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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/175

3:00 p.m., December 16, 1983

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

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
J. de Groote	
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	
T. Hirao	T. Yamashita
	Jaafar A.
	L. Leonard
	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	S. El-Khouri, Temporary
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	
	E. A. Ajayi, Temporary
M. A. Senior	
J. Tvedt	A. Lindø
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director; E. L. Bornemann, E. A. Calamitsis, C. A François, A. Jbili, I. Kapur, M. E. Massourakis, B. R. H. S. Rajcoomar, M. Sidibe, A C. Woodward. Asian Department: J.-P. C. Golle, I.-S. Kim. European Department: D. Gros, V. Marie. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; G. A. Maciejewski. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman. Middle Eastern Department: F. Drees. Research Department: K.-Y. Chu, N. M. Kaibni, A. Salehizadeh, H. H. Zee. Secretary's Department: A. Wright, Deputy Secretary; A. P. Bhagwat, K. S. Friedman. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. H. Brown, S. I. Fawzi, Q. Md. Hafiz, R. B. Hicks, B. E. Keuppens, J. T. McDonald, T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, H. A. Arias, C. J. Batliwalla, S. E. Conrado, L. K. Doe, K. A. Hansen, W. Moerke, Y. Okubo, I. R Panday, P. D. Péroz D. I. S. Shaw. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, J. R. N. Almeida, J. Bulloch, M. Camara, M. B. Chatah, L. E. J. M. Coene, R. J. J. Costa, M. Eran, G. Gomel, D. Hammann, N. U. Haque, C. M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, J. K. Orleans-Lindsay, G. W. K. Pickering, M. Rasyid, A. A. Scholten, Shao Z., S. Sornyanyontr, P. Verly, J. C. Williams.

1. ZAIRE - 1983 ARTICLE IV CONSULTATION AND STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors continued from the previous meeting (EBM/83/174, 12/16/83) their consideration of the staff report for the 1983 Article IV consultation with Zaïre, together with a request for a 15-month stand-by arrangement in an amount equivalent to SDR 228 million or 100 percent of quota, and a proposed decision concluding the 1983 Article XIV consultation with Zaïre (EBS/83/257, 11/30/83). In addition, they took up a request by Zaïre for a purchase equivalent to SDR 114.5 million under the compensatory financing facility (EBS/83/260, 12/1/83; and Sup. 1, 12/15/83). They also had before them a report on recent economic developments in Zaïre (SM/83/248, 12/9/83).

The staff representative from the African Department, responding to questions on the exchange rate system, confirmed that the Bank of Zaïre could obtain additional foreign exchange from the market at the market rate. In the first phase of the reform of the exchange rate system, the Bank of Zaïre had simply quoted the market rate based on the weighted average of the various rates that commercial banks intended to apply in their operations. In the second phase of the reform, the central bank presided over weekly meetings to fix the exchange rate, and in some cases it actually participated as a buyer or seller of foreign exchange. Irrespective of the weekly fixing rate, commercial banks were free to negotiate any rate in their daily transactions among themselves, as well as with their clients.

With regard to the budget, there were certainly targets for key expenditure categories, with the provision that the Fund staff should be consulted by the authorities in the event that those targets were threatened, the staff representative explained. The expenditure pattern had been strongly influenced by the recent exchange rate adjustments, and foreign outlays would require five times as much domestic currency as in September 1983. Nevertheless, excluding debt amortization, the program envisaged a small surplus in 1984. If debt amortization were included above the line, there would be a deficit equivalent to net government borrowing from the banking system. Expenditures by the presidency and the political institutions were estimated to amount to the equivalent of 7 percent of total budget expenditure in 1983, compared with about 11 percent in 1982, and were expected to decline to 6 percent in 1984. Transfers and subsidies were also expected to be reduced from the equivalent of 10 percent of total expenditure in 1982 to 6 percent in 1983 and somewhat below that ratio in 1984. In comparison, the external debt service, which was estimated to account for 24 percent of total expenditure in 1983, was projected to increase to 35 percent in 1984. The impact of the devaluation on the debt service was clearly large, and even after considerable rescheduling the debt service would amount to about Z 8.1 billion in 1984, a figure substantially larger than the wage bill of the entire administration.

In response to a question whether the improvement in the current account deficit of the balance of payments was sufficient, the staff representative stated, first, that the overall adjustment under the program would appear significant if it were viewed in a two-year perspective. Second, if scheduled interest payments were excluded from the current account deficit, the current account would show a surplus of SDR 66 million in 1984, compared with a deficit of SDR 55 million in 1982.

One advantage of the new exchange rate regime was that if some aspects of the program were not to materialize, the exchange rate would tend to depreciate, the staff representative indicated. If necessary, however, additional budgetary action should be taken to restrain expenditures.

He agreed with Mr. de Groote about the need to improve statistics in the area of pricing, the staff representative went on. For a number of years, the staff had taken the consumer price index for Kinshasa as indicative of the overall rate of inflation. That definition was restrictive but was the most reliable indicator available to the staff. The inflation rate for the country as a whole was probably lower than that registered by the consumer price index for Kinshasa.

A number of points should be considered when determining whether the program ceiling on private sector credit was too tight, the staff representative remarked. First, in the past a considerable amount of credit had been used to finance the buildup of coffee stocks. However, as a result of drought, coffee production had been low in 1983. As the stocks were drawn down to maintain the export volume of coffee, the financing requirements would be much less in that crucial sector. Second, external trade financing amounted to about 30 percent of private sector credit, so that the exchange rate could not be applied to the whole credit figure. Third, the credit ceilings had been underutilized in September 1983. In fact, the program attempted to encourage the extension of credit to the private sector by restraining credit expansion to the Government and providing relatively more resources to private enterprises. The ratio of private sector credit to net domestic assets, which had been 21 percent in 1982, was expected to rise to 23 percent in 1983 and 27 percent in 1984 on a year-end basis.

The devaluation as well as the contribution of GECAMINES had affected budget revenue in 1983 and would do so again in 1984, the staff representative explained. The contribution by GECAMINES to the 1984 budget had been worked out in close cooperation with the Government.

Commenting on a question about whether the external borrowing ceilings might be too high, the staff representative said that a wide margin had been allowed to accommodate a possible resumption of export credits following a regularization of Zaïre's external arrears. There was no ceiling on short-term borrowing, but the Bank of Zaïre had little access to such borrowing and the staff did not consider that there would be any significant problems in that regard. On a related point, the staff had noted in EBS/83/257 that although there had been an accumulation of domestic arrears totaling Z 136 million in the first six months of 1983, there had also been a significant improvement in bugetary performance over the previous year. The credit ceilings under the program envisaged the liquidation of a large part of the domestic arrears.

As for the foreign exchange allocation system, the staff representative remarked, first, that commercial banks were free to allocate for imports 75 percent of their foreign exchange earnings in any way they deemed appropriate. They no longer had to surrender 30 percent of their foreign exchange earnings to the Bank of Zaïre. Second, restrictions remained on payments for invisibles, which had to be limited to 25 percent of the banks' total foreign exchange earnings. One Director had questioned whether such an allocation system was too gradual in view of the medium-term prospects. The introduction of a more liberal foreign exchange system did not seem appropriate at the present stage, but the staff would continue to review the matter in 1984.

On when the staff expected the inflationary impact of the devaluation to subside, the staff representative from the African Department commented that there were a number of elements that should be considered. First, many prices in Zaïre had been adjusted prior to the devaluation because numerous sectors had been operating at the black-market rate even before the exchange rate reform. Second, the devaluation had had a large impact on retail prices of petroleum products and, consequently, public utility tariffs, which had both been adjusted. Third, some price increases in the private sector had been unjustified. He hoped that the inflationary impact would subside during the first half of 1984.

Mr. de Groote remarked that he had calculated the volume of credit to the private sector in SDRs in order to approximate its real value. If 30 percent of that credit were used for trade credit and therefore calculated in U.S. dollars, the counterpart in zaïres would increase considerably if the zaïre depreciated against the U.S. dollar. The remaining credit under the ceiling available for the private sector would accordingly be considerably smaller.

The staff representative from the African Department responded that there were many possible measures of the adequacy of credit; private sector credit could be measured in relation to GDP, or rates of increase of private credit could be compared with rates of inflation. Some of the staff had felt that the implicit private credit ceiling had been on the high side.

The Deputy Director of the Exchange and Trade Relations Department commented that a number of Executive Directors had referred to the question of access. Some of them had felt that access of 100 percent of the old quota was on the generous side; others, that it was too low; and one, that it was appropriate. The staff believed that with the 15-month program, during which purchases were well spread, the amount of financing to be provided by the Fund--63 percent of the new quota at an annual rate--was consistent with Zaïre's needs, with the use made by other members, and with the strength of the program, including the prior actions. At the same time, there were reasons why the staff felt that access should be limited. Zaïre had already made use of Fund resources amounting to 94 percent of the new quota. Furthermore, the staff had to bear in mind Zaïre's track record and to expect that over the next five years there would be a continuing need for exceptional financing, with the Fund possibly being called upon to help to mobilize it. Moreover, Zaïre's debt to the Fund had been increasing and would rise further in the following two years.

The staff did not consider that the purchases were front-loaded, as a number of Directors had suggested, the Deputy Director noted. Only 16 percent of the total amount available could be purchased before the first review in February 1984, and only 50 percent could be purchased before the second review. The resources available under the compensatory financing facility were not subject to phasing.

A meeting of the Paris Club would be held on December 19-20, 1983, the Deputy Director stated. The Zaïrian authorities hoped that as many of Zaïre's official creditors as possible would participate in that meeting. In signing a Paris Club agreement, a debtor country agreed not to grant more favorable treatment to nonparticipating official creditors than to participants in the Paris Club meeting. It was the staff's understanding that the authorities would approach the non-Paris Club official creditors in the near future in order to regularize Zaïre's arrears and seek appropriate debt relief. The staff was continuing to urge the authorities to take such action. With regard to multilateral creditors, Zaïre's adjustment program allowed for no accumulation of arrears, and the staff had stressed to the authorities the importance of liquidating existing arrears to those creditors as soon as possible.

In general, the staff was of the view that arrears should be liquidated as soon as possible; the maximum repayment period ranged from three to five years, the Deputy Director continued. Arrears repayments should be front-loaded, but sometimes they had to be back-loaded because of the pace of the needed reserve buildup. In the event of a new accumulation of arrears, the usual performance criterion would be breached. That usual provision also held true for Zaïre.

The staff had worked on the principle that the Fund should not commit resources until the adjustment program for Zaïre was fully financed, the Deputy Director noted. If foreign financing fell short of the staff assumptions, greater adjustment would be required to meet the objectives of the program; the original set of policies might not be sufficient to meet the criteria for the use of Fund resources. As Mr. Polak had stated, it was not the existence of an arrangement with the Fund but rather the existence of a set of policies needed to correct the member's balance of payments problems that would meet the requirement of the test of cooperation for a drawing in the upper credit tranche. In Zaïre's case, the policies under the stand-by arrangement would not be sufficient if the assumed foreign financing did not materialize. For that reason, the staff had stated on page 40 of EBS/83/257 that "...the nature and scope of such rescheduling is critically important for the completion of an overall financing package, without which the program would not be viable and hence could not be supported by the Fund." Such an application of policy was fully consistent with previous cases brought to the Executive Board. Requests by a number of countries had been considered by the Executive Board only after external financing had been put in place.

Some Directors had questioned why performance criteria but been set only through the end of 1983, the Deputy Director recalled. Only one purchase would be made before the February review, and it was subject to the availability of sufficient external financing. The February review would take into account the precise nature of the debt rescheduling and the available financing; the relevant performance criteria for the following period could then be set. The staff had, nevertheless, included in its papers a set of financial targets for the whole of 1984, even though no performance criteria had specifically been established.

Some Directors had seen benefits in a shadow program, the Deputy Director observed. Shadow programs--both formal, with the approval of the Executive Board, or informal, as a result of discussions with the national authorities--had been useful in a number of countries. There had been a few cases where programs had gone off track, and the staff and authorities had recast the program so that over a period of time the original targets could be reached.

Finally, with regard to Mr. Polak's questions on the design of the program, the Deputy Director of the Exchange and Trade Relations Department stated that the staff had applied the normal set of performance criteria. Developments in the fiscal sector were also subject to monitoring, and the data on the public finances were subject to a consultation clause.

The staff representative from the Research Department, responding to questions about the application of the "beyond the control of the member" requirement to Zaïre's cobalt exports, said that before the authorities' previous request for compensatory financing in 1982, a sharp rise in prices for cobalt had resulted in significantly higher earnings in 1979 and 1980, the two preshortfall years. Although prices had been adjusted downward in 1981, the shortfall year, export earnings had declined because the volume of exports had also declined, and there had been a buildup of stocks. At that time, a few Directors had questioned whether the shortfall in cobalt exports should be compensated because, in their view, it had been attributable to Zaïre's cobalt pricing policy. The staff analysis at that time had indicated that even if the authorities had pursued a policy of lowering the price of cobalt, export earnings would probably not have increased in 1981. In addition, the overall shortfall was significantly larger than the requested drawing. Since 1981, the authorities had continued to pursue a policy of adjusting prices downward in an effort to increase export volume. Unfortunately, that policy had not always been accompanied by higher export earnings. In the present shortfall year, the export price had been reduced by nearly 50 percent, and the volume of exports had increased, while stocks had remained below the normal level; the net result was a decline in the value of cobalt exports of about 20 percent. In sum, the staff had concluded that the cobalt shortfall had not been affected by the pricing policy pursued by the authorities, but that it was related more to changing market conditions. Moreover, in accordance with the established practice, a judgment whether changes had been beyond the authorities' control was made by reference to all the factors involved. In Zaïre, the overall shortfall in export earnings had been overwhelmingly related to lower prices, rather than to volume factors.

In response to Mr. Clark's concern that the price projections for copper in EBS/83/260 differed from those in EBS/83/257, the staff representative remarked that copper prices for 1983 were projected to be 73 cents a pound. The price projection for the postshortfall year extending to March 1984 was 71 cents a pound. Therefore, the two periods had nine months in common--April-December 1983--and the average price for those months was 73 cents a pound. The difference between the two figures--73 cents for 1983 and 71 cents for the year ending March 1984--was due to the fact that the price for the first quarter of 1984, projected at 65 cents a pound, was lower than the price of 73 cents a pound for the comparable period of 1983.

The time lag between the end of the shortfall year and the Executive Board's consideration of Zaïre's request for compensatory financing was longer than the standard six months, the staff representative from the Research Department noted. That lag had been brought about by unavoidable delays in processing and preparing the papers. Data on Zaïre's exports became available with a long lag; in that respect Zaïre could benefit from technical assistance provided by the Fund to make data available on a timely basis.

Mr. Erb commented that the staff did not carry the analysis of the cobalt shortfall far enough in terms of the authorities' pricing and production policies. In the late 1970s, Zaïre, a dominant producer, had pursued a policy that had contributed to the sharp rise in the price of cobalt from $9-10 a pound to $23-25 a pound. During that period, stocks of cobalt had increased, which suggested that the authorities had been holding cobalt off the market and were therefore contributing to the rise in price. As a result, there had been a structural shift away from cobalt into other metals that had become more competitive, and demand for cobalt had declined. His argument was that the high price level in 1981 and the following decline had resulted from the authorities' pricing and production policies in the late 1970s. The export shortfall should therefore have been treated differently.

The staff representative from the Research Department stated that it was the staff's view that Zaïre had in fact been following the market during the period associated with its 1982 drawing. If at that time the authorities had pursued a different pricing policy and had not built up stocks, Zaïre's earnings might have declined more sharply owing to the price inelasticity of demand in the short term.

Mr. Erb said that he could agree with the staff representative as far as 1981 was concerned, but the situation in 1979 and 1980 had been different.

The staff representative from the Research Department commented that in the late 1970s there had been considerable uncertainty about the adequacy of cobalt supplies because of the security situation in Shaba Province. As a consequence, demand had increased; prices had risen sharply. It was his understanding that Zaïre had pursued a moderate pricing policy during that period and had resisted pressures to raise its price to the free-market level, which had reached about $50 a pound. Zaïre's official price had never exceeded $25 a pound.

Mr. Erb recalled that in a previous paper the staff had shown that between 1978 and 1979 the price of cobalt had increased from $8.40 a pound to $23.70 a pound. During that period, exports from Zaïre had declined from 15,000 tons to 12,000 tons, while stocks had increased from 14,100 tons to 15,800 tons. It was those figures that had led him to conclude that the authorities had in fact contributed to the price rise by holding stocks of cobalt.

Mr. de Maulde observed that another country had also held stocks of cobalt.

Mr. Erb confirmed that the United States was the largest importer of cobalt, but there were over 75 competitive bidders, including the U.S. Government and a large number of private sector bidders. Although the United States was a large buyer, that market was a competitive buyer's market.

The Deputy Managing Director explained that for a number of reasons the management and staff felt that Zaïre's adjustment program would be successful, in spite of the country's poor track record in recent years. First, during the previous year the authorities had introduced a comprehensive and firm set of measures, particularly the liberalization of the pricing system, the depreciation and freeing of the exchange rate system, and the introduction of fiscal measures. Second, the authorities had followed a shadow program for the first six months of 1983, and between January and June there had been an overall budget surplus. The authorities had considerably overperformed under the shadow program, which in effect provided a track record for a period of time. Third, the staff and management had held a substantial number of discussions in Kinshasa and Washington, with the authorities. Several discussions had taken place with the President of Zaïre, and he himself had met with President Mobutu in Washington in August. Those factors provided the basis for the belief by the staff and management that the Zaïrian authorities were committed to the adjustment program. The final decision however was a matter of judgment.

Responding to a question by Mr. Nimatallah, the Deputy Managing Director commented that the adjustment program was founded on the assumption that the authorities would not accumulate arrears and would reduce existing arrears to multilateral financing agencies. With regard to non-Paris Club bilateral creditors, the staff and management had urged the Zaïrian authorities to meet with those creditors, perhaps under the aegis of the Paris Club, in order to reach a settlement that should be consistent with the terms of the Paris Club. The Fund could play a role by providing a way in which the parties could meet. If the authorities did introduce new restrictions on the payment of interest or amortization, their drawing rights under the terms of the stand-by arrangement would be interrupted.

Mr. Alfidja stated that his authorities were determined to correct the serious imbalances facing the Zaïrian economy. As for some Directors' concerns about delaying discussion of an Article IV consultation in order to combine it with a request for a stand-by arrangement, his authorities considered that in some cases it was necessary to stick to the 12-month cycle of Article IV consultations. However, in other cases it might be necessary to delay Executive Board discussion of the Article IV consultation until negotiations on an adjustment program had been completed.

Much of the discussion at the present meeting had focused on the track record of Zaïre, Mr. Alfidja observed. He was not sure that Zaïre had the worst track record in the Fund. Fund support should not be withheld on the basis of the evaluation of the country's track record. The fact that the authorities had agreed to work out and implement an adjustment program should constitute sufficient evidence of their willingness to tackle seriously the financial and economic problems of the country. The test of cooperation with regard to the compensatory financing facility had been met. The staff's interpretation of the test of cooperation as expressed in EBS/83/171, Supplement 2 (9/19/83) was too restrictive, and the decision on compensatory financing should not be dependent on the entering into force of a stand-by arrangement.

He agreed with other Directors that a country such as Zaïre should have an incomes policy, Mr. Alfidja went on. However, such a policy should be realistic, and he supported the idea of linking wages to the actual rate of inflation.

His authorities were considering the possibility of having a Fund resident representative in Zaïre, Mr. Alfidja said. Zaïre was already benefiting from Fund technical assistance, and the authorities intended to request further assistance in problem areas.

With regard to cobalt exports, the authorities had adopted a reasonable policy in view of the long-term prospects, Mr. Alfidja considered. The price and market mechanisms for cobalt were difficult to assess, as they were for other strategic minerals. He would continue the discussion on that issue with Mr. Erb on a bilateral basis.

The Deputy Managing Director made the following summing up:

Executive Directors recalled that, despite its large and diversified resource base, Zaïre had faced serious economic and financial difficulties almost continuously since 1975. The economy had generally stagnated, the rate of inflation had been high, the balance of payments had been under great pressure, the servicing of the external debt had been a major problem, and substantial payments arrears had accumulated. Almost all Directors observed that the major internal and external imbalances were largely due to a long period of inadequate economic and financial management. In that context, they emphasized Zaïre's poor track record in most of its Fund-supported adjustment programs. Zaïre's difficulties, however, were compounded by structural problems, and were also due in part to factors beyond the authorities' control, particularly a marked deterioration in world market prices of the country's principal exports, notably copper.

Directors noted that in 1981 and 1982 the authorities' efforts to come to grips with the country's acute problems had not been sufficiently vigorous or sustained. Thus, the overall economic and financial situation had greatly deteriorated. A major area of domestic policy weakness was inadequate control over government expenditure, including the operations of public enterprises, which had led to a marked widening of the budgetary deficit, thereby compromising the actions taken in the exchange rate field and other areas.

In view of this experience, Directors welcomed the authorities' resolve in early 1983 to bring the budget under control by limiting government outlays, strengthening tax enforcement, and, more generally, improving financial management. They noted the budget results achieved so far, which had helped contain net government borrowing from the banking system. The commitment to reduce the budget deficit from the equivalent of 8.7 percent of GDP in 1982 to 1.9 percent in 1983 was a strong indication of the magnitude of the adjustment effort, which the authorities should pursue in a steadfast manner and continue into the future. Directors also noted the progress made in improving the allocation of resources by continuing the process of domestic price liberalization and by rationalizing the operations of GECAMINES and SOZACOM.

Directors stressed, however, that much stronger and more sustained adjustment efforts would be required to bring about a fundamental improvement in Zaïre's overall economic and financial situation and, especially, to achieve a viable balance of payments position over the medium term. Accordingly, they felt that the adoption of a comprehensive program of adjustment for the period October 1983-December 1984 was an important step in the right direction. Directors welcomed and stressed the importance of the far-reaching price and exchange rate reform initiated by the authorities, coupled with the substantial liberalization of the exchange and trade system, as well as with appropriate fiscal and monetary policies. The exchange rate reform--involving a large initial devaluation of the zaïre that had brought the rate to a realistic level and the implementation of a floating exchange rate regime based on an interbank foreign exchange market--was considered appropriate in Zaïre's circumstances; and it was hoped that it would ensure permanent responsiveness of the exchange rate to market forces. In this context, Directors pointed to the adoption of a temporary dual exchange rate arrangement and emphasized the importance of strict adherence to the timetable for a unification of the rates. However, some Directors were not convinced that wage policy, particularly with regard to public enterprises and the private sector, was adequately tight. They and others also called for decisive measures to improve the operations and financial viability of the public enterprises, as well as for further reductions in budgetary subsidies. Moreover, while monetary policy appeared appropriate, the authorities were encouraged to assure positive real interest rates.

Directors emphasized that the most recent policies and measures, though difficult and painful, needed to be vigorously applied if the adjustment program were to succeed. In this regard, it was critical for the authorities not only to maintain but also to strenghten the present stance of policy, and to continue to improve the allocation of resources. Furthermore, given the scope of the liberalization effort, the private sector now had greater opportunities for contributing to the revival of the economy. The increased realism of the 1983-85 public investment program was welcomed.

In approving Zaïre's request for a stand-by arrangement, Directors stressed the need for the authorities to restore fully the credibility of their economic and financial management. In that regard, the performance of Zaïre under the shadow program was encouraging. Directors attached great importance to Zaïre's commitment to taking any further measures that may be necessary to achieve the objectives of the program, and they intended to follow developments closely on the occasion of the reviews of the stand-by arrangement. Close monitoring mechanisms were stressed in this connection. A few Directors were unable to give their support to the policy program underlying the request for a stand-by arrangement, citing their doubts about wage policy, public enterprises, and the problems regarding arrears and the balance of payments gaps. Moreover, a number of comments were made about the amount of access to Fund resources in this case, ranging from the view that access is too large and front-loaded to those who felt that access could well have been larger.

Despite the extent of the authorities' adjustment program, Directors observed that sizable financing gaps remained for both 1983 and 1984, reflecting the heavy external debt service burden. Zaire's external debt situation was clearly serious, and several Directors stressed that a major collaborative effort by the creditors would be needed in order to obtain appropriate rescheduling arrangements that would close the projected gaps, thereby ensuring the viability of the program. Directors attached great importance to strict compliance by Zaïre with the external debt obligations stemming from these and other arrangements on a strictly nondiscriminatory basis.

Directors regretted that there had been a long delay since the last Article IV consultation with Zaïre, and emphasized the importance of holding the next consultation with Zaïre on the standard 12-month cycle.

The Executive Board then turned to the proposed decisions.

Mr. Alfidja suggested that paragraph 2 of the proposed decision on compensatory financing should be deleted.

Mr. El-Khouri indicated his agreement with the decision as proposed by the staff. It would be unwise for the Fund to release any resources to Zaïre under the compensatory financing facility without first determining that the package was financially viable and that Zaïre would be able to make repurchases. The stand-by arrangement would have to become effective, and it could do so only after the meeting of the Paris Club.

Mr. Finaish, Mr. Erb, Mr. Salehkhou, Mr. Grosche, and Mr. de Maulde stated that they supported the decision on compensatory financing as it was proposed in the staff paper.

Mr. Ajayi indicated his support for Mr. Alfidja's proposal.

The Executive Board then took the following decisions:

Decision Concluding 1983 Article XIV Consultation

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

2. Zaïre maintains restrictions on payments and transfers for current international transactions, including external payments arrears, and a multiple currency practice resulting from the introduction of a dual exchange rate arrangement as described

in EBS/83/257. The Fund welcomes the liberalization of the exchange and trade system effective September 12, 1983, and notes the intention of the authorities to unify the exchange rate system by February 29, 1984. The Fund urges the authorities to remove the remaining restrictions on payments and transfers for current international transactions as soon as possible. In the meantime, in light of Zaïre's adoption of comprehensive policies for balance of payments adjustment supported by the stand-by arrangement contained in EBS/83/257, the Fund grants approval for the maintenance of the multiple currency practice resulting from the dual exchange rate arrangement until the completion of the first review under the stand-by arrangement; the Fund also grants approval for the retention of the existing exchange restrictions, including external payments arrears, until December 31, 1984, or the completion of the 1984 Article IV consultation with Zaïre, whichever is earlier. The Fund urges Zaïre to terminate the bilateral payments agreements with Fund members as soon as possible.

Decision No. 7583-(83/175), adopted
December 16, 1983

Stand-by Arrangement

1. The Government of Zaïre has requested a stand-by arrangement in an amount equivalent to SDR 228 million for a period of 15 months.

2. The Fund approves the stand-by arrangement set forth in EBS/83/257, Supplement 2, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b)(iii).

3. The stand-by arrangement set forth in EBS/83/257, Supplement 2 shall become effective on the date on which the Fund finds that satisfactory arrangements have been made for the reduction of Zaïre's debt service obligations for 1983 and 1984 to a level consistent with Zaïre's program.

Decision No. 7584-(83/175), adopted
December 16, 1983

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request by the Government of Zaïre for a purchase of SDR 114.5 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representation of Zaïre and approves the purchase in accordance with the request, as of the date on which the stand-by arrangement set forth in EBS/83/257, Supplement 2 becomes effective.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7585-(83/175), adopted
December 16, 1983

2. RATE OF REMUNERATION AND FUND INCOME POSITION

The Executive Directors considered a staff paper on the rate of remuneration and the Fund's income position (EBS/83/237, 11/2/83).

Mr. Senior observed that the staff had suggested that the rate of remuneration, as well as the rate of growth of reserves, should be increased significantly, which would lead to a higher rate of charges. In view of the adverse economic environment and the implications of higher charges on debtor members, the Executive Board should consider together the Fund's income position, the rates of remuneration and charges, and the target rate of growth of the Fund's reserves before taking a separate decision on any one of those factors. A further study on the specific proposals regarding higher rates of charges discussed in the staff paper would also be necessary prior to the Board's taking a decision on the rate of remuneration.

He could not support any increase in the rate of remuneration, Mr. Senior indicated. He was concerned about the tone and focus of the staff paper, which failed to take into account the cooperative character of the Fund or the multiple objectives addressed by quotas and quota increases. Furthermore, he had some problem with the staff's assertion regarding the liquidity of the reserve tranche position vis-à-vis other Fund-related assets. There was clearly a trade-off between the rate of remuneration and the rate of charge, representing the different interests of debtor and creditor members of the Fund. In the past, such conflicting interests had been overcome. On the one hand, the Fund's resources were made available at concessional rates; on the other, conditionality was attached to the use of those resources, and the Fund maintained surveillance over the exchange rate policies of member countries. If the operations of the Fund had been dictated only by narrow concepts of the use of its resources, the Fund would never have reached its present position. The cooperative character of the Fund had helped it to grow and to play a central role in the international monetary system.

He was disturbed to see that the staff had indicated that some creditor countries were showing reluctance to support policies that would increase their reserve tranche position because of the relatively low rate of remuneration of that asset, Mr. Senior commented, and that the rate of remuneration was one of the most important factors that could hinder the expansion of the Fund's credit activities. If members had reservations about the Fund's credit activities, he would have thought that they would be on more fundamental grounds, for instance, that the Fund should be only a lender of last resort or that it should provide only a small amount of financing, while imposing strict conditions for external equilibrium. He had not previously heard the argument that the size of the Fund and the magnitude of its credit activities could be curtailed because the rate of remuneration was too low. In 1969, the concept of remuneration had not existed in the Articles of Agreement; the first preferential distribution of net income to members had been made only in 1968. The rate of remuneration had been increasing steadily since 1974, from 35 percent to 85 percent of the combined market rate.

The reserve tranche position as a percent of total reserves had changed rather erratically (Table 2, EBS/83/237), and did not seem to be highly correlated with the rate of remuneration, Mr. Senior continued. Those developments did not support the staff's assertion regarding the yield and the growth of the reserve tranche, or the alleged relationship between the rate of remuneration and the credit expansion of the Fund. On the contrary, actual developments in the rate of remuneration and reserve tranche position tended to confirm the cooperative character of the Fund; reserve tranche positions fluctuated with the evolution of Fund credit activities in response to economic developments and external imbalances.

He was not fully convinced by the staff's argument that reserve tranche positions were less liquid than other Fund-related assets and that, therefore, they should carry a higher rate of return, Mr. Senior went on. In his view, the reserve tranche was the most liquid Fund-related asset; it was certainly more liquid than loan claims and at least as liquid as SDRs. Although, in a legal sense, the encashment provision of loan claims made them very liquid, members perceived the SDRs and reserve tranche positions to be more liquid still. As for loan claims, a member would have made an intentional decision to lend a certain amount of resources to the Fund for a given period. Barring adverse circumstances, those resources would be repaid as originally defined. He did not have the figures, but he imagined that member countries with loan claims had used their reserve tranche positions or their SDR holdings before encashing their loan claims. He invited the staff to comment on that issue and would appreciate any appropriate data that it could provide. If what he had said was correct, indications were that members' perceptions of the liquidity of different Fund-related assets varied considerably, and that the narrow concept of yield, while important, was not the primary factor determining the use of reserve assets.

On a related point, Mr. Senior pointed out that, contrary to the staff's argument, reserve tranche positions were highly transferable; a member was able to draw on its reserve tranche position, effectively transferring it. By drawing on the reserve tranche, a member would not be signaling a deteriorating economic situation, while encashment of a loan claim, entailing an early repayment, could indicate such a deterioration.

The large impact on the rate of charge of a significant change in the rate of remuneration was evident, Mr. Senior remarked. A rate of remuneration equal to 100 percent of the SDR rate would require a 1.73 percentage point increase of the rate of charge, to 8.33 percent. Those figures were based on the assumption that the Fund's net income would be sufficient to finance the target of an increase in reserves of 3 percent a year. The rate of charge would have to be higher if the Fund intended for the annual increase in reserves to be greater, as the staff had suggested. The double effect of that increase on charges would have an adverse impact on debtor countries. It was inappropriate to try to protect the Fund's financial position only through changes in the rate of charge. The concessionality attached to the use of Fund resources should not be eliminated, even though it had been decreasing in the past three years. Finally, a more balanced analysis and adjustment of the rate of charge, the rate of remuneration, and the level of reserves were necessary.

Mr. Erb stated that he advocated an increase in the rate of remuneration to 100 percent of the SDR rate. The cooperative character of the Fund was reflected in its major functions and legal framework. With respect to the Fund's financing function, cooperation meant that countries with a strong balance of payments position used their access to capital markets to lend, through the Fund, to countries facing temporary balance of payments problems. The financial structure of the Fund had become more complex, reflecting in part the fact that the Fund had been lending on a larger scale in recent years. The reserve tranche positions of a number of countries had become a significant part of their reserves.

In the near future, there would be a need for additional reserve tranche increases and for countries voluntarily to maintain their reserve position, Mr. Erb noted. The staff, in EBS/83/237 and EBS/83/251, made a strong case for continuing the trend of adjusting the rate of remuneration toward the SDR rate. He would favor raising the rate of remuneration immediately to the SDR rate, which would amount to a rate of charge of 8.33 percent, assuming a reserve growth of at least 3 percent a year. It was relevant to compare that rate of charge with other rates applying in the capital markets. As for other multilateral institutions, the World Bank was lending at a rate of 10.5 percent, and some of the regional banks applied a rate of charge of 11 percent. In the private markets, the cost of borrowing at the London interbank offered rate (LIBOR) was in the 12 percent range. A considerable amount of concessionality would therefore remain in the Fund's rate of charge even if the rate of remuneration were increased to 100 percent of the SDR rate.

If the increase in the remuneration rate were implemented over a longer period, the impact on the rate of charge could be spread out, Mr. Erb observed. The staff suggested that the rate of remuneration could be raised in two steps over 12 months, with the initial step taken at the beginning of the following fiscal year, and the second step taken halfway through that fiscal year. In conclusion, his authorities favored an immediate increase in the rate of remuneration to 100 percent of the SDR rate, although they would be willing to consider phasing that increase over 12 months.

Mr. Malhotra said that the proposal to raise the rate of remuneration had come at an inopportune time, when many borrowers were facing acute liquidity and debt problems. At a recent seminar on the debt problem, the participants had observed that the present situation was characterized by large-scale rescheduling, rising spreads, high real interest rates, and increasing fees. In such an environment, the Fund should be trying to provide relief regarding charges, rather than considering policies that would place added burdens on borrowing members. Any increase in the rate of remuneration would have an adverse impact on the rate of charge.

In its paper, the staff had looked at reserve tranche positions like any other investment and had ignored the important implications of the fact that those positions were quota related, Mr. Malhotra remarked. Quotas determined voting power, which was regarded as extremely important by Fund members, particularly creditors. It was therefore inappropriate to compare a reserve tranche position to a simple deposit of reserves. The staff paper even implied not only that should reserve tranche positions be remunerated at the combined market rate, but also that there could be a case for the rate of remuneration to exceed that rate. It then noted, perhaps ruefully, that the Articles of Agreement did not permit the rate of remuneration to be higher than the SDR interest rate. An argument had also been advanced that owing to a somewhat lower return on reserve tranche positions, some creditors might be disinclined to provide the requisite resources to the Fund. Mr. Senior, referring to data from previous years, had pointed out that there was no correlation between the rate of remuneration and increases in the reserve tranche positions. He himself believed that, considering the past growth in the Fund's operations, the staff's suggestion was unfair to the creditors.

The paper had made the statement that, if the rate of remuneration were raised, it might be appropriate to avoid frequent variations in the rate as a means of protecting the Fund's financial position; the statement implied that, if measures were needed to safeguard the Fund's financial position, the impact should be borne by charges, Mr. Malhotra remarked. Clearly, the burden of any increase in the Fund's administrative charges--which continued to increase at a rapid rate every year--would fall on a minority of the membership that borrowed from the Fund, most of them developing countries. Such a development would be incompatible with the cooperative character of the Fund. An increase in the remuneration coefficient to 100 percent of the SDR rate would mean that members in creditor positions would not be contributing to future increases in administrative expenditures and reserves of the Fund.

The staff's comments in Appendix I on the evolution of remuneration were incomplete, Mr. Malhotra considered. The sentence at the bottom of page 20 and continuing on page 21 said: "In the discussions on the Second Amendment the view was expressed that it would be desirable for the rates of interest on the two assets to be equal, with the possibility of some divergence as there could be occasions when equality between the rate of remuneration and the SDR interest rate would have a substantial and undesirable effect on the Fund's income position and on the rate of charge on the use of the Fund's resources." First, that view had not been the only one expressed by Executive Directors. He would have expected the paper to pay regard to the other viewpoint as well. Further, the argument in favor of maintaining an element of concessionality in the use of Fund resources had by and large been ignored.

The rate of remuneration had increased from 35 percent to 85 percent of the combined market rate since 1974, Mr. Malhotra noted. The latest increase, from 72 percent to 85 percent, had been effected as recently as 1981. Further, the proportion of a member's reserve tranche position on which remuneration was paid had gone up from 75 percent of quota in 1977 to about 88 percent of quota at present. After the increases under the Eighth General Review of Quotas became effective, that proportion would increase further, perhaps to 93-94 percent. In short, there had been a progressive increase in both the rate of remuneration and the portion of the reserve tranche position being remunerated. Mainly as a result of that increase, the rate of charge had risen sharply to historically high levels. When compared with the rate of inflation in major industrial countries, the present rate of charge of 6.6 percent was positive in real terms. Furthermore, considering the use of borrowed resources by the Fund under the enlarged access policy, the overall cost of Fund resources to borrowing members was higher. In the past, interest subsidy accounts for low-income countries had been established for the oil facility and the supplementary financing facility. However, the resources of the interest subsidy accounts were almost depleted; the effective cost of borrowing from the Fund would therefore be higher still.

According to Table 4 of the staff paper, the grant element of Fund resources was only about 7-9 percent, Mr. Malhotra went on. He wondered whether there were any grounds for supporting a further decline in the grant element. When considering the rate of charge, the Executive Board should not forget the difference between the conditionality of the Fund and that of other institutions, whether commercial banks or the World Bank. The adjustment efforts associated with Fund loans were of a difficult and far-reaching character and involved changes in overall policies. Project lending did not have such an impact. Fund resources should therefore be seen as concessional; if members considered that charges on the Fund's resources were nonconcessional, many of them might not be encouraged to approach the Fund early; their hesitation could retard the adjustment process. The role of the Fund in the international financial system could diminish. Considering the size and strength of the economies of creditor countries and given the implications of further increases in charges for the objective of the Fund, a different conclusion from that being suggested by the staff would be more appropriate.

The Interim Committee, when discussing access levels under the enlarged access policy, had made no mention of the rate of remuneration, Mr. Malhotra recalled. He was concerned about the artificial linkages that the staff appeared to be seeking to establish between the rate of remuneration, the extension of the enlarged access policy, and access limits under special facilities. Those were distinct issues that should be considered individually on their respective merits rather than as a package. What was there for borrowing countries in such a package that meant reduced real access under the enlarged access policy and the special facilities, as well as higher charges? The Board ought to consider all relevant issues, including the level of charges, when determining the rate of remuneration. The time was not right for raising the rate of remuneration. In any case, an increase in the remuneration rate to 100 percent of the SDR rate could not be set as a target. It was important to maintain the cooperative nature of the Fund.

Mr. de Maulde stated that the conflict of interest between the debtor and creditor members of the Fund was more apparent than real. He urged his colleagues to be flexible: no country permanently remained a creditor country or a debtor country. In fact, a number of developing countries were among the creditors--Trinidad and Tobago, Colombia, Singapore, and China--and it was neither in the interest of debtors to discourage creditors, nor in the interest of creditors to weaken the position of debtors. An extremely large increase in reserve tranche positions was forecast for 1984. The ratio of reserve tranche positions to total reserves for creditor members, which had been 7 percent in 1982, had increased to more than 9 percent in 1983, and was forecast to grow to 15 percent in 1984. Member countries should not be discouraged from increasing their reserve tranche position; there was always the alternative of investing their resources in other assets with a much higher rate of interest.

It was important from the creditor's viewpoint that the capacity of borrowers to repay should not be jeopardized, Mr. de Maulde commented. A recent quarterly report of the U.S. Federal Reserve Board emphasized the consequences of inappropriate terms and conditions on the economic recovery in heavily indebted countries. Furthermore, the Chairman had stated in a recent speech in Chicago that credit should be provided on reasonable terms so that the balance of payments and financial problems of debtor countries would not be exacerbated. It would be inappropriate for the Fund to increase its rate of charge after the Chairman's speech. Furthermore, the recent trends in interest rates were already threatening the ability of debtor countries to repay. The Fund should not add the last straw to the camel's back.

The aim should be to find a balanced and constructive compromise between the two viewpoints, Mr. de Maulde said. The debtor members should accept an eventual increase in the rate of remuneration to 100 percent of the SDR rate. The creditor countries should accept a phasing of the increase in the rate of remuneration in such a way that it would not damage the debtors' ability to repay the Fund. More precisely, the rate of remuneration should be progressively increased at the same pace as the decline in the SDR rate, brought about by the decline in the rates of interest in the major currency countries. In that way, the nominal rate of charge would not need to be modified. Reviews could be held semi-annually or quarterly, and the increase in the rate of remuneration could be adjusted in the light of the decline in market rates. The debtor countries would lose an element of concessionality, as the rate of charge of Fund credit would not decline with market rates of interest, but the decline of those market rates and the improvement it would bring to the balance of payments position would make that sacrifice relatively painless. Creditors, on the other hand, would have to wait before the principle of full remuneration was implemented, but as compensation the ability of the debtor countries to repay would be enhanced.

Table 3 of EBS/83/237 showed that for the Fund to have a rate of remuneration at 100 percent of the SDR rate, while maintaining the current nominal rate of charge, the SDR rate would have to be 6.85 percent, Mr. de Maulde observed. It was not at all unrealistic to expect that the SDR rate would decline to such a level over time, for two reasons. First, prior to the end of 1978, before the period of high inflation, the SDR rate had been well below 6.85 percent. Given projections on rates of inflation in the countries whose currencies made up the SDR basket, it was reasonable to expect that the SDR rate would soon decline to 6.85 percent or below. Second, the exceptionally high level of interest rates should turn out to be only temporary, as the major currency countries were likely to follow the Fund's recommendations and improve their policy mix.

Mr. Ajayi commented that although the staff paper made a case for increasing the rate of remuneration, it also pointed out that an upward adjustment of the rate of charge would be necessary as a result of an increase in the rate of remuneration, in order to protect the Fund's income position. He recognized the validity of the staff's proposals, but there should continue to be an element of concessionality in the use of Fund resources. Concessionality not only encouraged members to have early recourse to the Fund in the event of balance of payments need, but also ensured that low-income member countries with only limited access to private capital markets were not cut off from resources.

Creditor members of the Fund should not be discouraged from increasing their reserve tranche positions, Mr. Ajayi considered. Nevertheless, it was important to bear in mind that net users of Fund resources bore the brunt of adjustment as a result of the asymmetry in the international adjustment process. That unfortunate situation was unlikely to change in the years ahead. Furthermore, Fund financing of balance of payments problems invariably resulted in increased exports of goods and services from the surplus countries, and it could be argued that low remuneration on the reserve tranche position was a small price to pay by the creditor countries. Moreover, the staff paper demonstrated that the reserve tranche positions were only a small percentage of the international reserves of the surplus countries. While that percentage was increasing and would continue to do so as more countries made use of Fund resources, the Fund should ensure that its activities served the basic purpose of correcting balance of payments problems rather than adding to the already difficult situation, particularly as the problem of remuneration was not really a serious one for creditor countries.

In the past, Executive Directors had stressed that some facilities should remain of a short-term nature, Mr. Ajayi recalled. However, if Fund resources were made available at the commercial market rate, the cooperative character of the Fund would be eroded. There was a cost to be borne both by the users of Fund resources and by the creditors of the Fund. But it would be inappropriate for the institution's expenses, including the reserve increases, to always be borne by the debtor countries. Quotas were important not only as a source of Fund resources but also as determinants of members' weight in the decision-making process. It was only fair to expect that members would pay a price for increased voting power. In sum, the rate of remuneration should not be increased to the SDR rate, and the rate of charge should remain unchanged.

Mr. Tvedt said that his authorities were in favor of raising the rate of remuneration over time to equal the SDR interest rate. There were indications of a growing uneasiness among Fund members about increases in their reserve tranche positions, which was due, in part, to the low yield on those positions when compared with other Fund-related assets, particularly taking into consideration the lower liquidity of the reserve tranche asset. The reserve tranche position, it could be argued, was an inferior asset. Corrective measures to improve the attractiveness of that asset would have to be taken urgently.

As a first step, the rate of remuneration should be increased to 90 percent of the SDR interest rate from the beginning of the next financial year, Mr. Tvedt considered. Furthermore, a timetable should be set for further increases to align fully the remuneration rate with the SDR interest rate within 12-18 months. However, a longer timeframe could be necessary, should international interest rates move strongly upward.

Unless offset by a decline in international interest rates, the increase in the rate of remuneration would bring pressure for an adjustment in the rate of charge, Mt. Tvedt remarked. The most common arguments for maintaining a low rate of charge were that concessional charges served as an incentive for countries with balance of payments disequilibria to approach the Fund at an early stage and that such a level of charges reflected the cooperative nature of the Fund. At present, when an exceptionally large number of members were already borrowing from the Fund, the first argument seemed to be less valid than previously. An increase in the charges would add to the debt service problems already faced by some countries. Nevertheless, that factor should not be overemphasized; members' debts to the Fund seldom accounted for a major part of their total external debt.

The existing system of determining the level of charges through semiannual reviews of the Fund's income position made it possible to adjust charges in a flexible manner, Mr. Tvedt concluded. Less attention therefore needed to be attached at the present stage to the preparation of a safe budget; in fact minor fluctuations in the rate of reserve accumulation ought to be tolerated in order to avoid frequent changes in charges. In any event, the rate of charge should maintain an element of concessionality, given the conditionality attached to Fund lending.

Mr. Salehkhou commented that the staff paper clearly underlined the trade-offs under various rates of remuneration and concentrated on the general financial impact of an increase in the rate of remuneration on the level of charges and on the Fund's income target. A table illustrating the amount of reserve tranche positions being remunerated and the ordinary resources used by debtor member countries during the previous ten years, at various rates of remuneration and charges, could usefully have been included in the paper. Such a table would have helped Executive Directors to observe the net impact of an increase in the rate of remuneration on both debtor and creditor Fund members. Furthermore, Directors would then have been able to determine whether there had been any direct or indirect relationship between the amount of reserve tranche positions being remunerated and the ordinary resources used by member countries during a given period. If any relationship--linear or otherwise--had been detected, it could have been extrapolated into the future at various rates of interest to determine any tangible impact on the Fund's resources.

A further point demanding close scrutiny was the entire international adjustment process and the role that concessionality of charges played in encouraging members to adopt adjustment policies, Mr. Salehkhou went on. How would a rate of charge that was close to market rates be perceived by potential users of the Fund's resources, and to what extent would it transform the Fund into an ordinary profit-oriented commercial banking institution? There was also the possibility of introducing graduated rates of remuneration and charges, depending on a member's stage of development. At present, such a system would be in conflict with the Articles of Agreement, but provisions of the Fund's Articles had not always remained sacrosanct.

As for the issues under discussion, the various reasons put forward in the paper for increasing the rate of remuneration essentially related to three factors, Mr. Salehkhou considered. First was the attractiveness, inter alia, of market-related rates of return on deposits, vis-à-vis the rate of remuneration on the reserve tranche position, and the effect of the rate of remuneration on the financing facilities of the Fund. It was a valid point that if further increases in Fund credit to members were to be realized, members' reserve tranche positions would need to be expanded. Table 2 of the staff paper, however, showed that despite the continuous gap between the rate of remuneration and market-related rates, the ratio of reserve tranche positions of creditor members as a percentage of total reserves had risen sharply over the previous three years. The staff's assumption that if members did not perceive an attractive rate of return on their Fund-related assets, they would be reluctant to accept further increases in their reserve tranche positions and hence to agree to a further expansion of the Fund's credit activities might prove untenable.

Second, the argument that reserve tranche positions were less liquid than other Fund-related assets and should therefore carry a higher rate of return was based on a commercial analysis, Mr. Salehkhou stated. There were other methods of increasing the attractiveness of the reserve tranche positions, while preserving a concessional element in the use of Fund resources. The staff should undertake a comprehensive study of ways to increase the liquidity, transferability, and usability of the reserve tranche position.

Third, he was yet to be convinced that frequent changes in the rate of remuneration as a percentage of the SDR rate would reduce the attractiveness of the reserve tranche position, Mr. Salehkhou continued. In fact, there had been few changes in that percentage. Only once since 1979--in May 1981--had such a change occurred, and only twice in the previous 15 years had the rate of remuneration as a percentage of the SDR rate been changed. The changing financial circumstances emphasized the need for flexibility in Fund operations.

With regard to the rate of charge, the alternative scenarios put forward on page 13 of EBS/83/237 merited closer scrutiny, Mr. Salehkhou stated. The staff's second suggestion--for delaying increases in the rate of charge and meeting the reserve growth target out of any income excess--seemed worthy of further consideration. In sum, his chair, representing both creditor and debtor countries, was opposed to any increase in the rate of remuneration at the present stage, primarily because of the impact of an increase in charges on the developing countries at a time when the grave financial problems of those countries made the need for concessional credit more acute than ever before.

As for the review of the Fund's income position, he agreed that there was no need to raise the rate of charge at the present time, Mr. Salehkhou said. The projected purchases in the credit tranches for 1984 had been revised downward substantially from the estimates made in April 1983. Projections of the use of resources under the compensatory financing facility and the buffer stock facility had also been revised downward. He understood that the revised estimates reflected a reassessment by area departments. While less dependence on Fund resources by member countries was a good sign, there was no evidence of a substantial improvement in the international economic climate in the past six months that would have explained the sharp decline in members' use of ordinary Fund resources. It should not be assumed that actual use of Fund resources would continue to decline in the next six months. Would the delays in some large purchases by members spill over into 1984? How did the access limits determined by the Interim Committee change the income and expenditure estimates in the second half of 1983/84? He would appreciate staff comment on those issues.

The upward revision in administrative expenses reflected the budget increases for May 1983 salary adjustments and the shift of some building costs from 1983 to 1984, as well as the changes in dollar/SDR rates, Mr. Salehkhou observed. He concurred with the suggestion that there was no need at present to change the rate of charge on the use of ordinary resources.

Mr. Polak remarked that the staff paper was a natural development, given the staff's attempt since 1958 to improve the reserve tranche position in the Fund in order to encourage the supply of usable resources to the institution. The Fund had made two amendments to the Articles, the first for the purpose of creating the gold tranche and, later, the reserve tranche positions, and the second for the purpose of instituting the concept of remuneration. Over the years, the rate of remuneration had been increased from 1.5 percent to 7.34 percent, representing 85 percent of the market rate. The staff suggested that even if the rate of remuneration were raised to 100 percent of the SDR rate, the reserve tranche position would still not be as liquid or as usable as other Fund-related assets. He agreed with Mr. Salehkhou that it would be desirable to study further the ways in which the reserve tranche position could be improved in that respect.

When deciding on whether to raise the rate of remuneration to 100 percent of the SDR rate, Directors should consider the impact of such an increase on the rate of charge, Mr. Polak suggested. The financial strength of the Fund should be maintained at all costs; the charges should continue to cover the Fund's administrative expenses, as well as the cost of remuneration, and there should be some buildup of reserves. He hoped that the Fund could raise the rate of remuneration to 100 percent of the SDR rate, while maintaining an element of concessionality in the use of resources, which was an essential part of the cooperative character of the Fund. He did not see any link between the issue of the rates of remuneration and charges and the question of access. Insofar as there was any linkage, he attached more importance to the moderation of access, and thereby to a sound financial structure of the Fund, than to some minor increase in the rate of remuneration. For all members, it was more important to maintain a financially sound Fund than to earn higher interest on their reserve tranche positions. Directors should try to find a reasonable compromise, possibly along the lines suggested by Mr. de Maulde. Agreement could be sought to increase the rate of remuneration to 100 percent of the SDR rate over a considerable period of time, say, five years starting on May 1, 1984. The necessary increase in the rate of charge would then be modest.

Mr. Clark indicated his agreement with the statement on page 17 of EBS/83/237 that "in view of present circumstances in which the Fund needs to strengthen its liquidity position, it would seem justified to raise the yield on reserve tranche positions relative to other Fund-related assets." In the past his chair had not pressed for a higher rate of remuneration, because it would have meant raising Fund charges at a time when interest rates were at historically high levels. However, by May 1983, the position had changed; market rates had fallen appreciably, and moving the rate of remuneration closer to 100 percent of SDR rates would have had less of an impact on Fund income even though reserve tranche positions had grown. That was why, in May, his chair had expressed the belief that there was a good case for moving the rate of remuneration toward 100 percent of the SDR rate. The time was right to begin that movement. While his authorities would have preferred the movement to be rapid, they were prepared to accept some flexibility in the timing. However, he would prefer that the process of adjustment to 100 percent should not extend beyond a year or thereabouts.

He had some difficulty with Mr. de Maulde's proposal, Mr. Clark said. First, the timing of a change in the rate of remuneration was indeterminate. Second, the real rate of charge mattered as much as the nominal rate of charge.

Any significant increase in the rate of remuneration would necessitate an increase in charges, Mr. Clark observed. But he was interested in the staff's suggestions for lessening the short-run impact. His authorities could agree to increasing the rate of remuneration in stages over a period of time, and he could support the idea of seeking to improve the income generated by some of the Fund's currency assets. In conclusion, he favored an increase in the rate of remuneration to 100 percent of the SDR rate within a period of about 12 months starting from May 1984, possibly in three steps at six-month intervals.

Mr. Grosche commented that, in principle, he supported an increase in the rate of remuneration to 100 percent of the SDR rate. Reserve tranche positions, though less liquid than other Fund-related assets, carried the lowest rate of interest. He recognized however that paying interest on reserve tranche positions at rates below those attainable in the market was one aspect of the cooperative nature of the Fund. By accepting a rate of remuneration significantly below the rates obtainable on other assets, holders of the reserve tranche positions had for a number of years enabled the Fund to maintain a rate of charge that was concessional. While the rate of remuneration should be increased in the long run, the Fund should try to avoid an excessive increase in charges. Mr. de Maulde had clearly expressed the shared interests of debtors and creditors. He himself would support an increase in the rate of remuneration to about 90 percent of the SDR rate, effective May 1, 1984. The rate of remuneration should be reviewed at regular intervals after that date with a view to raising it to 100 percent of the SDR rate.

He did not support any of the staff's suggestions on ways of avoiding a rapid increase in the rate of charge, Mr. Grosche said. The first proposal--delaying an adjustment in the rate of charge until a shortfall in the Fund's income target occurred--might necessitate a rather substantial upward adjustment later on. The income targets for financial years 1982 and 1983 had been met with positive margins, and the excesses had been added to the special reserves. He did not want to view those excesses as having fulfilled the Fund's reserve accumulation targets for some future years. Finally, he did not support the suggestion of investing part of the Fund's reserves in order to generate additional operational income. Such a provision should be resorted to only in an extreme emergency, the nature of which was not definable in advance.

The Executive Directors agreed to continue their discussion on December 19, 1983.

APPROVED: April 17, 1984

LEO VAN HOUTVEN
Secretary