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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/177

3:00 p.m., December 19, 1983

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	L. E. J. M. Coene, Temporary
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	C. Robalino
	H. A. Arias, Temporary
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
M. A. Senior	
J. Tvedt	A. Lindø
N. Wicks	T. A. Clark
	Wang E.

A. Wright, Acting Secretary
B. J. Owen, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: J.-P. C. Golle. European Department: V. Marie, L. L. Perez. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; M. Allen. External Relations Department: H. O. Hartmann. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman, S. A. Silard. Middle Eastern Department: F. Drees, S. Thayanithy. Research Department: R. R. Rhomberg, Deputy Director; N. M. Kaibni, P. R. Menon, H. H. Zee. Secretary's Department: A. B. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; M. N. Bhuiyan, D. H. Brown, S. I. Fawzi, Q. M. 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, E. A. Ajayi, C. J. Batliwalla, S. E. Conrado, L. K. Doe, K, A. Hansen, W. Moerke, J.-C. Obame, Y. Okubo, I. R. Panday, P. D. Péroz, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, J. R. N. Almeida, M. B. Chatah, G. Ercel, G. Gomel, V. Govindarajan, D. Hammann, A. K. Juusela, H. Kobayashi, M. J. Kooymans, E. Portas, M. Rasyid, A. A. Scholten, Shao Z., S. Sornyanyontr, Wang C. Y., A. Yasseri.

1. FUND RESERVES AND DETERMINATION OF CHARGES

The Executive Directors considered a staff paper on the level and growth of Fund reserves and the determination of Fund charges (EBS/83/251, 11/25/83; and Cor. 1, 11/29/83).

Mr. Clark recalled that at EBM/83/176 (12/17/83) he had said that his authorities accepted that, as the staff's analysis showed, an increase in the rate of remuneration would in due course necessitate an increase in charges. However, they considered it worthwhile to examine how the impact could be ameliorated, not just through some limited phasing of the increase in remuneration, but also through some of the other techniques discussed in the staff paper on remuneration (EBS/83/237, 11/2/83), including the possibility of earning income on the Fund's currency assets.

Referring to the mechanism for setting charges, he supported a review of the present system as suggested by the staff on page 21 of EBS/83/251, Mr. Clark continued. He had read with interest the various possibilities outlined in Appendix I to that paper; of the three methods suggested, he would prefer the third. Relating charges to past use of Fund resources seemed a sensible way of eliminating the current uncertainty over the Fund's income position. The way charges were set on borrowed resources under the supplementary financing facility and enlarged access policy provided a good precedent. The quarterly fixing of the rate of charge would have the advantage of smoothing out changes in the rate and would also bring the frequency of adjustment into line with the frequency of repurchase of ordinary resources. At the same time, the rate of charge could still be adjusted to reflect a desired rate of reserve accumulation, which would continue to be set annually at the start of the financial year.

His authorities considered that the desired rate of accumulation of the Fund's reserves would allow a modest degree of flexibility in smoothing out changes in the rate of charge, Mr. Clark stated. For the longer term, the staff paper offered some useful analysis on the question of whether to increase the target rate of reserve accumulation from the present 3 percent. Without putting great stress on it, he could go along with the conclusion on page 20 of EBS/83/251 that "it would not seem unreasonable to accept, for the next few years, an actual increase in reserves that might be greater than would be indicated by the net income target of 3 percent...." The correct time to make that judgment would be at the start of the financial year. Therefore, he encouraged the staff to include estimates of the financial implications of adopting a higher target level of reserves in the paper it prepared for the Board at the beginning of fiscal year 1985.

Finally, on the broader question of the underlying purposes of the Fund's reserves, although no one purpose was paramount, he attached importance to the need for the Fund to maintain reserves to meet contingent operating deficits, Mr. Clark stated. That had indeed been the reason for establishing the special reserve, which constituted the bulk of total Fund reserves, and was the second of the three purposes identified by the staff. Although he recognized the role of reserves as an indicator of sound financial management, the third purpose noted by the staff, the Board would recall that it was his chair's view that the Fund's financial standing rested primarily on its backing from member governments. For the same reason, he could not accept the argument that the primary purpose of reserves was to provide a "sinking fund" to meet significant potential capital losses, and he did not, therefore, favor a move to quotas or assets as the basis for determining the level of reserves. Nevertheless, he broadly concurred with the staff that the Fund's integrity demanded a reasonably strong and rising level of reserves. He hoped that the Executive Board would return to the latter aspect at the time of its next full discussion of the Fund's income position in spring 1984.

Mr. Grosche said that his authorities saw no convincing arguments for changing either the present system of determining the appropriate level and rate of growth of the Fund's reserves or the present method of setting charges, both of which had served their purpose. Charges had remained relatively stable since the new system had been implemented two and one-half years previously, and the primary objective of achieving a marked increase in the Fund's reserves had broadly been met.

He agreed with the staff that the level of reserves should be large enough to serve as a cushion to protect the Fund from potential capital losses, Mr. Grosche continued. The arguments put forward in favor of further increasing the level of reserves were quite reasonable and he could basically support them. However, account should be taken of past experience. So far, the Fund had had no loss arising from a member's failure to observe its obligations, and there seemed therefore to be no urgent need to speed up the growth of reserves.

The suggestion had been made that the rate of growth of reserves might equal the rate of interest on the SDR, Mr. Grosche remarked. That would not be the most reasonable way to achieve an appropriate level of reserves, and he fully shared the staff's reservations about that suggestion. Reserves should be considered mainly as a cushion against the failure of member countries to meet their obligations. It might therefore be argued that the growth of reserves should be related to the outstanding use of Fund credit. However, that solution did not seem very attractive because the volume of outstanding purchases fluctuated substantially over time.

It had also been suggested that the Fund's need for reserves should be related more directly to its administrative expenses and less directly to the volume of its financial operations, Mr. Grosche noted. From what he had already said, it would be clear that he did not support any such suggestion.

To sum up, there were convincing arguments for adhering to the present target of net income of 3 percent of the Fund's reserves, Mr. Grosche considered. Net income in excess of the target should be placed to reserves or be used to increase the rate of remuneration.

As a final comment on the setting of charges, there was sufficient flexibility in the present method to react to unforeseen developments in the Fund's income position, Mr. Grosche noted. It was crucial to avoid deficits, and the safeguard mechanism of Rule I-6(4)(b) should meet that objective effectively. Methods that avoided deviations between the income target and the actual outcome might lead to too frequent adjustments of charges, an undesirable development; it was important for debtor countries to be able to count on relatively stable interest rates being charged by the Fund over time.

Mr. Prowse said that his conclusion was that the existing system for determining the level and growth of Fund reserves and Fund charges was adequate. The present objective of a 3 percent rate of growth of reserves remained acceptable. It was evident from the staff paper that a reasonable case could be made, in the abstract, for a more rapid rate of increase of reserves. But the package of decisions being considered by the Executive Board included the issue of an increase in the rate of remuneration. To seek simultaneously, and at the present difficult time, to raise the rate of reserve accumulation as well would surely strike a double blow at the debtors and would thus seem unreasonable. Moreover, reserves had increased in the past three years, as shown in Table 3, by a healthy 9 percent on average. Thus, he would be happy to maintain the 3 percent target for net income for the time being. Any excess income should remain the subject of an ad hoc decision at the beginning of each financial year; it seemed important for the Fund not to be committed to the principle that any excess should be attributed to reserves because such a commitment might influence various other actions and estimates.

As he understood it, Mr. Prowse remarked, there were two reserves in the Fund, the special reserve, which was intended to absorb annual deficits, and the general reserve, which apparently had broader purposes. He noted that there had been no additions to the general reserve since 1972, and he wondered whether there was a case for reconsidering the structure of the Fund's reserves, and indeed reassessing the value of having different reserves. While he agreed with the staff that the Fund's reserves seemed fairly adequate in relation to potential income deficits, on the broader issues it seemed to him that the standing of the Fund in the eyes of its members and creditors, as well as of the general public, should rest rather on the fact that it was supported by 146 sovereign governments, and that it had large gold holdings. Yet nowhere in the staff paper was there any comment on the relevance of the Fund's gold stock.

Mr. Ismael considered that reserve adequacy should not be considered in isolation from the other issues related to charges, remuneration, and net income. He agreed with the staff that not much would be gained from changing the present method of setting charges, although he had an open mind on the matter. The present arrangement had served well, and the provision for a review had been effective in allowing timely corrective action to be taken, should expected income fall short of the target, although the same could not be said of large income surpluses.

An element of uncertainty in the projections would remain under the current practice of trying to achieve a given net income target, Mr. Ismael stated. It would be possible to minimize the uncertainty if the rate of charge was made more flexible. But as long as the market rate could not be projected or estimated with any degree of accuracy, the Fund could do no better than at present in achieving an absolute income or reserve target.

As for the adequacy of the level of reserves and the related problem of whether or not to set the reserve growth target higher than the one already fixed, he was inclined to preserve the present approach to the accumulation of reserves, Mr. Ismael said. Reserve accumulation over the past several years had been adequate to cover any possible operational contingencies; to add other purposes would be inappropriate. While it might be desirable to accumulate somewhat more reserves than targeted if actual income exceeded the target, which had happened on a number of occasions in the past, he was not convinced that any attempt should be made to accumulate reserves systematically in the future as a hedge against "other potential losses." He was even more concerned about the relevance of saying that higher levels of reserves were required as an added source of liquidity and as an indicator of sound financial management. The commitment of members to increase their quotas and to supplement the Fund's reserves, through official borrowing, coupled with the application of credible and prudent adjustment policies for members, were more effective ways of instilling confidence in the institution.

Given the present relationship between reserves and potential income, Mr. Ismael stated, he tended to agree with the view that the present level of reserves was adequate. The present 3 percent net income growth target was therefore also appropriate. However, he was prepared to consider other reasons for an increase.

Mr. Lovato considered that the starting point for a discussion of the two staff papers on the rate of remuneration and on the determination of charges should be the level and the rate of growth of reserves believed to be adequate for a proper functioning of the institution. Nobody could argue against the proposition that the Fund needed a sound financial position over time; however, it should not be forgotten that the Fund's reserves were not comparable to those of private enterprises. In the past six years, the level of reserves had diminished substantially in relation to the variables considered by the staff to be the most important ones, yet no shadow had been cast on the image of the Fund. Confidence in the Fund was not only a function of its reserves but also of prudent and systematic management and of its ability to promote adjustment. The Fund was a multinational institution, with very substantial assets, and its ability to service its debt should be beyond question. Besides, the Fund was a cooperative and, by definition, it should not be striving for a level of reserves higher than was strictly necessary. The decision to set a net income target of 3 percent a year of the reserve stock properly reflected a balance of various considerations. If the target was met, net income could increase reserves in a moderate and steady way. Admittedly, the task of meeting the target was not an easy one. But the staff had already made substantial progress in evaluating the use of the Fund's ordinary resources. The difficulty of forecasting the trend of interest rates, which was and would remain the most important variable, would not disappear if other methods were used.

The other methods proposed in the Appendix to EBS/83/251 had their merits, Mr. Lovato remarked. However, he agreed with the staff that they would have the consequence of changing the rate of charge on the use of ordinary resources more frequently than at present. The existing system had worked reasonably well, especially if the particular circumstances were taken into account, and it allowed for a reasonable degree of flexibility. Not only did it prevent too slow a rate of reserve growth; it also offered the Executive Board the possibility of deciding how and when to use the excess of net income in relation to the target. In that respect, he would not be in favor of reducing the rate of charge or of increasing the rate of remuneration retroactively. Instead, he would prefer to transfer the excess to the net income of the following fiscal year and to increase the rate of remuneration, or to reduce the rate of charge, according to the prevailing economic circumstances.

Mr. Hirao said that he was in general agreement with the thrust of the staff paper. Like the staff, he felt that it might be desirable to increase the present level of reserves in line with the activities of the Fund with the object of strengthening its financial position. But as the present system had the merit of keeping the rate of charge relatively stable at a time of instability in market interest rates, he supported the staff view that the practical solution would be to maintain the present 3 percent target, while permitting somewhat more upward flexibility in the actual accumulation of reserves.

Mr. Senior noted that the staff paper once again highlighted the difficulties involved in making accurate forecasts of the Fund's income position. He was not very surprised by the deviations from the original net income forecasts, which were in any event small, related to gross income or expenditure. The deviations did generally tend to underestimate rather than to overestimate net income, with the result that reserves had increased in the past few years by much more than the original target of 3 percent a year. In the past two years the deviations had not been large enough in absolute terms to warrant a permanent increase in the rate of remuneration or a retroactive decrease in the rate of charge, and it was primarily for that reason that excess net income had been placed in the special reserve.

Reserves served only one main purpose, Mr. Senior considered, namely, to protect the Fund's capital from possible losses arising from a shortage of income. Somewhat like Mr. Clark, he believed that, given the special character of the Fund, reserves hardly acted as an indicator of sound financial management or as a cushion to protect the Fund's capital from loan losses if a member failed to observe its obligations. The Fund's conservative financial management was well known and would not, in his opinion, be much enhanced by a small increase in reserves. At the same time, the possibility of loan losses seemed remote, because of the cooperative character of the institution and its relevance to the international financial system. Indeed, he had always believed that the best asset the institution had, and which represented its real reserves and backing, was that same unique cooperative character.

On the basis of those considerations, he did not find the present level of reserves inadequate, Mr. Senior remarked. As the staff indicated, the level of reserves could be changed in relation to potential income deficits, which in his view were the only indicator for judging reserves. In addition, the impact of an increase in the rate of growth of reserves on charges should not be overlooked. He could not go along with the proposal to increase the rate of reserve growth.

The alternative methods of setting periodic charges discussed in Appendix I were no better than the present method, as the staff itself had noted, and there was no need for change, Mr. Senior concluded. The present system was relatively new, and too frequent changes should be avoided. In any case, he did not see an overriding need for forecasting net income with extreme precision.

Mr. de Maulde observed that the staff had shown a tendency to minimize the Fund's likely income and therefore to overestimate the level of reserves it needed. For four financial years from 1980 through 1983, the net income forecasts and the actual outturn had been, respectively, minus SDR 14 million against SDR 3 billion; minus SDR 23 million against SDR 80 million; minus SDR 140 million against SDR 92 million; and minus SDR 63 million against SDR 65 million.

As for the Fund's reserves, as he understood it, the market value of the institution's gold holdings was approximately SDR 10 billion more than the official value of SDR 3.6 billion, an excess that could be used to help pay creditors if the Fund went into liquidation, Mr. de Maulde remarked. The question therefore was whether the Fund did not have a hidden reserve of SDR 10 billion, rather than the declared reserve of SDR 1 billion; if so, the creditors should have every assurance that their loans to the Fund would be repaid. He had no problem with maintaining the 3 percent target rate of growth in net income; furthermore, if income was more than forecast, the excess should be used for purposes other than increasing the special reserve. He recalled as an example the suggestion by his chair for moderating charges.

Regarding the determination of the rate of charge, Mr. de Maulde added, the possible methods described in Appendix I to EBS/83/251 did not seem likely to produce better results than the present one, which should therefore not be changed.

Mr. Joyce said that he agreed with the staff that it was difficult, if not impossible, to achieve a net income target in the face of unpredictable variations in market interest rates and in the use of Fund resources. Despite recent experience, given the number of variables involved, it would be surprising if it was always possible to earn enough income to meet the target of a 3 percent annual increase in reserves.

The role that reserves should play in a cooperative, intergovernmental institution like the Fund was not completely clear to him, Mr. Joyce remarked. The main guarantee of the Fund's existence was clearly the continued commitment of its members. Yet both the staff and the Executive Board must ensure that the institution pursued sound and responsible practices and policies of financial management; inter alia, access to Fund credit should not strain available resources and there should at all times be a high probability that all outstanding loans would be repaid. The annual and midyear reviews of the administrative budget were of course also important in that context.

The importance of reserves should therefore not be overemphasized, Mr. Joyce considered. While he agreed with the staff that reserves had a role to play in offsetting potential losses arising from unexpected developments, the primary focus should be on ensuring that the budget was constructed so as to permit the Fund to take early action to prevent deficits rather than building up reserves to absorb them. Reserves might have some part to play in offsetting losses arising from a default by a repurchasing member; however, they were not likely to make a large contribution to enhancing the Fund's liquidity.

The present system for setting the rate of charge had worked reasonably well in preventing deficits in the Fund's income position, Mr. Joyce noted. Both interest rate developments and the use of Fund resources, at least over the past two years, had worked to produce better income positions than had been expected, as the figures cited by Mr. de Maulde showed. Although it was unnecessary at the present time to review the method of setting charges, it might be worthwhile returning to the issue early in the coming year. Several possibilities were open, including more frequent reviews, say, at quarterly intervals, or the establishment of a floating rate of charge expressed as some proportion of the SDR rate or the rate of remuneration.

Mr. Polak said that he was not entirely satisfied that Rule I-6(4) was the best possible guide for setting the rate of charge, nor did he agree with the staff paper in its entirety. However, he had concluded that for the time being it would probably be best to retain the method decided in 1981 for setting charges. The main practical advantage was that the method was based on an agreed 3 percent annual increase in the Fund's reserves and that it virtually guaranteed income in excess of the target. He expected the excess to decline over time, which was also a merit of the method. If an attempt was made to reach agreement on a technique that would ensure a better approximation of income to the target set, the income target itself would become a matter for contention.

There were three reasons for hoping that deviations from the income target would be smaller in the future than in the past, Mr. Polak considered. First, if the rate of charge was brought closer to the rate of remuneration, which would be the result of bringing the rate of remuneration itself closer to the interest rate on the SDR, errors induced by wrong estimates of the amount of use of the Fund's resources would have less of an impact. In fact, if the Fund's debit and credit interest rates were the same, the amount of use of the Fund's resources would no longer be a relevant factor. Second, the staff would more and more find it possible to improve its estimates of the amount of outstanding drawings. Third, there was a reasonable hope that interest rates would not be as volatile in future as they had been in the past two years.

For all those reasons, Mr. Polak concluded, he was prepared to gain more experience with the present decision, although he foresaw the desirability of changing the method at some time in the future.

Mr. Malhotra said that he agreed with those Executive Directors who believed that the present rate of annual increase of 3 percent in reserves was adequate, as was the present level of reserves, viewed in terms of the variations in the Fund's net income, the most relevant variable to be kept in mind. For an institution like the Fund, a larger growth rate in reserves was unnecessary. The point had already been made that the Fund had the backing of 146 sovereign nations. Another point was that the Fund had never faced a real default or loss of capital, although there might have been a few months' delay in some repurchases. Therefore, relating reserves to the volume of lending or to the size of quotas was not the right approach. Rather, the approach should be to determine whether the net income growth target that had been agreed and the absolute level of reserves were adequate to take care of the likely variations in net income. Judged by that criterion, there was no justification for setting a higher reserve target.

There were some defects in the present method of calculation, Mr. Malhotra remarked. The major one was that although there was a rule according to which the rate of charge could be increased, if at a given time during a year it was found that the net income target was not likely to be met, there was no corresponding rule for reducing the rate of charge, if net income was expected to be much in excess of it. That asymmetry needed to be corrected. Furthermore, if the rate of charge was set on the basis of a given rate of remuneration, and if net income was well in excess of the target, the only logical outcome should be a decision to reduce the rate of charge. The staff could not assume that net income in excess of the target would be allocated to reserves. Even on the basis of a 3 percent rate of growth of reserves, large excesses of income were being earned, probably because of the staff's conservative estimates of income. There was a need to review the placement of such excesses to reserve.

Subject to certain observations that he had made at the previous meeting relating to the rate of remuneration, Mr. Malhotra said, he could go along with the present method of computing charges for the time being, with the qualifications he had mentioned: first, that there should be provision for correcting excesses in income as well as for correcting shortfalls; and second, that excesses should not be appropriated to reserves but should go to reduce charges.

Mr. Erb remarked that although he would not at the present stage advocate a change in the procedure for setting charges or in the reserve target, from a long-run point of view the preference of his authorities would be for the rate of reserve growth to be at least equal to the rate of return on the SDR so that there would, in effect, be no real decline in the reserve base over time. It might also be appropriate, during periods when the rate of Fund lending was increasing, to have the rate of reserve growth accelerate above the rate of return on the SDR.

If the 3 percent reserve target and current method for determining charges was retained, Mr. Erb noted, there was a greater likelihood in current circumstances of excesses rather than deficiencies of income. Nevertheless, in spite of the adjustment made at the midpoint of each financial year, there was no absolute guarantee that the Fund would not end the financial year with a deficit. The practice of adding excess income to reserves should be continued; the excess should not be passed on either in the form of remuneration or in the form of reduced charges. As a general proposition, the objective of building up reserves to the extent possible was to enable the Fund to take every possible advantage of its circumstances to increase its reserve base, or its own resources, over time.

Mr. Coene said that his chair considered the present arrangements to be satisfactory. It was not clear what additional purpose would be achieved by raising the yearly reserve growth targets. The present system, with its safeguard mechanism, more or less ensured a minimum reserve increase of 3 percent a year. The experience of the past two years had shown that actual reserve accumulation was more than double the target fixed at the beginning of the financial year. It was not particularly useful for the Fund to aim at stability in its net income position; stability in the rate of charge was much more important. As the present system offered such stability, and moreover almost guaranteed a minimum reserve growth, there would be little advantage in changing it.

Mr. Nimatallah considered that the Fund should continue to add to its reserves over the medium term. He sympathized with those who argued that the target growth in reserves should be higher than 3 percent a year, but the different considerations that had led to the adoption of the 3 percent annual target remained valid. Therefore, the Fund should retain that target as a prudent minimum, and it should also continue the past practice of placing any excess income into reserves.

The present method of setting charges had certain drawbacks, as the staff acknowledged, Mr. Nimatallah continued. In particular, it had not been possible so far to achieve the income target because the projections were extremely sensitive to changes in market interest rates and in the use of Fund resources. However, it was not clear at the present stage whether an alternative method would be more satisfactory. Judging by the analysis in Appendix I, the costs of the other possible methods could outweigh the benefits. For example, while it might be possible to achieve the income target more accurately, the more frequent adjustments in charges that would be involved could create uncertainty and inconvenience for Fund borrowers. The present method was, after all, fairly new, and it had had to operate under difficult circumstances. The method had the important advantage of keeping charges relatively stable; it also provided some flexibility in dealing with changes in the Fund's income position. On balance, therefore, he would support the continuation of the present method for the time being, although it should be reviewed in a few months with the benefit of more experience.

Mr. Camara observed that, as pointed out in the staff paper, in deciding in 1981 to set the rate of growth of reserves at 3 percent, Directors had taken cognizance of conflicting but pertinent considerations. While agreeing that a moderate rate of increase in reserves would strengthen the Fund's financial position, they had also found it necessary to avoid an increase in the rate of charge that would place an additional burden on members making use of the Fund's ordinary resources. That consideration was as vital at present as it had been in 1981. Furthermore, the target had led to increases in the Fund's reserves, while also providing some flexibility in the rate of reserve accumulation. He would therefore agree with the staff that there were "advantages in maintaining the present 3 percent target while permitting some upward flexibility in the actual rate of accumulation of reserves" (EBS/83/251, page 15).

The present method for determining the rate of charge should be continued unamended, Mr. Camara considered. According to the staff, the method had worked reasonably well in somewhat difficult circumstances, and it seemed to contain a reasonable degree of flexibility to accommodate changing circumstances. There appeared to be no particular virtue in the other possible methods of determining periodic charges that the staff had provided in Appendix I; without producing results superior to the present system, they would increase the frequency of changes in the rate of charge. Because charges were sticky downward, a more rapid change in the rate of charge would mean more frequent upward adjustment of charges, something that would not be acceptable to his chair. Furthermore, the alternative approaches might induce periodic changes in the net income target that would not seem warranted over the medium term. The staff had been forthright in concluding that "the present system has provided not only useful flexibility in the rate at which reserves have accumulated but has avoided the need for frequent changes in the rate of charge at a time of considerable instability in interest rates." Surely, the method should be kept unchanged.

Mr. Tvedt remarked that the staff seemed to be suggesting that the rate of annual reserve growth should be higher than the present 3 percent. He had, however, like other Directors, some difficulties with the argument that an increase in reserve accumulation was needed in order to strengthen the Fund's standing in the international financial community. His view was similar to that of Mr. Clark, namely, that that standing depended primarily on the Fund's backing from member governments. Although there were many good reasons, as noted by the staff, for the Fund to have ample reserves, he saw no reason why it should set a fixed reserve accumulation requirement for each individual financial year. In his opinion, reserves were to provide for flexibility in the management of the Fund. At the present juncture, that flexibility might be needed to avoid an abrupt increase in charges. In other words, reserves should give the Fund a certain, even if rather limited, buffer to accommodate a more stable development in charges.

Mr. Salehkhou said that he found the staff's arguments, which by implication called for an increase in reserves, unconvincing. It was argued that, as a percentage of quotas, reserves had declined over the years. However, the decline had been relatively modest. In relation to world trade, quotas themselves had declined but without apparently convincing industrial countries that they should be increased sufficiently to maintain the old ratio. Therefore, he saw no compelling reason for attaching undue significance to the decline in the proportion of reserves to quotas. Moreover, the Fund was not a commercial institution, and the concept of sound financial management should not be applied to an international institution in the same way as it was applied to a profit-motivated commercial enterprise. In fact, there was apparently some difficulty in determining an optimum level of reserves for an organization like the Fund, mainly because there were so many indeterminate factors. The argument that a high level of reserves would give the assurance that the Fund would have resources to meet administrative expenses if the volume of its financial activity declined, was untenable. In past years, income in excess of the target had been placed to reserves. He therefore supported keeping the present arrangement.

As for the disposition of net income, the practice so far of placing excess income to reserve had been satisfactory, Mr. Salehkhou commented. He strongly believed that the approach should be kept as flexible as possible without an advance commitment to raising the target or aiming at a greater actual reserve increase.

Three possible procedures for determining the rate of charge had been set out in Appendix I, Mr. Salehkhou observed. It was explained that the third method, based on the past use of Fund resources, would achieve the net income target precisely. The staff pointed to the inflexibility of that method, particularly in the event of a need for a faster rate of reserve accumulation. Nonetheless, he believed that the method merited further consideration. For the time being, however, he could agree that there was no need to change the current procedures.

Mr. Delgadillo considered that both the system for attaining a given level of reserves and the method for determining the rate of charge were adequate. Therefore, they should not be modified for the time being. It was also the view of his chair that the rate of charge should be kept stable over time.

Mr. Zhang said that he accepted the staff's view that there would be comparatively little advantage in changing the present systems.

The Treasurer explained that the special reserve could be used to cover any kind of loss--including deficits between income and expenses, and any capital losses--but it could not be used to make an annual distribution of net income, should a decision be taken to distribute any part of the Fund's net income. To provide for capital losses in the event of deficits, excess income had in the past first been placed to the special reserve, rather than to the general reserve for distribution to all members.

Although it was true that the Fund had so far not written off any losses resulting from operations with members, the Treasurer continued, the failure of one member to repurchase balances of its currency totaling SDR 18.7 million had in fact required the Fund to record in its balance sheet an asset item in the form of deferred income, which was being accumulated because the member had not paid the charges on its outstanding purchases. It might be of interest to note that although the situation varied widely among member countries, some governments would be required by their legislative systems to make special provision for such nonperforming assets or to record them as a loss. In principle, therefore, the Fund's reserves did have a role to play, if only as a counterpart to an asset that was not earning income. Delays in repurchase and in the payment of charges had also been short in the past, but as shown in recent reports to the Executive Board on the failure of members to meet their obligations on time, the number of delays was rising, even though the amounts involved were still relatively small.

There was no bias in the estimates of expenses and income submitted by the staff to the Executive Board, which was moreover always free to question the assumptions, the Treasurer said. It should also be noted that the outcome for the current financial year, unlike that in the preceding four financial years, was for a much smaller surplus than had been estimated, of around SDR 60 million instead of SDR 100 million. Moreover, the swings from the original estimates were only of the order of 2-3 percent, because over the past four years the Fund's gross income had increased vastly, from SDR 600 million to SDR 2.8 billion.

The discrepancies between the estimates of net income and the actual outturn were mainly beyond the control of the Fund, the Treasurer added. First, there had been large swings in interest rates; the practice of the staff, endorsed by the Executive Board, had been not to attempt to prognosticate changes in interest rates. Whatever views the staff might formulate for itself, forecasting interest rates would be a difficult undertaking at best, and at worst would be damaging to the Fund if the results became publicly known. Another reason was that the staff's general working assumption was that members having stand-by or extended arrangements would be able to carry out the programs they had undertaken. It would be difficult to assume the contrary, and indeed it would be impolitic and detrimental to the position of the members to do so. There had in fact been considerable delays on the part of members in making purchases under arrangements; if drawings of even SDR 1 billion were not made in accordance with arrangements, the Fund could readily experience swings in income of SDR 10-20 million.

Even if financial considerations were subordinate to the cooperation and assurances of members and to the good management of the institution and the adjustment policies it fostered, the Treasurer stated, it should be borne in mind that if the Fund ever needed to borrow in the market, the first question would be whether it had recently recorded deficits and how much net income it had added to its reserves, if any. The institution had no capital in the true sense of the word. The Fund's gold holdings and reserves belonged to the membership at large; the gold holdings could be sold at any time by a decision of the Executive Board, and members could withdraw from the Fund. If the Fund had not made provision for a modest net addition to its reserves--in an amount of around SDR 30 million with the present 3 percent target--it might well have to pay another half percentage point a year on its outstanding borrowing, which at present stood at SDR 13 billion.

The Director of the Legal Department confirmed that the only purpose for which the special reserve could not be used was to make distributions of net income to members. The Fund's gold holdings, indeed all its assets, were available to meet its liabilities; if the Fund were to be liquidated, its creditors would have priority of repayment.

Mr. Erb remarked that in a sense, the existence of reserves was a useful backdrop for either private or official borrowing. He asked what additional technical steps would have to be taken to allow reserves to be used as collateral for borrowing.

The Director of the Legal Department replied that the Fund's reserves were at present not segregated; they were in the form of an unallocated surplus, and they were used in the Fund's operations. It would be possible, once a number of operational and other problems were resolved, to separate and place in a separate fund an amount of assets equal to the reserves to serve the purpose mentioned by Mr. Erb.

Mr. Salehkhou said that he maintained his view that the credibility of the Fund was based on its membership and not on its financial position. As a matter of fact, his chair had always been opposed to private market borrowing because it would deliver the Fund into the hands of the commercial banks, and thus lead to its dissolution. The Fund was a cooperative organization, supported by its members; it should not have to explain itself to commercial banks or submit to their conditions in order to meet its financial needs. After all, there should be a difference between a Fund of 146 sovereign members and a commercial institution based mainly on its own financial resources.

The Chairman noted that the consensus was in favor of continuing the present system for determining the level and growth of reserves and the rate of charge. Alternative mechanisms had been explored, as requested by Executive Directors, but the outcome of the discussion was that the most reasonable course of action would be to retain the present methods.

The Executive Directors concluded their discussion of the level and growth of Fund reserves and the determination of Fund charges.

2. POLICY ON ENLARGED ACCESS - PROPOSED DECISIONS; AND ACCESS LIMITS - SPECIAL FACILITIES - PROPOSED DECISION

Executive Directors considered a staff paper containing proposed decisions on certain aspects of the policy on enlarged access and the access limits for special facilities (EBS/83/270, 12/16/83).

The Director of the Legal Department explained that a consensus had been reached on the substance of proposed decisions I, II, and III, on the policy on enlarged access, with the exception of the bracketed language. One Executive Director had asked for the inclusion of the descriptive language in square brackets in proposed decision I on the annual review of the enlarged access policy, and several Directors had been opposed to the inclusion of the bracketed sentence in proposed decision II on the guidelines on access limits under the enlarged access policy. No consensus had yet been reached on access limits under special facilities, and Executive Directors might wish to pay particular attention to proposed decision IV, where the alternative access limits, including those proposed by the Managing Director as a compromise, and the options for a review, were shown in square brackets.

Mr. Nimatallah stated that he could go along with access to the compensatory financing facility of 85 percent of quota, with the threshold set at 50 percent of quota. He had no difficulty with the first three proposed decisions.

Mr. Grosche commented that he had asked for the insertion of the bracketed language in proposed decision I because, like members of the Interim Committee, who had used the same language in their communiqué, he had thought that it might be helpful to explain the possible outcome of future reviews. But it was obvious that a review would extend to all relevant considerations, and he was ready to withdraw his proposal.

He would prefer to keep the sentence in square brackets in proposed decision II, Mr. Grosche added.

On the fourth draft decision, he could go along with an 80 percent access limit, but could also accept 82 or 83 percent in order to reach a compromise, Mr. Grosche remarked. For the combined limit, 105 percent was acceptable. His preference for the review would be not later than December 31, 1984 and annually thereafter. He strongly favored setting the threshold at the midpoint between zero and the access limit.

Mr. Ismael said that he had no difficulties with proposed decisions I, II, or III, with or without the language in brackets. His difficulties were with proposed decision IV. His chair had accepted the Managing Director's compromise proposal for access to the special facilities, including the threshold of 50 percent of quota, and not a threshold at the midpoint between zero and the amended quota limit. Therefore, if the figure of 42.5 percent in square brackets in proposed decision IV was a midpoint, it was unacceptable to him.

As for the reference in paragraph (d) of proposed decision IV to a review, Mr. Ismael stated that he recalled no discussion of a review hitherto, nor had any provision for a review been included in the 1979 decision amending the compensatory financing facility. Finally, he saw no need for linking policy on the special facilities with the review of the policy on enlarged access.

The Director of the Legal Department confirmed that the references in brackets to 42.5 percent would have to be deleted to satisfy Mr. Ismael's wishes to retain a threshold of 50 percent of quota, the present figure. The inclusion of the review clause reflected the wish of the Interim Committee, which had mentioned in paragraph 5(e) of its communiqué on access limits to the special facilities that those limits "should be reviewed at the time of each review of the enlarged access policy." Because provision had been made for an annual review of the enlarged access policy, as agreed by the Interim Committee, the same provision had been made for the compensatory financing facility.

Mr. Alhaimus remarked that his only problem was with draft decision IV, and specifically, with the proposal to change the figure of 50 percent of quota to 42.5 percent. His chair had supported the Managing Director's compromise package on the understanding that the 50 percent of quota limit would be retained. On paragraph (d), he would prefer a review from time to time.

Mr. de Maulde remarked that he had no problem with proposed decisions I or II, with or without the wording in brackets, or with proposed decision III. On proposed decision IV, he accepted the Managing Director's compromise proposal of 85 percent of quota; as for the figure of 42.5 percent, he had understood that the proposal had been to keep the present figure of 50 percent.

Mr. Wicks observed that the four proposed decisions under discussion would of course have to be taken together with the decisions to be reached on the rate of remuneration and the rate of charge. Those decisions would be an important element in his agreement to the rest of the package.

He agreed with Mr. Grosche that the sentence in square brackets in proposed decision II should be retained, Mr. Wicks said.

In proposed decision IV, he continued to believe that the 85 percent figure was somewhat generous and he would prefer a figure of 80 percent, Mr. Wicks stated, although he might be prepared to go one, two, or three percentage points higher, depending on the rest of the decisions to be reached. As for the alternative to the present limit of 50 percent of quota, his preference was for a midpoint, between zero and the ceiling, and he would therefore like to see the bracketed figure of 42.5 percent replaced by 40 percent, if the 100 percent limit was changed to 80 percent, his preferred position.

As for the options in paragraph (d), he was indifferent between a review not later than December 31, 1984 and annually thereafter, and one to be held at the time of each review of the policy on enlarged access, Mr. Wicks said. He could not accept a review from time to time.

Mr. Salehkhou recalled that it had been widely recognized during the previous discussions that there was no direct link between decisions on enlarged access and those on special facilities, and that it was undesirable to establish any link. Therefore, he would prefer the decision on access to special facilities to be adopted without paragraph (d) in proposed decision IV. If it was decided to keep that paragraph, it would be better not to have a deadline date for reviewing access under the special facilities, and it would thus seem more appropriate to make reference to a review from time to time.

Mr. Erb remarked that the positions he would state on each of the proposed decisions would be related to his position on remuneration and charges during the ongoing discussion of those issues. He could accept or leave out the reference in brackets in proposed decision I. On proposed decision II, he would prefer to retain the sentence in brackets, reading "the annual and triennial access limits shall not be regarded as targets." The following sentence mentioned that "within these limits, the amounts of access in individual cases will vary according to the circumstances of the member in accordance with criteria established by the Executive Board." As he had indicated immediately following the Executive Board's discussion of enlarged access, he had feared that his authorities would not be pleased with the outcome of that discussion, and his fear had been borne out. Their apprehension was that over time, there would be pressure in the Executive Board for a broader interpretation of the criteria for enlarged access; the failure to reach a broad consensus on the principles and criteria elaborated in the staff paper was thus a cause of concern. Nevertheless, in implementing the policy on enlarged access, his authorities would of course attach great importance to the criteria and principles that would shape the application of the enlarged access within the limits of 102 or 125 percent of quota.

On proposed decision IV on access limits under the special facilities, Mr. Erb stated, again in light of his position on remuneration and charges, that he could accept 80 percent for access to the compensatory financing facility, or perhaps an additional one or two percentage points, up to 82 percent. He retained his support for the concept of a midpoint break between the upper and lower segments; for instance, 40 percent would be the appropriate midpoint if the limit was 80 percent. He had no problem with a combined limit of 105 percent for the two compensatory facilities. Similarly, he would support an 80 percent ceiling for access under the cereal decision, with a midpoint of 40 percent.

On paragraph (d) of proposed decision IV, Mr. Erb concluded, his preference would be to stay with the language of the Interim Committee communiqué, referring to a review of the new percentages of quota at the time of each review of the policy on enlarged access. However, he could accept a review not later than December 31, 1984 and annually thereafter.

Mr. Senior said that in a spirit of compromise he could accept the Chairman's proposal relating to the proposed decision on access limits under special facilities. Access of 85 percent for those facilities, with a threshold at 50 percent of quota, was acceptable to him. He would prefer proposed decisions I and II without the words included in square brackets, but he could go along with their inclusion if that was the consensus.

Finally, Mr. Senior considered that the decisions were independent of any package and that the Executive Board should move forward by adopting those decisions. He had understood that there was already a consensus on extending the period of the enlarged access policy.

Mr. Tvedt commented that he had no difficulties with proposed decisions I, II, and III, and that he was ambivalent with respect to the language in brackets. He could go along with access limits under the special facilities of 85 percent or somewhat lower, and with a combined limit of 105 percent. His clear preference was for maintaining the lower segment of the compensatory financing facility at 50 percent of quota, but he could go along with a midpoint.

Mr. Joyce said that he had no difficulties with proposed decisions I, II, and III, and that he would be prepared to drop the brackets in the first two decisions.

On proposed decision IV, his preference would be for access at 85 percent of quota, and he would be prepared to accept 42.5 percent as the threshold rather than 50 percent of quota, Mr. Joyce added. In the interests of compromise, he would be prepared to go along with a slightly lower limit of 82 or 83 percent, if that was the consensus. He had no problem with the 105 percent overall limit.

Referring to paragraph (d) of proposed decision IV, Mr. Joyce recognized that the communiqué of the Interim Committee did mention a review being carried out at the time of each review of the policy of enlarged access. However, he would prefer to use the words "not later than December 31, 1984 and annually thereafter," which would have the same effect on timing but would have the advantage of making clear that access to the special facilities would not automatically be reduced as and when enlarged access was reduced, those two matters being quite separate.

Mr. Arias said that he had no difficulties with proposed decisions I, II, and III. On proposed decision IV, relating to access limits under special facilities, he supported the 85 percent limit, with a threshold of 50 percent of quota.

Mr. Camara said that he had no problems with proposed decisions I, II, and III. On proposed decision IV, he aligned himself with Mr. Ismael.

Mr. Tshishimbi said that he too could accept proposed decision I in its modified form, including Mr. Grosche's suggestion that the wording in square brackets be deleted.

On proposed decision II, Mr. Tshishimbi inquired whether the reference to the different limits "depending on the seriousness of the member's balance of payments needs and the strength of its adjustment effort" was meant to be additive, or whether the word "and" should not be replaced by the words "and/or."

He agreed with the figures in square brackets of 85 percent and of 50 percent in proposed decision IV, Mr. Tshishimbi added. Like some other Directors, he would strongly prefer a complete separation of the decision on the special facilities from the decision on enlarged access. Therefore, he would go along with the inclusion in paragraph (d) of the phrase "from time to time," which nevertheless tended to be a little imprecise, or alternatively with the phrase "not later than December 31, 1984 and annually thereafter."

The Chairman explained that the wording in proposed decision II, stating that access limits would depend on the seriousness of the balance of payments need and the strength of the adjustment effort, was also used in paragraph 5(c) of the Interim Committee's communiqué.

Mr. Polak said that he had no difficulty with proposed decisions I, II, and III, with or without brackets. On proposed decision IV, his preferred numbers would be 80 percent and 40 percent in paragraph (a), or a trifle higher if that would help to find a compromise, provided that the threshold was set at the midpoint between zero and the ceiling. In paragraph (b), he could go along with 105 percent. He would prefer the more specific reference to the timing of the review in paragraph (d) rather than language associating the review on access to special facilities with the enlarged access policy, for reasons similar to those advanced by Mr. Joyce.

Mr. Delgadillo said that he had no difficulty with proposed decisions I, II, and III. On proposed decision IV, he agreed with the figure of 85 percent; the understanding of his chair had also been that, under the Managing Director's compromise proposals, the threshold was to be 50 percent of quota.

Mr. Coene commented that he had no problems with the first three proposed decisions. In the fourth draft decision, his preference would be for a limit of 85 percent, and a threshold of 50 percent; in paragraph (d), he could go along with the language in the second set of square brackets, mentioning the dates for the review.

Mr. Lovato remarked that he could accept proposed decisions I, II, and III, with a preference for maintaining the language in square brackets in the first two decisions. As for proposed decision IV, he reiterated his position in support of an 85 percent limit, a 105 percent combined limit, and a threshold at the midpoint.

Mr. Zhang stated that he had no problem with proposed decisions I, II, and III. For proposed decision IV, he preferred a limit of 85 percent and a threshold of 50 percent of quota; the time of the review should not be linked with the future of the enlarged access policy.

Mr. Prowse restated his position, which was that he could accept, in proposed decision IV, 80 percent or 85 percent, or for that matter 83 percent. What was important was to maintain access in absolute terms. It was also more important to reach agreement than to quibble over a few percentage points. He would accept 105 percent as the combined limit. In the interests of seeking agreement, he would also accept the midpoint between zero and the ceiling as the threshold. Like others, he saw some attraction in the review being held not later than December 31, 1984 and annually thereafter. The link between access to the special facilities and access under the normal facilities would as a result tend to be less obvious.

As for the provision in paragraph (d) of proposed decision II, Mr. Prowse asked for clarification of whether the review of the guidelines on access limits could also take place under the less constrained review clause that he would prefer in paragraph (d) of proposed decision IV, namely, before the end of 1984 and annually thereafter.

The Director of the Legal Department explained that because the review of the guidelines concerned only the limits on access under the enlarged access policy, there had been no need to look for different language that would not suggest a link to access limits under the special facilities.

Mr. de Maulde added that, like Mr. Joyce, he wished to support the language in the second set of square brackets in paragraph (d) in proposed decision IV.

Mr. Hirao stated that his preference was to keep the sentence in square brackets in proposed decision II.

On proposed decision IV on the access limits for special facilities, Mr. Hirao continued, he could go along with a figure of about 80 percent, possibly going up to 83 percent; with the midpoint between zero and the ceiling as the threshold; with 105 percent as a combined limit; and with 45 percent for the buffer stock financing facility; all on the understanding that there was an agreement on the appropriate structure of remuneration and charges. As for the review clause, he could go along with either the second or the last version in square brackets.

Mr. Malhotra remarked that, as Mr. Grosche had said that he would not insist on retaining the words in square brackets in proposed decision I, he had no difficulty with the decision. So far as proposed decision II was concerned, his preference was still not to include the sentence stating that the annual and triennial access limits should not be regarded as targets. There were references in the preceding sentence to limits in general, and in the subsequent sentence to the amounts of access in individual cases within those limits, which meant that the limits were ceilings and not targets. It was clearly understood that a ceiling was not an entitlement and would not be applicable to every case. The sentence in square brackets was redundant and might give rise to special interpretations.

Referring to Mr. Erb's statement about the earlier discussion in the Executive Board relating to access in individual cases held in response to the Interim Committee's request, Mr. Malhotra said that conclusions already reached should be followed.

He had no problem with proposed decision III, Mr. Malhotra continued. On proposed decision IV, he recalled stating that he would attempt to persuade his authorities to go along with--if a consensus developed--the compromise originally proposed by the Chairman, namely, 85 percent access limit under the compensatory financing facility, 50 percent as the threshold under that facility, with 105 percent as a combined limit for compensatory financing and cereal facilities, and a limit of 45 percent under the buffer stock financing facility. He was still unable to express a final view, pending consultations with his authorities. Indeed, it seemed impossible to reach a decision at the present meeting because of the need to seek instructions from national authorities on several issues.

As for paragraph (d) of proposed decision IV, Mr. Malhotra added, his own preference would have been not to have a review clause, because the Executive Board had the discretion to review any policy at any time. The occasion for calling for a review of access under the special facilities had arisen in the context of the recent increase in quotas. Since no quota increase was contemplated for the coming two years, there would seem to be no need for paragraph (d). However, if it was the general view that there should be a review clause, his preference would be for holding it before the end of 1984 and at any time thereafter, rather than annually thereafter.

The Chairman considered that a compromise agreement was not very far off. The discussion at the previous meeting on the rate of remuneration also called for further thought. He suggested that Executive Directors might wish to ponder the issues in an effort to arrive at a package that was acceptable to all members of the Board.

Mr. Nimatallah asked whether the enlarged access policy should not be extended once again on a temporary basis.

The Deputy Managing Director recalled that the temporary extension of the enlarged access policy would expire at midnight on December 19, 1983. There should be no practical problem in dealing with Madagascar's request for a stand-by arrangement on December 21, because the arrangement would become effective only when the member's financing gap was filled.

The Director of the Legal Department, replying to a question by Mr. Tshishimbi on the legal consequences of postponing a decision on enlarged access, responded that the Executive Board could of course decide to continue to apply the enlarged access policy under another temporary extension, beyond the one granted until December 19. Alternatively, it could agree in principle to Madagascar's request for an arrangement with the proviso that it would only become operative when the final decision on enlarged access was taken.

The Chairman recalled that Madagascar's request was among those that had been covered by the earlier assurance that arrangements being negotiated would be considered by the Executive Board, pending completion of the quota review and the Fund's borrowing arrangements. However, it was clear that every effort should be made in the coming days to complete the package on access, remuneration, and charges, because there would not be the same flexibility for dealing with future requests for arrangements.

Mr. Wicks said that he was fully conscious of the need to make progress on all parts of what had become a package, and a very complicated one. But he did not favor taking one item out of that package for immediate consideration; the four decisions under discussion, plus the decision to be reached on the rate of remuneration, should be viewed as a whole. It might be helpful to have a text, with possible variants in square brackets, of the proposed decision on the rate of remuneration, in order to further the discussion.

The Chairman commented that various ideas had been expressed at the previous meeting on how to make a more gradual approach to bringing the rate of remuneration up to the rate of interest on the SDR. The staff would try to prepare alternative solutions, to further the process of reaching agreement.

After a further discussion, the Executive Directors agreed to revert to the proposed decisions on access limits, and in particular, draft decision IV on access limits under special facilities, together with their further consideration of the rate of remuneration. (See EBM/83/183 and EBM/83/184 (12/28/83), and EBM/84/1 and EBM/84/2 (1/3/84)).

APPROVED: April 17, 1984

LEO VAN HOUTVEN
Secretary