideration of possible improvements in the asset ratio further discussion of the question might take place. The Executive Board had previously accepted one ratio--the quota ratio--which was the total of outstanding borrowing, used credit lines, and some GAB resources to total quotas. Attempts to establish a solvency ratio, which would be more comprehensive and more directly related to the management of the Fund's assets, had been discussed at great length by the Board. At present, the staff had not found ratios that accurately reflected the unique characteristics of the Fund's assets--currencies, gold, and SDRs--and agreement had not been reached on how to construct a minimum ratio along those lines.

The staff would investigate the possibility of finding another asset ratio that would better serve the Board, the Treasurer remarked, though he was not sure that the staff would produce a better ratio than those already presented. Alternatively, the staff might try, of course, to indicate which of the present ratios revealed a strained position that merited close monitoring so that Executive Directors could comment on the staff's opinions and observations.

Mr. Nimatallah said that he would appreciate that alternative, as well as a set of ratios with different assumptions and a few explanatory notes by the staff, either monthly or quarterly.

The Executive Directors then concluded their discussion of the Fund's liquidity and financing needs.

APPROVED: September 10, 1984

LEO VAN HOUTVEN
Secretary