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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/60

3:00 p.m., April 8, 1983

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

Executive Directors	Alternate Executive Directors
A. Alfidja	
J. Anson	C. Taylor
	L. E. J. Coene, Temporary
	A. Le Lorier
A. Donoso	M. Teijeiro
R. D. Erb	C. Dallara
M. Finaish	T. Alhaimus
	J. Reddy, Temporary
	T. Yamashita
R. K. Joyce	
A. Kafka	
	G. Grosche
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	
J. J. Polak	T. de Vries
A. R. G. Prowse	
G. Salehkhou	
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	A. Lindø
Zhang Z.	

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

Administration Department: J. D. Huddleston. Asian Department: S. Shah. European Department: W. E. Hermann. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; M. Allan. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel. Middle Eastern Department: Z. Iqbal. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. S. Cutler; H. Flinch, D. Gupta, Q. M. Hafiz, O. Roncesvalles, T. M. Tran, G. Wittich, P. K. Woolley. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, C. J. Batliwalla, S. El-Khouri, H.-S. Lee, P. D. Péroz. Assistants to Executive Directors; E. M. Ainley, H. Arias, J. Bulloch, M. Camara, T. A. Connors, M. K. Diallo, I. Fridriksson, A. Halevi, M. Hull, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. K. Orleans-Lindsay, J. G. Pedersen, G. W. K. Pickering, E. Portas, M. Z. M. Qureshi, D. I. S. Shaw, Zhang X.

1. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Anson on completion of his duties as Executive Director for the United Kingdom.

2. FUND LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors resumed from the previous meeting (EBS/83/59, 4/8/83) their consideration of a staff report on the Fund's current and prospective liquidity position and financing needs (EBS/83/59, 3/18/83).

Mr. Polak recalled that, in his remarks at EBM/83/59, the Treasurer had suggested that there might be reserve tranche drawings of about SDR 2 billion by the end of 1983, although the amount could go as high as SDR 4 billion. How much of those potential drawings could be eligible for purchase under the General Arrangements to Borrow (GAB)?

The Treasurer said that about one third of the "central estimate" of SDR 2 billion or the "outer estimate" of SDR 4.5 billion could be financed under the GAB. The possible use of the GAB increased the ability of the Fund to meet such drawings, but not significantly. The major point to bear in mind was that the liquidity of the Fund was at a low point, both by historical standards and in light of the state of the world economy. The Fund had little leeway to respond to any sudden developments before the end of 1983; it would be prudent, therefore, to regard the staff estimate of SDR 9.6 billion for the Fund's uncommitted ordinary resources by the end of April 1983 as a conservative figure.

Commenting on the longer-term projections, the Treasurer noted that the increase of usable funds expected from the forthcoming quota increase appeared to be just sufficient to cover the upper range of the likely increase in the demand for use of the Fund's resources in FY 1984/85 and FY 1985/86, assuming that there was no unexpectedly large demand by the larger countries, in particular the large participants in the GAB. However, the projections could not be regarded as predictions of what would happen. As the staff had always indicated in discussions of the quota increase, a larger increase in usable funds relative to total quotas--about SDR 15 billion--would have provided a useful margin of safety.

The staff had used an assumption of no change in the current policy of enlarged access, the Treasurer continued. It was true, as one Director had suggested, that the staff could have assumed that access might be limited to 450 per cent of the new quotas; but the staff could also have assumed a lower percentage of access after the quota increase went into effect. The issue remained for the Executive Board to decide. The staff had attempted not to prejudge the outcome of the forthcoming Board discussion of access. The staff papers reviewing the policy on enlarged access under the compensatory financing facility would contain analyses of the effect that any changes in policy would have on the Fund's liquidity.

Neither had the staff made an assumption about the availability of resources from the enlarged GAB in 1984 and 1985, the Treasurer remarked. First, if there were large reserve tranche purchases by GAB participants, and if the Fund's liquidity remained constrained, the GAB could be used to finance those reserve tranche purchases. Second, the prevailing crisis in balance of payments positions might continue to exist at the time that the enlarged GAB entered into effect. If so, the Fund could appropriately indicate that the demand that it foresaw and its own liquidity position necessitated an activation of the GAB. However, the staff had not wished to prejudge the question. In principle, the existence of the enlarged GAB would improve the Fund's liquidity position in 1984 and 1985; he hoped that it could be activated readily if developments demanded it.

In estimating the potential demand on the Fund in 1983, the Treasurer went on, the staff had taken a case-by-case approach. His department had consulted with the area departments with regard to which countries were likely to have balance of payments deficits, the possibilities of financing from the private market, or other official sources, and the like. The staff had then attempted to judge the probability that those countries would be able to adopt the required adjustment measures if they were to seek Fund financing, within the existing limits of access, and whether the countries would be willing to accept Fund conditionality as it presently stood. The probability that a part of the deficit would be financed through the Fund varied tremendously, depending on the size of the quota, the size of the deficit expected, and other factors. The staff would prefer not to provide Directors with detailed estimates. First, the estimates were based on the staff's judgment, without consultation with the member. Second, the judgment could be wrong: some authorities might not welcome inclusion on a list of countries expected to draw on the Fund's resources within the next two to three years; others might feel disadvantaged by not being included on such a list. The estimates were reviewed at least once a year, and sometimes quarterly. A number of Directors had regarded them as likely to be accurate.

One Director had suggested that future cancellations of Fund programs could provide additional leeway that would be beneficial to the Fund's liquidity, the Treasurer added. The large-scale cancellations that had occurred in recent months emphasized the point that it was sometimes difficult to maintain three-year programs. Furthermore, the shift to shorter programs implied that the risk of cancellation was smaller than it had been. In fact, he did not expect a significant improvement in the Fund's projected liquidity position to come from cancellations in the near future, given the present mix of three-year, two-year, and one-year programs. Another Director had wondered whether the staff could project the liquidity ratio for the end of FY 1985/86. The staff would consider the possibility, but Directors should bear in mind that the liquidity ratios were the net result of the projections for demand and supply, both of which were difficult to estimate.

The estimated commitment gap for the end of 1983, SDR 5.7 billion, was on the low side, the Treasurer commented. Furthermore, although the liquidity position looked healthier on a disbursement basis, at

SDR 9.5 million, it would not be prudent to assume that the whole of that amount would be available to counter any sudden demands by Fund debtors or creditors before the end of 1983. A number of Directors had suggested that the Fund should undertake borrowing on a bridging basis. From the point of view of managing the Fund's liquidity, that approach was preferable to the use of the Fund's scarce cash resources; nevertheless, bridging finance raised similar issues to those involved in the use of cash. Bridging finance implied anticipating the inflow of funds from the quota increase and, perhaps, the use of the GAB. If a large part of the commitment gap were financed in that way, the estimated SDR 15 billion increase in usable resources arising from the enlarged quotas would have to be reduced by the amount of the bridging finance, since the borrowing would have to be repaid, probably within a year. If only half of the anticipated gap--i.e., SDR 3 billion--were financed in a bridging operation, 20 per cent of the addition to Fund liquidity from the quota increase would have been used, without access having been increased.

The role of short-term finance was generally limited, the Treasurer considered. The staff would issue a paper in the near future on the mismatch of maturities in the Fund's lending and borrowing and the degree of mismatch that could be sustained. All financing carried out when lending was longer than borrowing depended on the assumption that the funds could be rolled over, if not by borrowing from the same creditors, which was preferable, then by finding new creditors. A number of countries had recently realized the difficulties involved in refinancing. There was, therefore, an important point of principle to consider. Although the Fund itself might have little difficulty in obtaining the necessary finance, it should set a prudent example to the other participants in the international financial system. There would be a certain degree of inconsistency in the Fund's advising countries not to borrow on a short-term basis if their needs were long term, while itself undertaking such an approach.

It was preferable to enter the private market before being forced to do so, the Treasurer remarked. One reason was that the Fund would be a newcomer to the market. If a syndicated credit were arranged, the question of the Fund's relationship with the commercial banks would have to be borne in mind. In addition, the SDR was not well established in the private market, and the Fund would have to proceed with caution. Both the presence of the Fund and the use by the Fund of the SDR would represent innovations in the market; it was much better to introduce innovations in the market from a position of strength rather than weakness. Most important, if the Fund were to enter the private market as a last resort, the cost of such borrowing would be high, since there would be an implication that the Fund no longer had the support of its membership, a situation that would cause the banks to be circumspect.

An important tactical question had been raised by Mr. Erb when he had suggested that it might not be appropriate at the present stage for the Fund to demonstrate its strength by private market borrowing when legislatures were considering the quota increase, the Treasurer noted. The staff had continued to discuss the issues involved in private market borrowing with market participants, in line with the guidance provided by the Executive Board and the Chairman. Discussions would also have to be held with the authorities of the countries whose currencies might be borrowed in the market, since their financial markets and their balance of payments could be affected, but no such discussions had yet been undertaken. Generally speaking, if member countries supported the Fund, the Fund would not need to go to the private market. On the other hand, if member countries were unwilling to support the Fund, it should enter the market at an early stage.

The Deputy Treasurer noted that Mr. Tvedt had asked for the breakdown of the SDR 10.1 billion of undrawn borrowed resources on March 15, 1983 shown in Table 6 of EBS/83/59. The amounts were: SDR 1.4 billion remaining under the supplementary financing facility; SDR 6.3 billion remaining under the first two tranches of the Saudi Arabian Monetary Agency loan; SDR 0.9 billion remaining under the arrangements with the central banks and the Bank for International Settlements (BIS); SDR 0.2 billion in the Borrowed Resources Suspense Account; and the commitment gap of SDR 1.3 billion, which would have to be filled in due course.

The staff no longer provided an analysis of the estimates on the basis of the distinction between countries with quotas of more than SDR 800 million and those with less than that amount, the Deputy Treasurer continued. The distinction had been used in earlier reviews of the Fund's liquidity because the staff had had information on the possible use of undrawn balances only for individual countries with quotas of less than SDR 800 million. In the past year, the staff had been able to make specific estimates for countries with larger quotas, so that the distinction had little further analytical use. It was preferable to treat all members in a similar fashion, rather than to provide two sets of figures, one an estimate, the other only a probability. The change had no significance other than the statistical convenience.

Mr. Erb commented that, even when the enlarged GAB came into effect, it should be regarded conservatively and prudently in assessing the Fund's liquidity. On a separate issue, would it not have been more appropriate, in strictly legal terms, for the staff to have assumed that the enlarged access policy would expire when the increase in quotas under the Eighth Review took effect, in the absence of a decision by the Board to extend the policy?

The Treasurer replied that the assumption suggested by Mr. Erb and that used by the staff were both acceptable from a legal point of view.

Mr. Feito asked whether the assumption used by the staff in EBS/83/59 with regard to enlarged access implied that the present policy would no longer apply in future.

The Treasurer noted that the existing enlarged access policy provided that a member could draw up to 150 per cent of quota in a year, or 450 per cent of quota over three years, with certain exceptions. The policy was subject to review on June 30, 1983, and again when the increase in quotas went into effect. The policy would lapse in the absence of a decision by the Executive Board either to continue the existing ratios of access or to provide for different ratios. The staff had assumed, simply for the purpose of the review of liquidity, that access would continue as if the proportions of 150 per cent and 450 per cent were maintained in relation to existing quotas, i.e., the absolute amount of potential access would remain the same.

Mr. Polak invited the staff to provide information on the overall probability that could be attached to the estimated demand for SDR 10-15 billion of Fund resources for the two-year period to April 30, 1986.

The Treasurer said that the average weighted probability was 50 per cent. However, the composition of that probability was important. If two or three large countries were included in the estimate, the probability could be affected significantly. The staff would provide additional information in future reviews.

Mr. Mtei commented that he remained concerned that commitments to small countries continued to decline. In October 1982, such commitments had been SDR 5 billion, and it had been estimated that they would amount to SDR 3.5 billion in the current fiscal year. However, the revised estimate indicated that they would be only SDR 1.9 billion.

The Chairman remarked that Mr. Mtei's concern was justified. The revised amount indicated that a number of commitments to small countries had had to be withdrawn as a result of the cancellation of programs or renegotiations, according to the circumstances. However, the Fund had to apply the principles of conditionality to all countries. Mr. Mtei's observation emphasized that a number of countries in Africa, in particular, were having serious problems in meeting the Fund's conditions in the present difficult economic circumstances. It had clearly become more difficult recently to meet the performance criteria attached to medium-term programs than it had been a few years earlier.

The Deputy Treasurer added that two minor statistical points could be borne in mind. A number of the countries for which programs had been canceled had quotas close to SDR 800 million, so that the amounts involved were larger than those for the very small countries. Second, if a three-year stand-by arrangement was divided into three one-year stand-by arrangements, the amount of commitments declined presentationally, even though there might be no real decline in practice.

Mr. Mtei said that the Executive Board could appropriately undertake a study of the reasons for the decline in commitments to small countries, including the appropriateness of conditionality.

The Chairman remarked that the staff would consider the possibility of such a study. He then made the following summing up:

The short-term outlook

First, Directors generally considered that the staff's short-term projections were reasonable: the uncommitted ordinary resources at the end of April 1983 of SDR 9.6 billion would fall to SDR 5.5 billion by December 1983, and to SDR 4.1 billion by April 30, 1984. Many Directors observed that those levels were low, especially bearing in mind the potential additional recourse to Fund resources from countries not included in the assumptions; and also bearing in mind the potential drawdown on reserve positions by members in weak balance of payments positions.

Second, the present commitment gap in terms of borrowed resources would grow and become very high. By December 30, 1983, according to the projections, there will be a commitment gap of SDR 5.7 billion, rising to SDR 6.8 billion by April 30, 1984. These figures are worrisome, as most Directors noted. Such a gap should not be allowed to occur, for, if it did, the Fund would be committing loans in the course of 1983 beyond its secured means of financing them.

No financial institution should act in such a way, certainly not an institution which is supposed to be the keystone of the international monetary system in a particularly troublesome period. Thus, I would urge the Board not to view the matter complacently by simply looking at the projections on a disbursement basis. The only way to establish securely the financing of an institution like the Fund is to consider the commitments being made, as those are the amounts the Fund will eventually have to finance. I am happy to note that that was the clear view of the great majority of the Board.

Running down the Fund's ordinary resources further--by changing the mix between ordinary and borrowed resources in its loans--is not really a feasible alternative to borrowing. If we proceeded in that way, the Fund would have more than exhausted its uncommitted ordinary resources by the end of 1983. I do not regard this as an acceptable policy. First, the Fund would have no margin to cover any further requirements beyond the end of 1983. We know well that there is no assurance that the Eighth Quota Review will be ratified by the end of 1983 or the beginning of 1984. Second, the Fund would not be able to meet potential additional requirements, e.g., under the compensatory financing facility, or of use of Fund resources by oil producing countries, or use of reserve tranche positions. By the way, it is important, especially in this troubled world, not to undermine, as Mr. Habermeier said, the perception of the perfectly liquid nature of reserve positions in the Fund.

Thus, if we wish to avoid reducing Fund financing under the enlarged access policy--a possible alternative to further borrowing, but an alternative suggested by no one today--borrowing becomes not a question of choice but of necessity.

Future borrowing arrangements

I was pleased to note that Directors suggested that I should actively engage in arranging borrowing agreements in the coming weeks and months. In that regard, I note the following points that emerged clearly from the discussion:

First, the Board welcomed Mr. Nimatallah's most helpful statement, and a number of Directors hoped that it would be possible, in the latter part of April, to reach an understanding with the Saudi Arabian authorities on the third tranche of the SAMA loan.

Second, the Board clearly expressed its preference for an approach to other official sources; in that respect, I thank Mr. Grosche for his helpful statement. We shall, indeed, be starting our contacts with his authorities, and all the other authorities of countries that are in a position to participate in such lending arrangements. I note his indication to the effect that those arrangements should be of a "bridging" nature. Of course, we will have to negotiate with the creditor countries and institutions; but I would like to warn Executive Directors against too narrow a view of "bridging." In my view, we should be looking somewhat beyond short-term "bridging" arrangements that would expire when the Eighth Quota Review comes into force. Mr. Habermeier explained the reasons for some caution with regard to the short-term aspect of such borrowing arrangements.

As a matter of policy, I do not think we should be pre-empting through short-term bridging operations too many resources of the Eighth Quota Review with commitments to be made in the course of 1983. Such a policy is certainly a better solution than exhausting the present scarce cash resources of the Fund. But, if we attach too short a time span to the notion of bridging, such a policy would have the drawback of pre-empting a rather significant part of the future ordinary resources received from the Eighth Quota Review, and it would, therefore, lead to the possible acceleration of the process of reconstituting our resources. I am not sure that, at the very moment when we are hoping that legislators will approve the quota increase, we should be moving in that direction. Thus, while I understand Mr. Grosche's indication, I would like him--and others who might be in the same position--to understand that we have to view the issue in a somewhat broader perspective.

Third, I have noted, once more, the reservations of those Executive Directors who feel that recourse to private markets would be a dangerous course. Four Directors have rather strong views on the matter, for respectable reasons of principle. But the majority of the Board takes a more pragmatic approach to the question. I noted that six Executive Directors felt that, while it was, in their view, too early at the present time to decide to take any precise step in that direction, they were not fundamentally opposed to such a possible course. Eight other Directors considered that we should be prepared to move rapidly, if necessary; and some of them felt that the need already existed and that it would be better to approach the markets before the liquidity position forced the Fund into that situation.

To sum up on the question of borrowing in private markets, the Board concluded that the option should remain open, a conclusion consistent with the Interim Committee's recommendations, and that the matter should be reviewed in the coming weeks and months in the light of the liquidity position as it evolves following the outcome of our discussions with SAMA and other potential creditors. In the meanwhile, the Treasurer's Department will continue to work actively, but quietly, on the subject.

The longer-term outlook

Directors noted the major uncertainties affecting the longer-term projections for the years beyond 1983: the eventual decision on the enlarged access policy; the state of the world economy; the pace of adjustment efforts; the role of the banking sector in financing balance of payments deficits. All those factors remain uncertain; it is, thus, difficult at the present stage to determine with precision the financial needs of the Fund in the 1984-86 period.

However, it is also clear that--according to the projections for that period given in the staff paper--the Fund might well be facing new liquidity strains in those years. That is one reason why we should be somewhat cautious in the way we organize our borrowing operations. We have to remind members that we need to live with the quota increase--which is, I hope, imminent--until March 1988. Given the uncertainties that prevail in the world economy, and in the attitudes of the banks, we should be exceedingly careful in maintaining our resources intact as far as possible, because it is extremely important in such an uncertain period to demonstrate that the Fund is in a strong liquidity position. The strength of the Fund should not be underestimated as an element in the stability of the system.

I will keep Directors informed as soon as I have new information with regard to the discussions with the Saudi Arabian authorities and with other official lenders. We shall come back to the issues as many times as we need, and maintain a pragmatic view on these important questions.

The Executive Directors concluded their review of the Fund's liquidity position and financing needs.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/59 (4/8/83) and EBM/83/60 (4/8/83).

3. PARAGUAY - TECHNICAL ASSISTANCE

In response to a request from the Central Bank of Paraguay for technical assistance, the Executive Board approves the proposal set forth in EBD/83/101 (4/4/83).

Adopted April 8, 1983

APPROVED: September 2, 1983

ALAN WRIGHT
Acting Secretary