January 24, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 83/59

The following corrections have been made in the minutes of EBM/83/59 (4/8/83):

Page 19, 4th full para., line 2: for "would inappropriate"
read "would be inappropriate"

Page 38, para. 3, line 8: delete first word "positions"

Corrected pages are attached.

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resources arising from increases in quotas and the GAB enlargement would only postpone borrowing until after the new quotas came into effect. The argument was understandable but unconvincing. Forecasts of developments in the years after April 1984 were subject to large uncertainties and should not serve as the basis for solving present financial problems of the Fund.

The analysis of the Fund's financing needs in the longer run should be comprehensive, Mr. Grosche considered, and should, inter alia, take two aspects of the problem into consideration: the range of drawing possibilities, and the discretion at the disposal of the management and the Executive Board. Considering the financial situation that the Fund was facing, he believed that the policy of enlarged access to its resources (EAR), including access to the compensatory financing facility, should also be reviewed in light of the financial resources available to the Fund.

Mr. de Maulde observed that the present review of the Fund's liquidity position was timely because, first, the Fund had committed an exceptionally large amount of money since the previous review in October 1982, and, second, rapid shifts in balance of payments and reserve positions had occurred in recent months, adversely affecting rich and poor countries alike.

With regard to the liquidity projections, Mr. de Maulde continued, he did not disagree at present with the assumptions made by the staff concerning the potential calls on the Fund's resources up to 1986. He noted that, on the supply side, the projections did not take into account either the potential increase in resources from the enlarged GAB or from a third tranche under the borrowing arrangement with SAMA. Under that kind of restrictive view of the Fund's resources, the Fund would be facing a gap in borrowed resources on a disbursement basis by the end of FY 1984. By the end of April 1986, the usable ordinary resources would have been fully committed, and a new gap would then appear. In sum, the Treasurer was warning Directors of two potential problems, one immediate, the other further in the future.

Commenting on the short-term outlook, Mr. de Maulde agreed with Mr. Grosche that a resort to market borrowing would be inappropriate. He did not wish to repeat the fundamental reasons why his authorities had always opposed market borrowing by the Fund, reasons related to the nature of the Fund. However, it was worth adding that the initial liquidity problem could be short term, for it would be remedied when the quota increase was finally paid in. The Executive Board should not consider a revolution in the nature of the Fund for the sake of a minor bridging operation.

Directors should avoid allowing the commitment gap to open, Mr. de Maulde considered. In that respect, a timely and successful conclusion of discussions on the third tranche of the SAMA loan would be helpful, as would adherence by all members to the agreed timetable for the conclusion of the quota increase and the GAB enlargement. However, if additional resources were needed, an unlikely development on a disbursement basis, they would be needed for only a short period; in those circumstances, the Fund should turn toward its natural creditors, the central banks, whose support could be easily coordinated by the BIS.

Commenting on the longer-term outlook, Mr. de Maulde remarked that the forecasts were subject to considerable uncertainties. As a financial institution, the Fund should be careful not to be overpessimistic and should not proclaim prematurely that it was facing financial troubles, since confidence was an important element in the Fund's operations. The possible emergence of a new gap as early as April 1986 led him to regret that it had not been possible to reach agreement on a higher quota increase. With regard to the steps to be considered, first, he agreed with Mr. Nimatallah that the Fund should not cut back on its lending to member countries in view of the increased need for such financing in present circumstances. Second, the Fund should attempt to achieve progressively a smooth and flexible use of the enlarged GAB, since it was part of the increase in the Fund's resources. Third, although it was early at the moment, it might be appropriate to begin to consider within the Fund ways of reconstituting the Fund's own resources for the future. Finally, it was important that consideration also be given to a possible modification of the mix between ordinary and borrowed resources.

Mr. Tvedt said that the revised estimates in the staff paper strengthened his view, advanced on earlier occasions, that the overall liquidity position of the Fund would come under considerable pressure by the end of 1983. That pressure was expected to increase until the Eighth General Review of Quotas and the enlargement of the GAB became effective. The liquidity situation at present was more worrisome than indicated by earlier estimates because of the existence of a commitment gap expected to widen to about SDR 6 billion by the end of 1983. Moreover, the borrowing requirement could well increase by an additional SDR 4 billion in 1983 if some members not included in the estimates in the tables in the main section of EBS/83/59 made use of the Fund's resources.

Against that background, Mr. Tvedt continued, he could fully support the main conclusion of the staff paper that there was an urgent need for the Fund to enter into new borrowing arrangements at an early date. He welcomed the remarks made by Mr. Nimatallah that his authorities were expected to reach a decision on a possible third tranche of the SAMA loan in the near future, and he hoped for a favorable outcome. He invited the staff to provide additional information on possible alternative forms of official borrowing by the Fund.

A commitment gap had emerged: by the later part of 1983, net uncommitted usable resources were likely to fall effectively to zero, leaving the Fund in a rather awkward situation, Mr. Tvedt went on. If only a limited amount could be borrowed from official sources because arrangements on new credit lines could not be concluded in the near future, his authorities believed that borrowing in the private market should be considered. If a direct approach to the private market were deemed necessary, he indications of the medium-term prospects. The Board had, therefore, supported programs in which there had been serious questions about the prospects for achieving a sustainable balance of payments position within the medium term and about the prospects of the Fund's being repaid. In that sense, Directors had stretched the general guidelines of Fund policies as far as possible. There had been no case of discrimination against any country, whether large or small.

The suggestion that the Fund should not take into account the resource constraints on its activities was also a matter of concern, Mr. Erb continued. His authorities believed strongly that the need for all countries, and all international institutions, to live within their resource constraints was a major lesson that had been learned in recent years. It was a significant aspect of the adjustment being made at present, and it was not a lesson that should be forgotten.

Mr. Mtei said that he had intended to suggest that, since Directors were aware that the problems confronting small countries were in practice medium or long term, the Fund should make a special effort to assist those countries to enter into medium-term arrangements, rather than act on the assumption that short-term arrangements would suffice for the next few years, as seemed to be implied in EBS/83/59.

The Chairman stated that the staff and management had not rejected the concept of medium-term arrangements. It was often extremely difficult to arrange a medium-term program with a member, simply because the administrative and policy infrastructure was inadequate. In such cases, the Fund had to resort to shorter-term arrangements. In some cases, the Fund had been provided with quantitative indications of policy for only six months or a year ahead. The staff and management had attempted to improve the situation by placing such one-year stand-by arrangements in a medium-term framework. They had also given countries assurances that if the first stand-by arrangement was successful, the Fund would be most willing to consider a second arrangement in a similar framework.

He could assure Directors that there was no discrimination in the way that the Fund addressed those problems, the Chairman continued. The Fund did not arrange three-year programs more readily with large countries because they posed a potential threat to the international system. Of the three large Latin American countries that had been in difficulty at the end of 1982, one did not have a three-year extended arrangement because the staff and management had believed that it would not have been possible to construct it. More three-year arrangements would be welcome, but they could only be developed if the fundamental policies were in place.

The Treasurer commented that Mr. Nimatallah had pointed out that the six-monthly review of the Fund's liquidity position was an early warning device. It was not an occasion for the staff to present policy options, but to convey the facts and to enable the Board to anticipate the risks. The staff did not intend to encourage pessimism, but, rather, to maintain and strengthen confidence on the basis of an agreed assessment.

Assumptions had to be made, the Treasurer continued, according to the information available at the time that the forecasts were made. The assumptions were also made on the basis of Fund policies existing at that time. Thus, the staff did not express a view on extended arrangements or on enlarged access policy in EBS/83/59. The assessment, like other similar assessments, including the World Economic Outlook exercise, had been made on the basis of existing policies.

The forecasts for the remainder of 1983 were relatively firm, the Treasurer remarked. If anything, they erred on the low side. A large number of countries remained in difficulty, and world economic conditions did not encourage the view that the demand for Fund resources would decline. There could also be additional demand under the compensatory financing facility. At the moment, the staff was aware of only one oil exporting country as a potential user of resources, but demand could always increase. The staff had made no assumptions on the general question of access by oil exporting countries to the compensatory financing facility.

It had been the practice not to deduct reserve tranche positions, which represented contingent liquid liabilities of the Fund, from ordinary resources, the Treasurer noted. However, the practice was being questioned, particularly at a time when the liquid resources of the Fund were falling to a low level. The deductions had not been made in the past because it was much more difficult to forecast the use of reserve tranche positions than the use of credit tranches. In addition, some reserve tranche positions represented large amounts, in some cases more than SDR 500 million. Thus, if a large reserve tranche position was drawn on, the liquidity estimate could shift by up to SDR 1 billion.

In recent reviews of liquidity, the staff had also provided a "guesstimate" of the average risk involved with reserve tranche purchases, the Treasurer went on. In EBS/83/59, the calculation had been between SDR 1.5 billion and SDR 2 billion. That amount could, in principle, be deducted from the estimated SDR 9.5 billion of ordinary resources on a disbursement basis. The result would be to appear to improve the liquidity of the Fund. However, it was doubtful whether that approach was realistic, because it could create a false sense of security. In practice, the use of reserve tranche positions could easily be more than double the staff's estimate. One Director had suggested, citing the SDR 9.5 billion figure, that the Fund's liquidity position had looked good on a disbursement basis. That was a reasonable argument--but only if countries did not use their reserve tranche positions. Another Director had suggested that the position should be monitored closely and that if the situation appeared to be deteriorating, the Board could review the issue again. In practice, however, countries, particularly those holding large amounts, did not give the Fund much advance warning of their use of reserve tranche positions; the funds had to be paid within two days of a member's request. Thus, the possibility of a rapid and large shift in the Fund's liquidity always existed.

An important point to bear in mind, the Treasurer considered, was that, as ordinary resources fell and reserve tranche positions remained high, some countries might feel reluctant to use those positions. They