NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/138

10:00 a.m., September 12, 1983

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

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
J. de Groote	
B. de Maulde	X. Blandin
A. Donoso	
R. D. Erb	T. A. Connors, Temporary
M. Finaish	
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	M. Casey
	H. A. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
F. Sangare	
M. A. Senior	S. E. Conrado, Temporary
	A. Linde
	C. Taylor
Zhang Z.	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

C. F. Schwartz, Consultant. African Department: O. B. Makalou, Deputy Director; F. d'A. Collings. European Department: D. A. Brodsky, P. Gotur. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; N. Kirmani. External Relations Department: A. M. Abushadi, H. P. G. Handy. Fiscal Affairs Department: P. S. Heller, D. C. McDonald. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; S. A. Silard. Middle Eastern Department: F. Drees. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. Artus, C. P. Blackwell, J. E. Blalock, M. C. Deppler, M. Knight, D. J. Mathieson, J. S. Smith, S. von Post. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Williams, Deputy Treasurer; W. L. Coats, Jr., L. E. Escobar, D. Gupta, A. F. Moustapha, T. M. Tran. Western Hemisphere Department: S. T. Beza, Associate Director. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, J. Delgadillo, L. K. Doe, P. Kohnert, I. R. Panday, P. D. Péroz, M. Z. M. Qureshi. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, R. Bernardo, J. Bulloch, M. Camara, M. B. Chatah, L. E. J. Coene, M. Eran, G. Ercel, I. Fridriksson, V. Govindarajan, M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, G. W. K. Pickering, E. Portas, J. Reddy, J. Schuijer, Shao Z., D. I. S. Shaw, M. Toro.

1. WORLD ECONOMIC OUTLOOK - GENERAL SURVEY

The Chairman made the following summing up of the discussion at the previous meetings (EBM/83/136 and EBM/83/137, 9/9/83) on the World Economic Outlook (ID/83/5, 8/19/83).

Executive Directors generally agreed that world economic prospects were better than they had been earlier in the year, but cautioned that much progress remained to be made in dealing with the many difficult issues confronting policymakers. In summarizing the discussion, I will deal in turn with the four major issues presented in Section VI of the staff's paper.

1. Policies for recovery and expansion

Directors noted that recovery appeared to have begun in the industrial world, but considered that the basis of sustained expansion still needed to be established. While vigorous growth had been recorded in North America in the first half of 1983, the signs of an upturn were much less pronounced in other areas. Moreover, even in North America, doubts existed as to the sustainability of the present expansion. The outlook for investment expenditures was not clear, particularly if interest rates should remain high. Thus, while recovery was expected to continue into 1984, and spread to other countries, care would have to be exercised in the evolution of policies if the projections of the staff were to materialize.

Concerning policies for recovery, Directors generally agreed with the staff view that lower inflation had played an important role in the revival of economic activity. It had contributed to renewed growth both by facilitating an expansion of real incomes and by permitting a decline in interest rates. In North America, the upturn in aggregate demand had been encouraged by an expansionary fiscal stance and an easing of monetary conditions; while in several countries structural improvements might also have contributed to the growth of output and productivity.

For the future, Directors considered that the most important objective was to broaden the geographical basis of the recovery and to improve its sustainability. An important requirement in this connection was the use of policies conducive to a revival of business fixed investment. A central element of such a strategy would be the continued pursuit of monetary policies consistent with consolidating and extending the progress already made toward better price stability. Also vital would be credible action to bring about a sustained reduction in fiscal deficits over the medium term. While the timing and speed of such a reduction might have to be adjusted in the light of the circumstances facing individual countries, it was important that the medium-term objective should carry conviction.

Such policies would help to promote a revival of confidence among the business community, and would permit growth in private investment to take place without creating undue pressure in financial markets. There was widespread agreement with the staff view that actual and prospective fiscal deficits were the principal factors maintaining interest rates at such high levels relative to ongoing rates of inflation.

Some Directors pointed out that the withdrawal of fiscal stimulus would be a factor tending to slow down the growth of demand, and noted that if lower budget deficits in the United States led to a decline in interest rates and a weaker dollar, this might tend to retard the recovery of export demand in the rest of the world. The view was expressed by some Directors that with unemployment still high and recovery only in its very early stages, additional measures of stimulus might be considered by countries where inflation was low and output growth remained weak.

On the other hand, it was generally acknowledged that the decline in interest rates that would accompany an improvement in fiscal positions would have a positive effect, particularly on investment demand, but possibly with some lag. Moreover, as Directors from the larger countries noted, the perception that government finances were being brought into line with official medium-term objectives would remove an important source of uncertainty and lead to an improvement of consumer and business confidence. There was no dissent from the view that a recovery of fixed investment was essential if the present upswing was to be sustained.

Other important components of a strategy for sustained growth that were stressed by Directors included continued attention to structural policies designed to improve the functioning of goods and labor markets. Directors from a number of industrial countries noted that the high level of wage costs was a factor impeding certain types of investment and thereby hindering a recovery of output and employment. It was considered that governments should make a special effort to explain the necessity for wage restraint if the present upturn in activity was to be consolidated and extended. It was also noted that inappropriate support for declining industries should be avoided and, more generally, that protectionist actions, if not vigorously resisted, would hamper output growth and undermine the efficiency of resource allocation.

2. Exchange rates and policy interactions

Directors considered that the continued strengthening of the U.S. dollar during 1983 was the most noteworthy feature of exchange market developments. It was noted that the effective exchange rate for the dollar had appreciated by a further 5 percent since the period used as the basis for the projections made in the staff's paper.

Directors generally agreed with the staff that the strength of the dollar reflected the expectation that the demand for funds in the United States would continue to outstrip domestic savings, thus necessitating high interest rates to attract the necessary capital flows from abroad. However, it was noted that many other factors also affected exchange market developments, and that a fully satisfactory explanation of recent exchange rate movements was hard to construct. One factor making for a growing capital inflow, for example, might be simply the strengthening of confidence in the U.S. economy and the breadth of the U.S. financial markets at a time when the U.S. inflation rate was being brought down to the same broad range as that prevailing in Germany and Japan.

While some Directors considered that the strength of the dollar would have generally beneficial effects, tending to increase U.S. net imports and thereby spread recovery to the rest of the world, the majority felt that it nonetheless represented a source of concern. In the first place, a point noted by several Directors from industrial countries, the strength of the dollar faced the United States' trading partners with the choice of maintaining higher interest rates or acquiescing in greater price pressures, either of which would be inimical to their short-term recovery prospects and their longer-run policy objectives. For the developing countries, the principal concern was that the high U.S. interest rates that appeared to be contributing to the dollar's strength would raise the burden of debt service and complicate their already severe financing problems. Moreover, their external debt was mainly denominated in U.S. dollars, while their external receipts were in a variety of currencies. An appreciation of the dollar therefore tended to worsen the ratio of debt to exports and GNP. Lastly, some Directors noted that if, as the staff projected, the appreciation of the dollar led to a substantial and possibly unsustainable deterioration in the U.S. current account, market sentiment might cause it to be reversed. The prospect of fluctuations in exchange rates was generally adverse to the smooth development of trade. In this connection, however, it was noted that the large errors and omissions item in the U.S. balance of payments statistics makes it difficult to assess the underlying position of the current account.

In light of these concerns, Directors generally agreed with the staff that a reduction of uncertainties concerning the evolution of fiscal positions, and in particular, a credible plan to reduce the U.S. fiscal deficit in the medium term, offered the best hope of restoring a pattern of exchange rates and savings flows that was more consistent with the needs of a sustainable world recovery.

3. Adjustment and financing in the developing world

There was widespread agreement with the staff view that the adjustment policies that had been put in place in developing countries in the recent period needed to be pursued steadfastly.

Many Directors noted that developing countries had faced a particularly difficult world economic environment in the past several years, and that if account were taken of exogenous factors affecting their balance of payments, the degree of external adjustment already achieved was substantial. The cost of this adjustment, however, had been high. The staff estimate for output growth in the developing world had been revised down for 1983 and this would be the third consecutive year in which per capita consumption in non-oil developing countries had been stagnant or falling.

Concern was expressed that the adjustment strategy advocated by the Fund, while appropriate for an individual country taken in isolation, might create difficulties when a large number of countries pursued it simultaneously. With recovery in the industrial world only modest, the scope for export expansion was limited, and adjustment through import compression could have adverse effects, both domestically and for trading partners. Several Directors pointed to the role played by demand in developing countries in contributing to output growth in the industrial world, although it was noted that such an effect would be relatively modest. On the other hand, it was recognized that in the present financial situation, the developing countries had no alternative but to adjust their current account position, although this should naturally be done in a manner that minimized the adverse effects on the development process. The more speedily and effectively a viable external position was restored, the sooner the countries concerned would be in a position to attract additional foreign capital and resume more vigorous growth.

It was noted that the current account deficit of the non-oil developing countries had been considerably reduced over the past two years, and that by 1984, its size relative to export receipts was projected by the staff to be only about half that prevailing in 1981. While this, in itself, was a cause of satisfaction, the manner in which it had been brought about--through a severe compression of imports, associated with pronounced weakness in economic activity--had imposed considerable hardships.

Directors noted that the staff's forecasts envisaged a gradual pickup in activity in developing countries from now on, but questioned how sustainable this would prove to be. They noted that even the existing level of the current account deficits of non-oil developing countries was only being financed as a result of extraordinary efforts to obtain funds from reluctant private lenders. Since the staff's projection for the medium term--which had been set out in more detail in the World Economic Outlook--involved a significant increase in the current account deficits, some Directors questioned whether the staff's estimate of the achievable growth of output in the medium term--4.5 percent--would prove to be realistic.

These considerations led a number of Directors to suggest the need, over the medium term, to develop alternative channels of finance to the bank lending that had played such a major role in financing developing countries' deficits in the past decade. In this connection, the role of foreign direct investment, and the greater use of capital markets in developed countries were mentioned.

For the immediate future, however, it was recognized that reliance would have to continue to be placed on finance from banks, encouraged by the efforts of the Fund, and supplemented by Fund resources. This latter point reinforced the conviction of a number of Directors that the increases in the Fund's resources recently agreed to were the minimum required, and should be speedily implemented.

4. International cooperation

Executive Directors unanimously endorsed the staff view that protectionism was a major threat, and if allowed to spread, would curtail the ability of developing countries to service their debt and regain the momentum of economic advance. It was pointed out that protectionist tendencies were widespread in all groups of countries, and were often encouraged by high levels of unemployment and the difficulties created for particular sectors as a result of exchange rate shifts. This made it all the more necessary, in the eyes of several Directors, to adopt policies that would result in a more stable and sustainable pattern of exchange rates, and a more durable recovery of economic activity.

Directors also endorsed the view that a continued, and indeed increased, flow of official development assistance was essential if those developing contries whose access to capital markets was likely to remain limited were to overcome their adjustment difficulties and resume a more satisfactory rate of economic development.

Finally, concerning the role of the Fund, several Directors commented on the desirability of maintaining and reinforcing the Fund's surveillance activities. The attempt that the staff had made in its paper to extend the treatment of policy interactions among countries was generally welcomed, as were several developments of a similar character undertaken in the context of Article IV consultation reports. However, several Directors considered that more attention could have been given to the implications for developing countries of policy developments in the industrial world. In the financial sphere, the continued tight position of many member countries made it essential that the Fund retain the capacity to support adequately realistic programs of adjustment.

2. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR SEPTEMBER-NOVEMBER 1983

The Executive Directors considered the proposed designation plan and operational budget for the quarterly period September-November 1983 (EBS/83/188, 8/29/83; and EBS/83/189, 8/29/83). They also had before them the following statement by the Treasurer:

> As noted in both the designation plan and the operational budget, data on the reserves of the United Arab Emirates were not available on the new basis recently agreed with the Bureau of Statistics, and the amounts of designation and sales of U.A.E. dirhams were calculated on data supplied, on the previous basis, to the Bureau for end-October 1982. The United Arab Emirates has now supplied new data up to end-July 1983. These new data, which are still provisional, show gold and foreign exchange holdings at end-July 1983 at about SDR 2,013 million as compared with the October 1982 level, calculated on the previous basis, of SDR 2,715 million. Had the new data been used in the calculation of the plan and the budget, the amounts of designation and sales of U.A.E. dirhams would have been SDR 13.4 million and SDR 15 million, respectively, compared with SDR 18.8 million and SDR 20.1 million in the proposals before the Board.
>
> However, there remain some technical questions as to whether the new series of data supplied by the United Arab Emirates fully reflect the new basis. These questions are expected to be resolved shortly, and it seems unlikely that the end-July data would differ significantly from those reported above. It is suggested, therefore, that the Executive Board take the proposed decisions on the designation plan and the operational budget, but that as soon as the technical questions have been resolved, amended decisions would be circulated to the Executive Board with appropriate reductions in the amount of designation for the United Arab Emirates and in sales of dirhams, with corresponding reductions being made in the totals of the plan and budget. The amounts for other members in the plan and budget would be left unchanged.

The Deputy Treasurer explained that supplements would be circulated following the meeting to update the transactions since the staff papers had been issued (see EBS/83/188, Sup. 1, 9/13/83; and EBS/83/189, Sup. 1, 9/13/83). The volume of transactions under the operational budget since August 29 had been small.

Mr. Grosche said that he could support both proposed decisions. He was glad that the question of how to define the reserves of the United Arab Emirates had been resolved; he hoped that an answer would soon be found to the remaining technical questions on the data up to the end of July, so that the new series of data could fully reflect the new basis. It was important that all member countries should provide the latest data

on reserves. The staff should be in a position to assess countries' reserve and balance of payments positions on an equal basis so that members made a fair contribution to financing the Fund's operations. As shown by Appendix Table 1 to EBS/83/188, several members had not provided any data for quite some time.

Mr. Taylor stated that he also could support the proposed decisions. Referring to Section 5 of EBS/83/189, concerning the calculation of amounts of currency and in particular the transfers of currencies, he commented, first, that over a year had passed since the introduction of the ad hoc limitation on the preannounced use for transfers of the currencies of the four members whose quotas were relatively low in relation to their gold and foreign exchange holdings. His authorities had been prepared to go along with that limit in the preparation of budgets, but only on the understanding that it did not become a permanent feature. His authorities continued to have reservations about the consistency of ad hoc limits on sales of certain members' currencies with the decision taken by the Executive Board in March 1981 on the use of currencies. The adjustments being made by the staff were not merely technical; they amounted to special treatment, and ran somewhat against the principle that quotas should be the basic measure of members' rights and obligations in the Fund. He hoped that the staff would find it unnecessary to propose the continuation of those ad hoc limitations following the implementation of the quota increase.

Second, concerning the possible depletion of the Fund's holdings of currencies of several members over the coming few months, Mr. Taylor went on, could the staff explain more precisely why it believed that an appropriate level for working balances of currencies was an amount equivalent to 10 percent of a member's quota? At times in the past, smaller percentages had been accepted as meeting the need for a working balance. He recognized that some balances were necessary to enable the Fund to pay remuneration to a creditor member in its own currency, and for other purposes. However, if the quota increase was delayed for a limited time, it might be possible to consider lowering the normal 10 percent level on an exceptional and temporary basis.

Finally, Mr. Taylor noted that the Fund still held a moderate amount of SDRs in the General Resources Account. According to the staff, even if the present operational budget were fully utilized, about SDR 1.3 billion would remain in that Account. It might be appropriate to compensate for any temporary scarcity of the currencies of one or two members, pending the implementation of the quota increase, by using more SDRs on the transfer side of the operational budget. It would be interesting to have an idea in general terms of the range of possible solutions that the staff might consider in due course, if a temporary scarcity of certain members' currencies were to materialize.

Mr. Connors said that he had no major problems with either the operational budget or the designation plan and that he could support both proposed decisions.

The Deputy Treasurer said that what constituted an appropriate level of working balances was in part a judgmental matter. Three considerations had led the staff to believe that it would be advisable in present circumstances not to allow the Fund's holdings of members' currencies to fall below 10 percent of quota. First, as Mr. Taylor himself had mentioned, the Fund had an obligation to pay remuneration, and the creditor could opt to receive its own currency in payment; the amount of remuneration to be paid had become a less certain figure as remuneration was being calculated on a weekly basis rather than on a quarterly retroactive basis. Second, provision was made under a number of the Fund's loan agreements for the payment of interest and repayment of the loans themselves in the creditor member's own currency. There was thus a need to hold balances of the currency of some of the creditor countries in case such provisions were utilized. Because members had the right, under the Articles, to make repurchases and pay charges in SDRs, there might also be times when the Fund would be unable to match those payments with repayment of a loan to a creditor member in its own currency, if that was its wish. Third, the staff needed to be alert to the possibility of the Fund having to finance certain transactions with members needing a specific currency to settle indebtedness by buying back their own currency, for example, in connection with European Economic Community settlements. Therefore, an attempt was made to keep a reasonable working balance of all members' currencies so that the Fund could effect such transactions quickly and maintain fully the liquidity of members' reserve tranches.

For those reasons, the Deputy Treasurer commented, a situation of unease would arise if currency holdings fell much below 10 percent of quota. However, the level would be looked at carefully in the context of the next operational budget and of developments relating in particular to the time at which the quota increase would take effect.

Following a review in the spring of 1983, the Deputy Treasurer recalled, the Executive Board had set the Fund's holdings of SDRs at about SDR 1.5 billion by the end of the year. That level had been considered about right for two reasons. First, as Mr. Taylor had remarked, if there was a temporary scarcity of any individual currency, SDRs would be used to replenish that currency. Second, in connection with the pending quota increase, the Fund would be asked--and indeed already had been asked--to sell SDRs to members against acceptable currency, permitting them to pay 25 percent of the quota increase in SDRs as well as enabling them to meet their other obligations to provide SDRs. As Directors were aware, the level of the Fund's holdings of SDRs would need to be reviewed again before the end of the year.

The Chairman said that he had taken note of Mr. Grosche's point on the importance of the timely communication of reserve statistics to the Fund. In addition, Mr. Taylor's points on the ad hoc adjustments to the amount of use of some members' currencies would be given further consideration.

The Executive Board then took the following decisions:

Special Drawing Rights Department - Designation Plan for September-November 1983

The Executive Board approves the designation plan for the quarterly period beginning September 12, 1983 as set out in EBS/83/188 (8/29/83), and Supplement 1 (9/13/83).

Decision No. 7519-(83/138) S, adopted
September 12, 1983

Operational Budget for September-November 1983

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/83/189, page 4, footnote 1, and the operational budget for the quarterly period beginning September 12, 1983, as set out in EBS/83/189 (8/29/83) and Supplement 1 (9/13/83).

Decision No. 7520-(83/138), adopted
September 12, 1983

3. GLOBAL NEED TO SUPPLEMENT EXISTING RESERVE ASSETS - LONG-TERM CONSIDERATIONS

Executive Directors took up a staff paper on considerations relating to the long-term global need to supplement existing reserve assets (SM/83/196, 8/26/83).

Mr. Donoso noted that the earlier staff paper relating to a possible proposal for an allocation of SDRs in the current basic period (SM/83/157, 7/11/83) had concentrated largely on the estimation of differences between the actual holdings of international reserves and the reserve levels that would result from the normal relationship between imports and reserves. The basic conditions underlying the lack of reserves had been touched upon only marginally in that paper in comparison with the recent paper on the long-term global need to supplement reserve assets. Going behind the problem of low reserve levels, the staff had been able to make a more detailed analysis, which clearly illustrated that the low level of reserves in some groups of countries reflected an adjustment to drastic changes in the availability of financing. The resulting picture was very worrying.

The deficit of the non-oil developing countries, shown in Table 5 in the earlier staff paper as the difference between actual nongold reserves and the "need for reserves" based on the concept explained by the staff in the new paper, seemed low--at SDR 9 million at end-1982--compared to the same group's imports or exports, Mr. Donoso said. Looking at the type of adjustment going on in that group of countries, and the uncertainties

relating to the availability of resources, gave a better idea of the real meaning of that deficit and of the real need for mechanisms to ensure that no further adjustment that might be beyond the reach of those countries became necessary.

Focusing his comments on the non-oil developing countries of the Western Hemisphere, Mr. Donoso remarked that their net external borrowing had fallen from SDR 36 billion in 1981 to SDR 19 billion in 1983, according to Table 15 of the General Survey of the World Economic Outlook (ID/83/5, 8/19/83). Borrowing from private sources had fallen by around SDR 20 billion in net terms, offset in part by an increase in other sources of financing. In order to cope with the lower availability of foreign financing, those countries had halved their current account deficits from SDR 45 billion in 1981 to only SDR 23 billion in 1983, an enormous adjustment. Their average rate of growth of GDP had fallen from 5.7 percent in the years 1978-80 to -1.03 percent in the years from 1981 to 1983. Roughly speaking, although in the earlier years GDP per capita had been growing at around 4 percent a year, it had been decreasing in the past three years at 3 percent a year. Income per capita had been reduced even more, as terms of trade had deteriorated and the rates of interest to be paid on external debts had risen. The reduction in the current account deficit had to be included to arrive at the total reduction in demand per capita. It was thus no wonder that those countries had reduced their holdings of nongold reserves.

According to SM/83/196, Mr. Donoso added, non-oil developing countries in general would require SDR 75 billion in each of the next three years to finance current account deficits and the acquisition of reserves. Official transfers and direct investment could, it was estimated, reach SDR 25 billion; long-term borrowing from official sources and use of Fund credit could furnish another SDR 30 billion a year; it would be left to private financial institutions to furnish about SDR 20 billion a year. In the words of the staff, non-oil developing countries would have to attract the lion's share of the expected growth of the Eurocurrency market to obtain what they required. The deterioration in the country risk rating of non-oil developing countries made it difficult to assure that outcome, according to the staff. Certainly, there was a risk that those resources would not be available.

For the non-oil developing countries in the Western Hemisphere, Mr. Donoso continued, the lack of resources might imply further adjustment and the postponement of the positive growth projected for 1984 in the paper on the world economic outlook. Given the deterioration already occurring in the standard of living in those countries, it might be difficult to bring about orderly adjustment. Thus, a further deterioration in their reserve positions and an increase in financing by means of arrears could not be discounted. It should be remembered that those countries as a whole had a total external debt of SDR 260 billion.

He shared the staff's view that a meaningful SDR allocation would be helpful in the circumstances to maintain orderly adjustment in non-oil developing countries, Mr. Donoso declared. Such an allocation would not

imply that those countries would escape conditionality or scrutiny. Because of the size of their debts, the allocation of SDRs would also help to reduce the possibility of financial instability in the lending countries and to avoid constraints in the latter countries' ability to pursue their money, credit, and price objectives, as the staff had advised.

An allocation of SDRs could not be expected to bring about an increase in reserves of the same amount, Mr. Donoso remarked, as the staff had clearly explained. In developing countries, the low level of reserves was the effect of a more general reduction in demand--for reserves and for goods and services--to cope with lower income owing to high interest rates, adverse terms of trade, and the lack of foreign financing. The reduction in income and availability of foreign financing was greater than the deficit in the stock of reserves, measured as the difference between the reserve need and reserve holdings. Thus, to solve the problem of insufficient reserves, other elements affecting income or the availability of capital to countries had to be considered alongside those affecting the allocation of SDRs.

So far, SDR allocations, when they had occurred, had been in the order of SDR 3-4 billion a year, Mr. Donoso recalled. The higher figure was probably less than debtor countries would pay yearly on account of the higher rates of interest being applied to their rescheduled debts, an issue that, as he had mentioned previously, should be considered separately in the Executive Board. An allocation of SDR 4 billion a year would be almost three times the difference in the Fund's borrowing needs under access limits of 150 percent of quota rather than 125 percent of quota during 1984-86, a problem that had merited a great deal of attention from the Executive Board. The staff had highlighted the difficulties of the present situation in such terms that the Board's discussions relating to SDRs, quotas, access limits, the determinants of interest rates, and terms of trade, took on special relevance. Given the potential financing gap that would remain, it was important to agree on an allocation of SDRs and to explore other areas where part of the solution to the present difficulties might lie.

Mr. Polak noted that although the additional staff paper and the additional time that the Executive Board had had to consider the earlier staff paper had contributed to a better understanding of the need for reserves, he did have some difficulty with the staff's approach. In the past, admittedly rather crude measures of the medium-term demand for reserves had been made, based in a fairly simple way on the ratio of reserves to imports, perhaps allowing for a certain trend change. On previous occasions the staff had not tried to explain year-to-year changes in the demand for reserves based on the use of a considerable number of variables, as had been done in SM/83/196. After discussing the subject with the staff, he wondered whether the approach was not too ambitious for the current state of knowledge. Specifically, he did not feel entirely confident that the deviations shown in Table 2 between the demand and the supply of reserves for the year 1982--indicating excess reserves where those deviations were positive and reserve deficits where they were

negative--were truly indicative of such excesses and deficits. Those deviations might in fact be due simply to the fact that the correlations were not good enough to capture all the elements going into the demand of countries for reserves on an annual basis.

It would perhaps be possible to resolve that uncertainty by additional work, but the difficulty of the undertaking and the lack of time suggested that it might be necessary to fall back on the simpler approach of the past, Mr. Polak observed. From about the mid-1970s until about 1981, most countries could usually obtain approximately the reserves they were willing to hold through the working of the international banking mechanism. In those circumstances, a global shortage of reserves--the subject of so much concern in the 1960s when the SDR facility had been created--had in fact become quite unlikely. In the circumstances of the 1970s, the arguments in favor of an SDR allocation had therefore been basically of a secondary nature: that the SDR system should be kept alive, that allocations produced a better composition of reserves, and that interest spreads should be reduced. But in 1982 the situation had reverted to some extent to what it had been in the 1960s. The developing countries were obviously suffering from a reserve shortage. The disease had not yet spread to the industrial countries, for which the prior mechanism presumably still held; but he saw no good intuitive reason why the industrial countries should have had a large surplus of reserves in 1982, as shown in Table 2 of SM/83/196. He did not preclude a reserve surplus for those countries in other circumstances, for instance, as in 1971 and 1972. His doubts about the surplus projected for industrial countries in Table 2 also led him to doubt the accuracy of the relatively small deficiency in reserves shown for non-oil developing countries.

He was also not entirely happy with the projections for 1982-86 in Table 2, Mr. Polak added, because they were based on the assumption that whatever deficit or surplus of reserves existed in 1982 would have disappeared by 1986. The staff had based its argument on past experience. Yet the mechanism of the past had broken down in the middle of 1982, and its repair before 1986 could by no means be assumed. The outcome would depend in part on the solution that might or might not be found for the present banking crisis, which in turn would depend on what was done about the reserve situation. The projections in Table 2 both for total reserves and their components by country groups were too mechanical.

On the basis of what was fairly well known at the present time, Mr. Polak continued, it would have to be acknowledged that the mechanism of reserve supply that had made the allocation of SDRs over the preceding five or ten years optional had partially broken down, leading to a general reserve problem. Although the mechanism seemed more or less still to be working for some countries, there could be general problems in economics without all countries suffering. It was for instance common to speak of serious unemployment problems when the overwhelming majority of the population was still at work. Similarly, there could be a general reserve problem when holders of more than half of the world's reserves still had no difficulty in getting the reserves they wanted. Recourse to the SDR

mechanism was thus justified. SDRs created and allocated to countries not suffering from a reserve shortage would simply tend to be held in larger reserve positions without there being any further economic effect--as he believed would happen to SDRs flowing to the United States--or would lead to a roughly corresponding reduction in reserves held in other forms.

It would be helpful if the staff could provide a new estimate of the reserve deficiency of the non-oil developing countries together with the high absorbing oil exporting countries, more or less along the crude lines on which the problem had previously been handled, Mr. Polak stated. Such a figure could then be considered as an estimate of the global shortage of reserves, on the assumption that the reserves of the industrial countries and the low absorbing oil producing countries would still be approximately at their demand level. An outer limit of what could be considered as an appropriate SDR allocation would thereby be set. While such a guide would not make decision making easy, it would at least provide some basis for the numerical aspect of the subject. He was not asking for elaborate or refined calculations, but only for "back-of-the-envelope" estimates. The secondary arguments used to justify SDR allocations in the past remained valid but they still remained secondary. With respect to one of those arguments--the composition of reserves and the relative role of SDRs in total reserve assets--the staff might have paid more attention to the large increase in SDR-denominated claims on the Fund that were the counterpart of the large credit extension by the Fund in recent years.

Mr. de Maulde remarked that it was difficult to find much in the staff paper about the criteria that could be used in measuring the additional long-term need for reserve assets. In fact, most of the staff's conclusions rested on sets of projections of reserves in different groups of countries. Those projections did not take full account of two major uncertainties: first, the share of borrowed reserves versus net reserves in the evolution of total reserves over the period under review; and second, the volume and, more important, the distribution of banking flows in the next few years.

As indicated in SM/83/196, "in the long run the demand for reserves is always satisfied at some price and with some economic consequences or accompanying conditions," Mr. de Maulde observed. In that respect, the risk or cost of promoting deflation was not acceptable. Avoiding such a risk did not mean that inflation would be rekindled. As indicated in the IFS supplement on trade statistics (Supplement Series No. 4, page xxii, 1982), variations in the rate of growth of imports tended to follow closely variations in the level of reserves with a lag of about two years. In the present circumstances, it might not be prudent to place too much confidence in the random progression of borrowed reserves by neglecting net reserves, which, from a long-term point of view, were the one essential element in the reserves of a given country.

SDR allocations were not a tool for contracyclical policies, as stated at the top of page 3 of SM/83/196, Mr. de Maulde agreed. The Articles referred to the long-term reserve need, but in his mind the usefulness of

an allocation would lie rather in avoiding the self-destruction of the structural adjustment effort under way. The need for reserve assets in a large number of countries, including naturally the most heavily indebted of them, was sufficiently acute to justify appropriate action by the International Monetary Fund.

The remarks of the staff on the composition of international reserves and on a calendar for future SDR allocations were to the point, Mr. de Maulde considered. Those considerations alone would justify SDR allocations.

Finally, Mr. de Maulde suggested, beyond the issue of the total volume of reserves, that of their distribution deserved special consideration. The different ways of enabling the distribution of SDRs to be focused on the neediest countries should be carefully examined.

Mr. Grosche noted that in dealing with the longer-term aspects of SDR allocations, the staff had raised rather fundamental and far-reaching issues relating to the international monetary system. Although the heavy workload and time pressures had prevented an in-depth examination of those issues, a study of the new staff paper had raised even more doubts on the part of his authorities about the appropriateness of SDR allocations in general. Some of the staff's reasoning had brought strongly to mind the discussions during the early 1970s in the Committee on Reform of the International Monetary System. He was referring particularly to the ideas of convertibility, and the consolidation and management of currency reserves in a reformed system.

He would outline the reasons why the paper had not convinced his authorities, Mr. Grosche stated. First, they could find no clear evidence of a global reserve shortage either at the moment or in the foreseeable future, a view that seemed to be shared by the staff. Under the present floating exchange rate system, international liquidity had taken on a new meaning. In a floating system in which countries held several reserve currencies, monetary authorities could enlarge their reserves simply by buying those currencies in the market. When that seemed difficult owing to exchange rate considerations or to a weak domestic currency, countries could in principle borrow on capital markets. The supply of international liquidity in a broad sense had become open-ended, subject to creditworthiness. Therefore, as the staff had predicted, only non-oil developing countries would face reserve shortages in the future, and their particular transmission problem had to be resolved mainly by a re-establishment of creditworthiness. He had taken note of the desire of countries, non-oil developing countries in particular, to be able to acquire at least part of the reserves they needed in some way other than by adding to their international debt. However, he doubted whether an SDR allocation that would add liquidity to an already open-ended system was the right answer to the problem. In his view, the right solution would be additional concessional flows.

His second reason for doubting the conclusions of the staff, Mr. Grosche added, was that the staff's argument for SDR allocation appeared to be based primarily on the fact that it would increase the share of SDRs in reserves, and thereby improve reserve composition. Although it was not stated specifically, that argumentation was based on Articles VIII and XXII, in which it was said that the SDR should be the main reserve asset of the international monetary system. His chair had entered qualifications to that argument in the recent discussion of the proposal for an allocation of SDRs.

A third doubt arose from one of the key sentences of the staff paper, Mr. Grosche continued. The staff stated on page 7 that "in the long run, however, substitution of allocated SDRs for other reserve assets is likely to be almost complete, as most countries adjust over time to eliminate differences between actual and desired reserve holdings." In those last two arguments, the staff appeared to be trying to convey the message that the founding fathers of the SDR had favored permanent and steady SDR allocations. That message came through particularly strongly in the concluding remarks in Section V. If the staff's interpretations were correct, why did the Articles of Agreement provide also for SDR cancellations?

Fourth, Mr. Grosche went on, the staff had tried to support its argument by criticizing the present multicurrency system. The basic underlying idea was again a reflection of the type of reformed system proposed in 1974 by the Committee of Twenty. Under such a system, better management of liquidity and avoidance of uncontrolled growth of reserve currency balances was to be achieved by international surveillance and management in the Fund. Yet, in an open system, effective control of the growth of reserve currency balances was still far from being achieved. Therefore, he did not believe there was any assurance whatsoever of the emergence of a more controllable reserve system as a result of allocating SDRs.

Fifth, on the reserve diversification aspects of SDR allocations, Mr. Grosche referred to the twofold argument by the staff in favor of increasing the share of SDRs in gross reserves: the reduction in the exchange valuation risk of holding reserve assets, and the fact that SDRs were not subject to sovereign risk or to the risk of default. If those views were generally shared by member countries, why was the level of SDR holdings by many members so far below the level of allocations? The staff had also put forward the argument that issuers of reserve currencies would encounter certain difficulties if they were to provide indefinitely for the bulk of the growth of reserves. That was surely also true when member countries in a strong balance of payments and reserve position received SDRs in exchange for their own currencies.

In conclusion, Mr. Grosche considered, the staff had provided an interesting paper that addressed some fundamental issues of the international monetary system, going beyond the mere issue of an SDR allocation, but it had not, at least in the view of his authorities, provided clear evidence that the time had come for a new round of SDR allocations.

Mr. Connors stated that the position of his authorities had not changed. They had serious doubts about the appropriateness of an SDR allocation at the present time. The staff had made a commendable and interesting attempt to lay out the various long-term considerations relating to an allocation of SDRs. However, more time was needed to study the paper before substantive comments could be made.

Mr. Arias noted that there had been a moderate resumption of total reserve growth since the end of 1982, when reserves had been lower than at the end of 1981. The staff was projecting continued reserve growth in line with the expected growth in the value of world imports to the end of 1986. Owing to the difficulties that were presently afflicting the international financial system, and because reserve growth had become increasingly dependent on the activities of commercial banks, all such predictions might have to be discounted, even for the world as a whole. But even if reserve growth should continue as predicted, that would not mean there was no requirement for reserve supplementation. He agreed with the staff that reserve need was not only different from reserve demand but that it had numerous dimensions other than quantitative ones.

One of those dimensions was the distribution of reserves, Mr. Arias went on. The reserves of the major oil producing countries had been falling since the end of 1981. Collectively, their reserves were still large by usual standards, a fact of no relevance to individual countries. The reserves of non-oil developing countries, which had already been on the low side in 1981, had shown a negligible overall rise, and a decline or near stagnation for four out of five subgroups--all except Asia.

He agreed with the staff, Mr. Arias said, that achieving reserve growth either through the accumulation of current account surpluses or through borrowing could be extremely costly for most non-oil developing countries, because of the opportunity costs or the spreads, as the case might be. Borrowing to augment reserves would further burden those countries with debt, which was already too high. Moreover, the volume of borrowed reserves was at all times uncertain because it depended on the policies of the lending institutions. To rely for a significant part of the reserve supply of an important group of countries on such an uncertain asset was not conducive to the appropriate operation of the international monetary system. Furthermore, even without taking an apocalyptic view of the uncertainties that potentially afflicted a multicurrency reserve system, excessive reliance on national currencies for reserve growth had numerous inconveniences, as pointed out in the staff paper, which would be absent if reliance was placed on SDR growth.

He also felt, like the staff, Mr. Arias added, that steady allocation rather than lengthy periods of zero allocation--even if the latter were interrupted with periods of positive allocation--was desirable from the point of view of maintaining the goal of an international reserve system centered on an international asset like the SDR.

In the present economic and financial environment, there was no danger that a resumption of SDR allocations would stimulate inflationary expectations, Mr. Arias stated. The improvement in the quality, and particularly in the yield of the SDR, made it unlikely that there would be any move toward dumping SDRs. It was more likely that, as excellent reserve assets, additional SDRs would be held by the initial recipients unless particularly unusual situations arose. Moreover, he saw no inconsistency between advocating both monetary stability and a moderate allocation of SDRs. There was no close relationship between national money supply and the supply of international primary reserve assets. Furthermore, nobody had ever claimed that the quest for national monetary stability implied freezing absolutely the size of the national money supply; nor did the quest for international monetary stability require freezing absolutely the volume of international reserves or of primary reserve assets. Finally, under present conditions of depressed output and trade, an allocation of SDRs could be of modest help in counteracting the tendency toward protectionism in both developed and developing countries.

Mr. Hirao observed that the key issue was whether or not there was clear evidence that the conditions for SDR allocation set forth in the Articles were met. On the first condition of whether there was a long-term global need to supplement existing reserve assets, the staff paper provided a helpful interpretation of the concept of long-term global need for reserve supplementation. The second condition was whether the SDR allocation was consistent with the objectives of avoiding either recession or inflation. His authorities had been open-minded, but after careful consideration, took the view that it had not been fully established that SDR allocation at the present stage of the world economy would serve the objectives of the Fund.

It was encouraging that significant progress had been made on inflation in some industrial countries, Mr. Hirao continued. Given that progress, it had been suggested that there might be less reluctance to resume SDR allocations. Nevertheless, inflationary expectations continued to exist in important countries, and in developing countries inflation remained high. In the circumstances, and given the psychological signal that a new allocation might impart, careful consideration should continue to be given to the matter.

An important issue concerning the long-term global need to supplement existing reserve assets, Mr. Hirao went on, was whether the growing size of the Eurocurrency market could supply a flow of credit to meet the needs of members for the acquisition of reserves as well as for deficit financing. In aggregate, and even on the assumption of a very modest rate of growth of that market, it could probably accommodate the need for funds. However, as noted in the staff paper, the access of developing countries to the market had changed markedly, reflecting debt servicing problems. Perhaps the staff was correct to suggest that, although reliance on borrowing in the international market could serve as an alternative to owned reserves in normal circumstances, there could be abrupt changes in the normal pattern of transmission of funds through the markets.

Despite those financing difficulties, Mr. Hirao noted, a series of important steps had already been taken to ensure orderly adjustment for a number of debtor countries. The full implementation of adjustment programs under way might take a relatively long time, but the creditworthiness of the countries undertaking them could be restored much earlier if confidence was regained in the steadfast implementation of programs. As a consequence, the present financing difficulties would become less pressing as time went by. The most important role the Fund could play in present circumstances would seem to be in continuing to assist its members' adjustment efforts. If the Fund's role were perceived as promoting adjustment through the provision of conditional liquidity, it would be worth undertaking further analysis of the effects of SDR allocation on the effectiveness of the Fund's adjustment programs.

Mr. Sangare said that the staff's assessment of the long-term global need for reserve assets was interesting because it brought into focus a basic point that had not received much attention in previous staff papers on SDR allocations; namely, that an important reason for supplementing existing reserve assets was the need to improve their quality and to reduce the costs and risks associated with complete dependence on some national currencies for the growth in international reserves. While he agreed with the staff's approach, he would add that the long-run global need for reserves also derived from the inadequacy of the existing reserve position of many countries, reflecting the skewed pattern of reserve distribution, the oligopolistic character of its supply, the impact of national policies in the reserve currency countries, and the malfunctioning of the international financial system.

Perhaps those were among the basic reasons why the Articles of Agreement had called for the establishment of the SDR as the principal reserve asset in the international monetary system, Mr. Sangare commented. The SDR was the only reserve asset created through the discretion and cooperative will of the entire international community. Because of the dismal rate of allocation of SDRs in the past, their share in nongold reserves had fallen from 7.4 percent in 1972--the end of the first basic period--to 4.9 percent in 1982.

The skewed pattern of reserve holdings and the limited ability of non-oil developing countries to augment their reserves, Mr. Sangare went on, made their situation of special importance in assessing the long-term global need for reserves. The continuing financial and economic crisis, aggravated by adverse external developments and disturbances in international financial markets, suggested that a large allocation of SDRs was both necessary and desirable.

The projection of a rising ratio of nongold reserves to merchandise imports for non-oil developing countries should not be taken as an indication of an expected improvement in the reserve position of those countries, Mr. Sangare observed. On the contrary, that projection was more a reflection of import compression and of restrictions on international transactions caused by increased reserve inadequacy. The

continuing stringent reserve position of those countries was clearly shown in Table 2 of SM/83/196, indicating a persistent excess demand for reserves. Hence, he fully endorsed the staff's conclusion that "under the present outlook, non-oil developing countries are not likely to be able to eliminate their excess demand for reserves by 1986...." Within the group of developing countries, African countries were in the even more difficult situation of suffering from a continuous erosion in the ratio of reserves to merchandise imports, which had declined from 10.8 percent in 1978 to 6.9 percent in 1982, despite a decline in imports in many of those countries.

Considering the reduced access of developing countries to international markets and the persistent deficit in their balance of payments, Mr. Sangare continued, he found it difficult to accept the staff's projection that non-oil developing countries would be able to add SDR 35 billion to their reserves by the end of 1986. He had noted the staff's interesting analysis of the external financing of non-oil developing countries. However, recent developments and disturbances in international capital markets seemed to make the expectation of raising SDR 20 billion from private financial institutions highly optimistic. Even the assumptions of SDR 25 billion in official transfers and direct foreign investment, and SDR 30 billion in loans from official sources and Fund credit, were highly questionable. Moreover, the long-term need of those countries for imports to sustain their development efforts made any accumulation of reserves possible only at exceptionally high cost and increased indebtedness. A prompt, large allocation of SDRs would help developing countries to acquire part of the reserves that they needed, at relatively low cost. Besides, in the present difficult circumstances, an SDR allocation would help to facilitate adjustment efforts as well as make it possible to implement investment and development programs. An orderly implementation of adjustment programs would also be beneficial to developed countries.

While he had stressed the long-term global need for reserves from the point of view of developing countries, Mr. Sangare remarked, that was not to say there were no other indications of the existence of a global need. The staff paper had verified that the diversified nature of the SDR could reduce the exchange valuation risk and sovereign or default risk inherent in the present multicurrency reserve system. Moreover, there was concern in reserve currency countries about their financial exposure and the discrepancy between their economic weight and the role of their currency in the international financial system. The international community was also concerned about the disproportionate role of a reserve currency in the international monetary and financial system, compared with the relative weight in world output and trade of the country issuing that currency.

He fully shared the view of those calling for a steady and appropriately paced allocation of SDRs over time, adjusted to changes in long-term global need, Mr. Sangare stated. Empty periods only imposed additional costs on the allocation process. His authorities reiterated their support for a substantial SDR allocation in the current basic period.

Mr. Lovato stated that it was difficult to make a judgment on the long-term global need to supplement existing reserve assets, all the more so because consideration had to be given to the qualitative character of any such judgment.

He concurred with those who were doubtful about measuring the global need for reserves on the basis of ratios that could be interpreted differently in different circumstances, Mr. Lovato added. Therefore, the staff paper had been useful in the sense that it hinted at the various implications of any decision, either to allocate or not to allocate SDRs. He remained convinced that, at the present juncture, and taking into account the still widespread recession and the high level of idle capacity, an allocation of SDRs would not do any harm as far as monetary stability was concerned. Given the modest amount that would be allocated, in comparison with the need for resources of countries with serious balance of payments deficits, the stringencies of conditionality that the IMF and the international financial market imposed would not be lessened, nor therefore would the probability of success of adjustment programs. He had always urged that any adjustment process should go as fast and as far as possible, but not to the point beyond which it became unrealistic. Therefore, he shared the view expressed by Mr. de Vries during the previous discussion of the proposal for a possible allocation of SDRs and at the present meeting by Mr. de Maulde, according to which a lack of reserves could prevent some countries from carrying out their policies of economic adjustment. That line of reasoning seemed even more convincing if account was taken of the changes in the attitude of international banks toward the deficit countries, particularly the less developed among them.

In present circumstances, consideration had to be given not only to the long-term global need to supplement existing reserve assets, a need that was in any case difficult to assess, but also to the institution's purposes in creating the SDR and the effects of such a decision on the future of the instrument, Mr. Lovato concluded. Thus, in his mind, an allocation of SDRs could be justified.

Mr. Joyce remarked that the staff's useful and stimulating paper deserved more thought than had probably been given to it in the time available. At the present stage, it was not completely clear to him that as a practical matter the distinction that the staff had attempted to draw between the need and the effective demand for reserves was meaningful. As the staff inferred, effective demand was, inter alia, a function of the cost of holding reserves. In addition, he had some problems with the staff's view that the demand for reserves would always be satisfied at some price, and that in 1983-86, developing countries would experience excess demand for reserves, while developed countries would have an excess supply. If the staff was defining excess in the conventional way, surely that disequilibrium phenomenon should correct itself through time. Table 2 indicated the excess of reserves in industrial countries, projected to offset reserve deficiencies of developing countries in 1986; one conclusion that could be drawn was that such problems of reserve adequacy as might exist were problems of distribution rather than of overall adequacy.

As for the staff's suggestion that an SDR allocation could ease the burden of adjustment on developing countries without lifting that burden altogether, Mr. Joyce said, it could be asked whether that was an appropriate purpose for the allocation of SDRs. A further question might be whether it was desirable, or even in the longer-term self-interest of those countries, to have the burden of adjustment eased in an unconditional manner, for instance, through an SDR allocation. In any event, he broadly agreed with the staff's view that "should SDR allocations be made, non-oil developing countries are not likely to be substantially less dependent on international credit markets or escape the foreign scrutiny, conditionality, and pressures to adjust that are imposed by international lenders merely by obtaining relief from a small part of their total need to borrow in those markets."

His Canadian authorities had some problem with the staff view that SDR allocations would provide a way to achieve desirable risk diversification in reserve holdings, Mr. Joyce noted. That view seemed to ignore the fact that any member could achieve such diversification by changing the mix of its reserve holdings. The possible concern over the buildup of the U.S. dollar component of reserves should not be a real source of vexation, since it presumably reflected choices made by reserve holders themselves. A new allocation of SDRs was not required on the score of diversification.

He was in broad agreement with the staff view that steady allocations, on however modest a scale, could help to minimize the disruptions associated with starting up an SDR allocation after so-called empty periods, Mr. Joyce commented. Admittedly, the support of his chair for an allocation of SDRs was based more on the need to maintain and enhance the use of the SDR as the principal reserve asset than on the existence of any clearly defined long-term global need at the present time. Equally, he did not think that a new allocation of SDRs would result in excess reserves in the system, or that such an allocation, if it was a measured one, would add to inflationary pressures. He would go further--indeed, he shared some of the concerns expressed by Mr. Polak--and say that the reserve creation role played by the international capital markets, and by the Eurocurrency market in particular, might not always be fully effective in meeting the legitimate reserve needs of a large number of countries. His chair favored a new allocation of SDRs in part for that reason, and in part because of a current concern that the SDR should come to play a more important role as a reserve asset. In conclusion, he continued to support a modest allocation of SDRs at the present time.

Mr. Finaish considered that an allocation of SDRs could be supported on many grounds, including the strengthening of the SDR as the principal reserve asset in the international monetary system. In the past, inadequate allocations had restricted SDRs to a small proportion of non-gold reserves--6 percent at the end of 1981. Unless the supply of SDRs was significantly increased, the envisaged aim of a strong SDR-based international reserve system would not be achieved.

The concern of many countries regarding their inability to insulate themselves from macroeconomic policies of reserve currency countries had been noted in the staff paper, Mr. Finaish continued. Furthermore, the latter group's disproportionately large weight in world monetary and financial affairs, compared to its share in world output and trade, indicated that the extent of its policy repercussions on others was greater than the size of its external sector. Similar concerns had led to the creation of the SDR, the Bretton Woods system having resulted, it had been suggested, in an increased exposure of smaller countries to the policies of large countries. To help establish a more symmetrical system, in which liquidity growth could be managed by international agreement, the SDR had been created. For similar reasons, all measures that would strengthen the SDR-based international reserve system that had been created, including further allocations, could be supported.

As noted in the staff paper and during the earlier discussion in the Executive Board of a possible proposal to allocate SDRs, Mr. Finaish remarked, an additional benefit of an allocation would be the alleviation of problems of deficit countries that had arisen because of recent developments in international credit markets. The case for an allocation was strengthened when, to that short-term benefit, was added the longer-term gain of providing countries with an internationally controlled reserve asset.

In Section IV of SM/83/96, Mr. Finaish observed, it was proposed that the growth of SDRs at a steady pace over time should be institutionalized. Note was correctly taken of the dangers of fine-tuning supply, and the desirability of supply growing at a pace required by longer-term considerations. The current allocation procedure, because of its discontinuous nature, involved larger start-up costs, which rose proportionately with the length of the empty period. Within national economies, the steady growth of money and of assets over time could be supported on grounds of standard growth theories. On similar grounds, the staff's suggestion for an uninterrupted growth in the supply of a reserve asset like the SDR seemed reasonable to those in favor of the establishment of a cooperative international monetary system.

Mr. Kabbaj said that his chair's position on the allocation of SDRs had not changed since the Executive Board's discussion in August 1983 (EBM/83/115 and EBM/83/116). He took note of the confirmation by the staff of the arguments his chair had made at that time in favor of a fresh SDR allocation, particularly the existence of a global need to supplement international reserve assets.

The staff had appropriately stressed that the Articles of Agreement referred to the long-term global need of the system, Mr. Kabbaj observed, and not necessarily to the demand for international reserves, which, as it was noted, "is always satisfied in the long run at some price and with some economic consequences." He broadly concurred with the thrust of the staff's analysis and with its projected medium-term trend of the need for international reserves. However, a distinction should be made among

non-oil developing countries, as mentioned by Mr. Polak and others, particularly in connection with the contribution of international financial markets toward satisfying that need. That contribution was concentrated in a number of large developing countries, and its evolution could hardly be viewed as indicative of the real needs of non-oil developing countries for external financing. The recent change in the process of international liquidity creation, with the sharp decline in commercial bank lending to sovereign countries, had led to a substantial curtailment of development expenditures in those countries, and to negative or very low rates of economic growth. Such a curtailment of development outlays was generally a part of broader adjustment efforts, but its implications in terms of domestic growth, international trade, and world economic recovery were unsustainable in the medium term.

Some Executive Directors had indicated that the decline in international lending had forced many developing countries to undertake domestic and external adjustment that was long overdue, Mr. Kabbaj noted. That might be true for countries with substantial access to external financing. But, while the domestic and external adjustment should be a continuous process, the successful implementation of most adjustment programs under way might be--and in many instances had been--jeopardized by a continuation of the recent declining trend in capital flows to third world countries. In that regard, a fresh SDR allocation could at the same time supplement a severely tight international liquidity position and ease the pressure of an excessively hard adjustment burden, which could thereby become more orderly and more compatible with the maintenance of investment and long-term growth as well as stable international transactions.

A few Directors had proposed a combination of allocation with conditional lending, Mr. Kabbaj observed. Although the Fund's resources should continue to be supplied within the framework of Fund-supported adjustment programs, the idea of conditional use of SDRs was hardly consistent with the special characteristics and purposes of SDRs, particularly the aims of making it the principal reserve asset in the international monetary system, and introducing greater simplification and flexibility in its use. Furthermore, as pointed out by a number of Directors and the staff, the proposed combination did not seem necessary, since the countries most likely to be net users of any new allocations were already under comprehensive Fund conditionality and surveillance. In addition, those countries were presently having to meet their obligations under the relevant Articles, including collaboration with the Fund relating to the use of SDRs.

Commenting on a few of the points discussed in SM/83/96, Mr. Kabbaj expressed agreement with the staff's view in Section IV on the timing of SDR allocations. He shared the staff's view that the undesirable expectations and perceptions that had come to surround any decision on SDRs had become inevitable because of long periods without SDR allocations.

Mr. Lindå recalled that the view of his constituency had been repeatedly stated, most recently during the Board's discussion on August 1; namely, that it was open to the idea of allocating SDRs in modest amounts

during the current basic period. His constituency was traditionally accustomed to considering SDRs as unconditional reserves for temporary balance of payments financing. However, Mr. de Groote's proposal for allocations of conditional SDRs was interesting and merited further study. To be able to make a thorough assessment of the proposal, further information about its various elements was needed, however, which might prove time consuming; the conduct of such a study should not be allowed to postpone consideration of the need for allocating additional SDRs in the current basic period. In further studies of the proposal, however, decisive weight should be attached to considerations regarding the future role of the SDR in the international monetary system.

As for the longer-term perspective in general, Mr. Lindø continued, the analysis in SM/83/196 was interesting and useful. Dealing directly and indirectly with the question of long-term developments in international liquidity, and thus of important structural and institutional conditions in the international monetary system, the paper provided a basis for discussion of the long-term aspects of SDR allocations. The question arose how greater continuity in SDR allocations could be reached. He felt that only a more explicitly stated long-term need for reserves as a basis for allocations could create such continuity and reduce the traditional difficulties associated with proposals for new allocations after empty periods.

The staff's definition of the differences between "need" and "demand" was useful, Mr. Lindø considered. It was important to emphasize that the need for SDR allocations did not depend entirely on whether major country groups found it difficult to cover their need for reserves at the prevailing cost. The need must equally be based on an assessment of whether the anticipated cost was the right one.

Developments in capital markets during the past year had adversely affected the borrowing possibilities of many countries, Mr. Lindø noted. Coupled with substantial refinancing requirements, countries' needs for nonborrowed reserves had thereby been increased. The growth of alternative international reserve assets would probably be weaker if SDR allocations took place. Even in periods when the shortage of reserves was not acute, SDR allocations might reduce dependence on the dollar and strengthen the role of the SDR in the international monetary system. The composition of total international reserves might thus be improved. In conclusion, an increased need for owned reserves and the risk of an inappropriate composition of reserves and inappropriate ways of raising foreign exchange reserves emphasized the need to supplement existing reserves by SDR allocations.

Mr. Taylor considered that both the intellectual and empirical arguments presented in the staff paper were inconclusive on the question of whether or not a resumption of SDR allocations was justified. Among the four points of principle dealt with in Section I of the paper, two seemed to merit particular emphasis. First, for SDR allocations to take place, the global need for supplementing reserve assets must exist in many and

diverse countries; it was not sufficient for it to be felt by one group or one category of countries. Second, the need must be assessed in relation to long-term trends, and not in relation to short-term or cyclical objectives. He strongly agreed with both those principles.

In Sections II and III of SM/83/196 containing the empirical assessments, Mr. Taylor continued, several aspects stood out. First, the staff's calculations--for instance, in Table 2--suggested that the supply of currency reserves was likely to rise over the medium term to meet the global demand for reserves assuming the rates of growth of output, imports, prices, and interest rates projected in the central scenario of the World Economic Outlook. That scenario seemed about the best that could be attained on the basis of present trends and adjustment policies. He could go along with the staff's conclusion in that respect, although he had been unable to find much information about how its reserve demand projection had been derived. To what extent had the underlying econometric equations taken account of such important factors as the changes in the structure of the international financial system and in exchange rate regimes over the past decade? He would have difficulty in accepting projections that did not take account of such developments. He would therefore not find it easy to go along with Mr. Polak's proposal that the staff should return to the relatively crude but familiar method used in the past for estimating reserve demands.

As his chair had mentioned during the previous discussion of a possible proposal for an SDR allocation, Mr. Taylor continued, the ability of currency reserves to play their part in meeting reserve holders' needs would depend greatly on the willingness of the reserve currency countries to pursue prudent anti-inflationary policies. Only then would the reserve currencies remain attractive assets in the eyes of potential holders. If such prudence was lacking in some countries, the SDR might possibly acquire new attractiveness as a composite reserve asset. For the time being, he adhered to the hope that all reserve currency countries would pursue sound policies.

His second point relating to the staff's calculations, Mr. Taylor added, was to note, along with others, that while the global situation seemed to be in balance in the medium term, some countries might well be unable to acquire their desired level of reserves through market channels via the ordinary processes of trade, investment, and borrowing. It could be broadly concluded that the non-oil developing countries' demand for reserves appeared likely to exceed the amount that they could acquire on acceptable terms, for such reasons as the severe recession, abnormally high interest rates, and the limited creditworthiness of a number of developing economies. To the extent that creditworthiness was the problem, it was best dealt with--at least so far as the Fund was concerned--through appropriately conditional financing in conjunction with Fund programs rather than through the provision of unconditional liquidity or SDR allocations. The staff had suggested that modest SDR allocations would not necessarily detract from conditional financing. That might well be true in some cases, but in others a new SDR allocation might lead a member to postpone the needed adjustment at a critical moment.

In principle, it would hardly seem consistent for the Fund to issue freely usable liquidity when it was trying to convince countries to accept conditional financing, Mr. Taylor stated. In almost all circumstances in which it was not realistic for small or low-income countries to obtain credit from the market, the appropriate solution, as others had pointed out, seemed to lie in concessional but still somewhat conditional official development financing. And the use of SDRs as a form of credit was certainly not a cheap option at present. It might be argued that if the recession or high interest rates made it necessary for non-oil LDCs to acquire needed reserves, an SDR allocation might be warranted. But the question in his mind was whether the problems were not cyclical or temporary ones with which SDR allocations were not designed to cope. His chair maintained that it would not be appropriate to resume SDR allocations simply in response to what might well be a temporary dip in reserves in 1982.

A further feature of the staff's projections that he had found somewhat debatable, Mr. Taylor observed, was that the demand of oil exporting countries for reserves was expected to rise somewhat in relation to their imports in the medium term. He wondered whether their countries' demand for reserves would be as pressing as the staff projected it to be in the coming few years, since the ratio of their reserve holdings to imports was running at around three times the average for other country groupings.

His chair supported the general objective of diversifying reserve assets, Mr. Taylor remarked, but it had not been argued to his satisfaction that diversification necessarily pointed to new SDR allocations. In the view of his authorities, the need for diversification pointed more toward the exploration of schemes for substituting SDRs for other types of reserve asset, including the promotion of the wider holding and transfer of official SDRs and the development of SDR-denominated instruments by both private and official lenders.

In sum, Mr. Taylor commented, although there was much that he could accept in the staff paper, a convincing case for resuming SDR allocations at the present juncture had not been made. However, his authorities had not closed their minds on the issue; they were skeptical but open to persuasion. At the present time, the Fund should be more concerned with securing prudent policies and well-designed adjustment programs in member countries rather than with providing liquidity.

Mr. Nimatallah said that the staff's well-balanced analysis had strengthened his view that there was a strong case for resuming SDR allocations as soon as possible. Everyone was familiar with the conditions, set out in Article XVIII, that had to be satisfied if SDR allocations were to be resumed. In brief, those conditions stated that there had to be a long-term global need to supplement existing reserve assets in a manner that would help to promote the Fund's purposes and avoid both stagnation and excess demand in the world economy.

The central question was whether those conditions existed at present, Mr. Nimatallah continued. He believed that they did, for various reasons. First, there was a need to supplement existing reserve assets. Inadequate reserves were a serious and growing problem for many countries. The upward trend in official holdings of nongold reserves had been reversed in the past two and one half years. The contraction had been particularly marked for the developing countries as a group, and could not be explained by demand factors alone; it had been accompanied by slow or negative economic growth, declining trade flows, and serious hardship for many members.

In his view, the explanation lay more on the supply side, Mr. Nimatallah said. As the staff had pointed out, there were three ways in which countries could acquire reserves. One way, available only to industrial countries, was by purchasing foreign exchange through intervention in the exchange markets. Another way was to earn foreign exchange by running a balance of payments surplus. And a third way was by borrowing foreign exchange in the international capital markets. The first two options, however, were not available to many members. The third option was excluded more and more, following the recent disturbances in the international capital markets that had led to a serious reduction in bank lending. In some cases, bank lending had slowed, and in others it had been cut off entirely. In most cases, bank credit was more costly. Those developments could have serious consequences for the adjustment process and could threaten the incipient world recovery.

The second reason why he believed that the conditions of Article XVIII could be met was that there was a long-term need for additional reserve assets, Mr. Nimatallah continued. The growth in world trade projected by the staff for the period to 1986 would have to be financed by a commensurate growth in reserves. Even beyond the medium term, the steady expansion of world trade would require a steady growth of reserves. But the present and prospective supply of reserves appeared inadequate for the task. As the staff had pointed out, it was by no means certain that the present difficulties in the international capital markets would have been overcome by 1986. There were also limits to the amount of conditional financing that the Fund would be able to provide in the period ahead. The recent interruption in allocations made it difficult to assess the long-term need for reserves. But looking back, it seemed clear that allocations at the start of the current basic period would have helped to lessen the serious problems of the past three years. Looking ahead, new allocations would certainly improve the prospects for a durable recovery over the medium term.

The third reason was that there seemed little doubt that the need for additional reserves was a global one, Mr. Nimatallah said. All countries had an interest in the smooth expansion of world trade. More immediately, the present and prospective shortage of reserves, and the difficulties of market borrowing, extended to most Fund members.

To cite Article I, new allocations would facilitate "the expansion and balanced growth of international trade over the medium term," Mr. Nimatallah continued. Allocations would also alleviate the harsh adjustment burden that many members were facing, thereby promoting exchange stability and helping members eliminate exchange restrictions. More specifically, allocations could help to avoid the risk of continuing stagnation in the world economy, at a time of high unemployment and considerable underutilization of capacity in many countries. Any risk that new allocations could contribute to excess demand and inflationary pressures was, in his judgment, questionable, particularly under the most likely scenario for the world economy.

More generally, Mr. Nimatallah observed, the staff paper reinforced his belief that strengthening the SDR through new allocations would benefit the international monetary system as a whole, and would therefore be in the interests of all Fund members. As the staff had explained, the present multicurrency reserve system was inherently unstable. Reliance on the U.S. dollar to meet global reserve needs imposed burdens on all countries, including the United States. The Fund had an international alternative in the SDR, whose full potential should be exploited. SDR allocations would be a more reliable form of reserve growth, which could reduce the cost and improve the quality of members' reserve holdings.

He agreed with the staff, Mr. Nimatallah said, that empty basic periods could send misleading signals to the international financial community. Allocating SDRs evenly over time would facilitate the task of estimating the long-run need for reserves to finance the growth of world trade, and thus make it easier to decide on the appropriate rate of allocations within each basic period. Such an approach would be helpful in smoothing the operation of the international payments system.

In sum, Mr. Nimatallah stated, there was a long-term global need for new SDR allocations, fully consistent with the provisions of Article XVIII. Furthermore, the SDR should be promoted to play a more effective role in the size and composition of global reserves. In his judgment, therefore, SDR allocations should be resumed as soon as possible.

Mr. Malhotra noted that the two papers prepared recently by the staff, taken together, provided a good rationale for a substantial allocation of SDRs. In its earlier paper, the staff had pointed out that sluggish activity, especially in the developing world, and the success achieved in many important economies in bringing down rates of inflation should lessen the fears expressed previously about an issue of SDRs giving wrong signals to the international monetary community. In fact, as Mr. Nimatallah had pointed out, an SDR allocation could assist in the process of recovery of international trade and development.

The chief merit of the staff's latest paper, Mr. Malhotra considered, was that it had tried to show that the long-term need for reserves could not be finely calculated. That need had to be looked at in terms of the future growth of the world economy and trade, as well as in terms of the

type and composition of international liquidity that the Fund and the international community in general should promote. Viewed from those standpoints, there could be no doubt that an allocation of SDRs was essential.

The staff had pointed out in its previous paper that developments in international capital markets were bound to reduce the availability to several large developing countries of funds for balance of payments support, Mr. Malhotra continued. The position of developing countries without adequate access to capital markets had deteriorated; their rates of growth had fallen, and as many as 90 countries out of 146 Fund members had been found, in connection with the increase in quotas, not to have enough SDRs or foreign currency to pay a portion of their quota subscriptions in reserve assets. A valid point emphasized by the staff in the earlier discussion in the Executive Board was that a global need to supplement reserves did not mean that every country was short of reserves. Furthermore, he had found persuasive the statement in SM/83/157 that if a large number of countries were not in a position to acquire adequate levels of reserves, there was a possibility that the consequent lack of demand on the part of their economies could prove to be a drag on the international economy.

The Fund was a cooperative international institution, Mr. Malhotra stressed. Mr. Taylor had made the point that the reserve needs of all categories of member countries had to be considered and not just those of one category. But countries in need of reserves at present embraced so many different groups of countries: there were countries that previously had had large access to capital markets but were no longer in that position, others with relatively small access, and yet others with no access whatsoever. The liquidity needs of all such countries could not be brushed aside solely on theoretical arguments.

Another point that had been made was that the Fund should be interested mainly in enforcing adjustment and in providing financing for it, and that there was no need for the Fund to provide unconditional liquidity, Mr. Malhotra added. It was an argument that struck at the root of the whole idea of creating the SDR as an unconditional asset. Countries with the economic power to create their own liquidity were not greatly concerned with that issue. But other countries that were not able to do so were very much interested in liquidity, and not in the form of quotas in the Fund on which they could draw in order to support adjustment programs. As he had said previously, any idea of the SDR becoming a conditional reserve asset, for use only in conjunction with programs, would destroy the concept of the SDR altogether.

One of the contributions made by the staff in SM/83/196, Mr. Malhotra noted, was to suggest that a better approach would be to create liquidity in the form of SDRs on a regular basis over a period of time, to avoid the undesirable effects of a stop-and-go approach. If the objective was to make the SDR the principal reserve asset, steady allocations would be necessary. Otherwise, as at present, after every empty period, the debate would be reopened as to what special problems justified an SDR allocation

and what signal would be given to the international economy. The staff had rightly pointed out that the longer the decision to allocate SDRs was delayed, the greater would be the problem of assessing the magnitude and the impact of an issue.

There had been some mention of a possible inconsistency in the implied suggestion by the staff that an SDR allocation could be useful and the Fund's general policy stressing the importance of adjustment by member countries, Mr. Malhotra remarked. There was no contradiction in his view: both liquidity and adjustment were needed. There had been a significant decline in the growth of liquidity in 1981; liquidity growth had been negative in 1982, and according to the staff, in April 1983 it had only returned to its level at the end of 1981. There had been a major change in the attitude of capital markets toward countries that previously had received large balance of payments support. More than 90 member countries had inadequate reserves. The overall inflation picture had improved in a significant way. The characteristics of the SDR had been improved to increase its attraction for holders. The asset would not be used irresponsibly because it now carried a market cost. It would be a sad commentary if, in face of all those developments, the Fund, as a cooperative international institution, failed to find a solution to the international liquidity problem.

Mr. Nimatallah, referring to the argument about whether the unconditional allocation of new SDRs would promote adjustment or growth, or hinder it by reducing the resolve of certain countries to adjust, considered that it was a matter of looking in depth at what was meant by adjustment. Balance of payments equilibrium could be reached by adjustment at a lower level of income or at a growing income level. If there was to be adjustment at any price, countries could be left to find their own financing. But if, as he believed, the objective was growth, additional resources would be required. It was easier for some countries than for others to find the financing to support growth. For certain countries, financing was no easy matter at all. For there to be a healthier world economy, and for adjustment to be accompanied by growth, particularly for those countries with a role to play in world trade, it was necessary to find a source of international financing to substitute for the market and for interruptions in the flow of reserve currencies and fluctuations in their value. A steady allocation of SDRs would play a role in the longer term in identifying and meeting that need for reserves.

Mr. Polak commented that, as Mr. Nimatallah had mentioned in his earlier statement, many of the possible remedies for the present situation could not be applied. That in itself was an argument to do what could be done. Allocation of SDRs would provide some modest amount of relief. It had been argued that a better way of providing countries with reserves, on the assumption that there should not be too much reliance on capital markets, would be to make additional concessional aid available. He was not absolutely sure that that argument was valid, but he was certainly sure that additional concessional aid for that purpose would not be forthcoming. Thus, even those who preferred that choice might have to fall back on the option of an SDR allocation.

Mr. Zhang stated his agreement with the staff's conclusion that the resumption of SDR allocations was warranted. Furthermore, the existing nature of the SDR should be preserved; it should not be made a conditional asset.

Mr. de Groote observed that by looking at a familiar issue, on which positions differed, from every possible angle, the staff had offered a pretext for a new look. As Mr. Polak had mentioned, thought had to be given once in a while to the simpler, earlier approach to liquidity, but the staff had introduced substantive arguments for taking account of new elements. He had been particularly impressed by the effects foreseen by the staff of not increasing the amount of SDRs in circulation and the costs in terms of world public opinion. The fact that so few members of the Fund were opposed to SDR allocations suggested that it would certainly be useful to continue discussing the issue.

It was interesting to note how heavily loaded with contradictions the debate was, Mr. de Groote continued. For instance, it seemed to be generally accepted that the SDR should be the centerpiece of the system. But some Executive Directors were willing to consider an increase in any type of international liquidity other than SDRs. On the assumption that the demand for international reserves would increase in a durable way over the long term, part of that demand should be met in the form of SDRs, in accordance with the principles of the SDR system. It was not enough to be against SDRs as a matter of principle; it would be necessary to demonstrate that any increase in international reserves over the longer term should continue to take place in the form of U.S. dollars and other currencies, rather than in SDRs.

The preoccupation with inflation was another contradictory element in the debate, Mr. de Groote said. In the years during which international liquidity had been expanding on a massive scale, in the form of U.S. dollars and other reserve currencies, little had been heard by way of argument about the inflationary consequences, even though at that very time, countries had been fighting inflation, and doing so effectively. If the fear of inflation was to be accepted as a major argument for rejecting SDR allocations, it would be only logical to begin studying ways of avoiding the expansion of international liquidity in the forms in which it was created at present. It was hard to understand how additional international liquidity of SDR 4-5 billion a year, in the form of SDRs, would carry a clear risk of inflation, whereas an increase of many times that amount in other forms of international liquidity would not carry the same risk. The Fund had a great responsibility to discharge in taking a decision that had a bearing on the distribution of international reserves and on the functioning of the international monetary system. The issue should thus be examined in greater depth. Certainly, the arguments advanced by Mr. Nimatallah should be taken into consideration. Adjustment with growth was clearly important; obviously, many countries were unable to adjust at a higher level of income while improving their balance of payments position, unless they had the reserves to do so. Finally, when the issue was further explored, he hoped that some consideration could be given to the idea of making conditional allocations of SDRs.

The Chairman said that he would ponder the views of Executive Directors when reporting to the Interim Committee. The different positions taken were close to those mentioned in his summing up of the Executive Board's discussion on August 1; he would therefore not attempt to sum them up again. However, it was fair to say that Executive Directors' interest in the staff paper had been sufficiently aroused to make them wish to return to the matter when they had had sufficient time to reflect on all its aspects.

He had been particularly interested in a number of the presentations made at the present meeting, the Chairman remarked, and the matter should be pursued. It should be possible to take up the issue after the Annual Meeting in the light of the discussion and of the circumstances. At the present time, it seemed fair to say that there was not yet the support in the Executive Board for an allocation of SDRs that would warrant a proposal in accordance with the Articles.

The Director of the Research Department observed that interest had been shown in the results of using earlier procedures, in particular, those featuring the ratio of reserves to imports. Between 1978 and 1982 the ratio of nongold reserves to imports for industrial countries had declined from 18.5 percent to 17.1 percent, whereas in the same period, non-oil developing countries had experienced a decline in that ratio from 27.2 percent to 20.5 percent, a substantially larger fall. The demand for reserves could be gauged by attempting to calculate projected ratios of reserves to imports using the import projections in Table 1 of SM/83/196 and making a comparison with the projections in Table 2 of the demand for nongold reserves. The projected demand for nongold reserves in 1986, as shown in Table 2 was, for industrial countries, SDR 221 billion; for non-oil developing countries, SDR 120 billion; based on the 1982 values of reserves to imports ratios, the figure for the industrial countries would be SDR 264 billion, and for the non-oil developing countries, SDR 98 billion. Applying as ratios the average of the 1978-82 values, the figures would be SDR 265 billion for the industrial countries, and SDR 108 billion for the non-oil developing countries. If the 1978 values of the ratios were used, the forecast demand for nongold reserves of the industrial countries would be SDR 285 billion, and SDR 129 billion for the non-oil developing countries.

It should be mentioned first, that those figures should be used with great caution, the Director commented. Second, to the extent that allowance was made in the projections for the severe fall in the ratio of reserves to imports for the non-oil developing countries, the greater was the projected demand for reserves by those countries. In the projections given in SM/83/196, which might have seemed complex to some, the position of the non-oil developing countries had been shown as recording some improvement, with much less of an improvement in the position of the industrial countries.

In the earlier staff paper (SM/83/157), the Director of the Research Department added, a considerable point had been made of the effects of changes in the international capital markets on the supply of reserves.

Not all aspects of the situation had been reviewed in the latest staff paper, which was one of a series. However, it was notoriously difficult in a changing system to make projections based on econometric analysis. Precise forecasts, either of the demand for reserves or of the manner of supplying reserves, should not be expected. Clearly, Executive Directors had an interest in seeing the numerical results of applying a specific approach, but it was hard to defend specific numbers in an area in which rapid change was taking place, change moreover that did not affect all members equally. It was perhaps for that reason that the staff had, in its most recent paper, paid particular attention to the distribution of the demand for increased reserves.

The Deputy Director of the Research Department, in response to Mr. Taylor's question about whether the change in the exchange rate regime had been reflected in the demand equations used in SM/83/196, responded that those equations were based on data from 1973 on, so that they covered the period of floating rates. That period of observation was fairly short, but use of a longer base period for the econometric work involved was subject to the objection that it might contain a change in the economic structure.

The Executive Directors concluded for the time being their consideration of the long-term aspects of SDR allocations.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/137 (9/9/83) and EBM/83/138 (9/12/83).

4. EXECUTIVE BOARD TRAVEL

Travel by an Advisor to an Executive Director as set forth in EBAP/83/228 (9/8/83) is approved.

APPROVED: March 12, 1984

LEO VAN HOUTVEN
Secretary