INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/57

11:40 a.m., March 30, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
	Jiang H.
C. H. Dallara	
	G. Seyler, Temporary
	M. Hepp, Temporary
	T. Alhaimus
G. Grosche	
J. E. Ismael	J. Reddy
	J. Hospedales, Temporary
	M. Foot
	H. Fugmann
	D. McCormark
	C. V. Santos
Y. A. Nimatallah	I. A. Al-Assaf
	L. Filardo
	S. de Forges
G. A. Posthumus	
	C.-Y. Lim
G. Salehkhou	O. Kabbaj
	L. E. N. Fernando
	A. Vasudevan, Temporary
K. Yamazaki	*M. Sugita*
	N. Kyriazidis

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

Also Present
External Relations Department: E. Ray. Legal Department: R. H. Munzberg. Middle Eastern Department: M. F. Melhem. Research Department: P. Isard, H. C. Kim. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, A. G. Chandavarkar, D. Gupta, Y. Ozeki, B. von Numers, B. B. Zavoico. Office of the Managing Director: R. Noë, Internal Auditor; C. P. McCoy. Advisors to Executive Directors: A. Bertuch-Samuels, L. P. Ebrill, J.-C. Obame, G. Pineau. Assistants to Executive Directors: A. R. Al-Abdullatif, H. Alaoui-Abdallaoui, F. E. R. Alfiler, O. S.-M. Bethel, R. Comotto, O. Isleifsson, S. King, V. K. Malhotra, R. Manfredi Selvaggi, H. van der Burg, E. L. Walker, Wang X.

1. LIQUIDITY POSITION AND FINANCING NEEDS - REVIEW

The Executive Directors considered a staff paper reviewing the Fund's liquidity position and financing needs (EBS/87/66, 3/9/87).

Mr. Yamazaki said that the staff estimates of the Fund's liquidity position during the period through end-1988 seemed reasonable and broadly appropriate although some of the assumptions on which such estimates were based needed to be borne in mind. In particular, the future evolution of the balance of payments of indebted countries would be an important element of uncertainty with respect to the adequacy of the liquidity position over the medium term.

The original purpose of the borrowing agreement with Japan, as stated by Minister Miyazawa, was to facilitate a flexible response by the Fund to the special needs of developing countries that faced serious balance of payments difficulties and financing requirements, Mr. Yamazaki recalled. It was in the spirit of his Government's initiative to leave the options for use of that arrangement as open as possible, within the provisions of the agreement. Therefore, he was willing to endorse the staff suggestion to initiate the use of the resources from Japan in financing purchases by members of the Fund's ordinary resources, if such a proposal were supported by a majority of the Board.

Mr. Ismael made the following statement:

> I agree with the staff's conclusion that the stock of ordinary resources is fully adequate to meet projected demand in the next two years, and that the stock of uncommitted resources would be ample to finance the enlarged access policy through 1988. I also note that the change agreed in December 1986, from 1:1 to 1:2, in the mix of ordinary resources and borrowed resources in financing purchases under the enlarged access policy would achieve its purpose of conserving ordinary resources. A cumulative amount of SDR 0.6 billion of ordinary resources would be saved by the end of 1988.
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> While I share the concern about the adequacy of the Fund's ordinary resources over the medium term, I cannot support the staff's suggestion that the loan from Japan should be used in financing a portion of purchases that would otherwise be financed with ordinary resources. First of all, this proposed change in our normal practice would constitute a fundamental shift in the principle that regular operations of the Fund should be financed with the Fund's own resources. This principle should not be compromised even though the expected increase in the rate of charge arising from the proposed change would be quite small. Second, the drain on ordinary resources resulting from the mismatching of some purchases financed by borrowed resources is only a temporary phenomenon which will be reversed in the coming years. The use of ordinary resources for the purpose can be regarded as fulfilling the role of temporary or bridging finance.

I would like to express my disappointment at the fact that the high level of liquidity of the Fund and the phenomenon of net repurchases by member countries are to a significant degree due to the very stringent and conservative application of the guidelines on access. Not only have access limits been reduced in the last few years, but in practice, actual access has fallen far short of these limits. In view of the Fund's present satisfactory liquidity position and the continuing large external imbalances among member countries, I would like to urge that the guidelines on access be applied in a less restrictive manner for members having genuine and urgent need for Fund resources. This approach would also help with the recycling of additional resources provided to the Fund by surplus countries such as Japan.

Finally, the review of the adequacy of the Fund's ordinary resources over the medium term should take into account the impending Ninth Quota Review. The need to conserve ordinary resources, as has already been done by increasing the mix of borrowed resources in financing purchases under the enlarged access policy, should not detract from the necessity of a quota increase as the world economy expands and uncertainties increase.

Mrs. Filardo made the following statement:

Since our previous discussion of this topic in December (EBM/86/197 and EBM/86/198, 12/15/86), the Fund's liquidity position has not changed much. It is the view of the staff that the "Fund's liquidity may be judged satisfactory at present and for the period immediately ahead." While I agree that it is a matter of judgment as to whether or not the liquidity of the Fund is adequate, a range of factors on the demand side as well as on the supply side could have a significant impact on the availability of usable resources of the institution, and they should be carefully assessed.

On the demand side, notwithstanding the revolving character of Fund resources, the prolonged use of those resources by some members and the accumulation of arrears at a rapid pace seem to be indicative of changing circumstances. The discussion of the world economic outlook and the staff papers on the debt strategy confirm the recent performance of the world economy and the bleak prospects for the future, especially those concerning developing countries, the unprecedented nature of the debt crisis, and the failure of the debt strategy to achieve its objectives. Therefore, it seems appropriate to adapt the institution to these changing circumstances and to devise imaginative and innovative mechanisms to try to make the use of Fund resources more flexible. But on the contrary, the Fund has been granting access below the agreed limits and has made the use of these special facilities more difficilt. An example is the increased conditionality for drawings under the compensatory financing facility.

As for the supply side, ideally, quotas should be sufficiently large to preserve the low financial cost and the quota base of Fund resources. Nevertheless, looking at the historical pattern of the Fund's liquidity, it is clear that borrowed resources have been very significant as a supplement to the Fund's ordinary resources. In part, this is because borrowing by the Fund has served the useful purpose of recycling resources from surplus countries, enabling the institution to play a more adequate role in the international monetary system while helping countries to overcome their internal and external imbalances as they move toward a more viable balance of payments and sustained growth. In this respect, the staff is projecting that outstanding Fund borrowing will decrease from its peak of SDR 14.7 billion in 1985 to SDR 11 billion through December 1988. It is also projected that adjusted and uncommitted usable ordinary resources will decline by SDR 4 billion to SDR 24.1 billion through December 1988, SDR 2 billion of which will stem from the use of ordinary resources in the repayment of Fund borrowing.

In addition, it has been pointed out that even though a change in the mix of borrowed and ordinary resources was agreed at the time of the discussion of the Japanese agreement, the pronounced shift toward the use of ordinary resources could imply that through 1988 SDR 1 billion from the Saudi Arabian Monetary Agency (SAMA) loan will remain untouched through 1988 and that only a modest part of the Japanese loan will be used. In the meantime, the Fund will experience a growing mismatch between the maturity of its borrowings and repurchases financed with these borrowings. Therefore, the staff could consider several issues for the next discussion of the Fund's liquidity. First, new mechanisms should be explored for making the use of Fund resources more flexible in view of the increase in arrears to the institution. Second, the future impact on the Fund's liquidity of the reduction of borrowed resources should be assessed. Third, it should be ascertained how fast the quota review can be implemented. Fourth, the most efficient way to use borrowed resources while preserving the quota base of the Fund and without adversely affecting its financial charges must be devised.

To conclude, since the staff paper indicates that the decline in the Fund's stock of usable ordinary resources could be faster as a result of a "weakening of the positions of members whose currencies are presently included in the operational budget, unanticipated demands for Fund resources, or further increases in arrears to the Fund," the Board should be ready to consider in a flexible manner how the Fund could improve its resource position and help members to overcome their internal and external difficulties. The Fund's role in the effort to promote adjustment and growth will require, in our view, a considerable injection of resources. Therefore, in case the abovementioned uncertainties materialize, the staff should indicate alternative ways of strengthening the Fund's liquidity.

Mr. Fugmann stated that the Fund's liquidity position, with respect to both ordinary and borrowed resources, had to be considered comfortable for the period under discussion, namely, until the end of 1988 and even after taking account of the usual reservations about the uncertainty in the calculations.

It was disturbing that arrears to the Fund had reached such a level that they could be considered to have a not unnegligible effect on the Fund's liquidity, especially as there were indications that the situation could deteriorate further. It was a positive development that use of the Fund's resources on a commitment basis was increasing again, because it was a reflection, inter alia, of the greater number of countries that were prepared to try to implement Fund-supported adjustment programs.

Yet despite the greater number of Fund-supported programs, Mr. Fugmann continued, net repayments to the Fund could be considered normal as they reflected the revolving character of the Fund's resources. At the same time, the ongoing net repayment from the poorest developing countries to the Fund implied that the situation of those countries had become even more difficult. Further financial assistance from the Fund to that group of countries should primarily take the form of structural adjustment arrangements, thereby again increasing the demand for the flow of other resources.

In December 1986, the Board had discussed several proposals for using the resources lent to the Fund by Japan, Mr. Fugmann recalled. His chair had expressed the view that those resources should be used consistently with the Fund's policies on the use of quota-based resources. The staff had reopened the issue of the desirability of using Japanese resources in part as a substitute for ordinary resources, although without making a concrete proposal at the present time. For his part, he saw no significant new arguments to justify reconsideration of the earlier position of his chair, namely, that borrowed resources should be used only in the context of the enlarged access policy.

Mr. Jiang said that it was encouraging that the Fund's liquidity was judged to be satisfactory not only for the present but also for the period immediately ahead. Repurchases were scheduled to reach a peak of SDR 7.8 billion in 1987, compared with projected purchases of SDR 6.1 billion in the same period. Outstanding Fund credit would thus decrease by SDR 1.7 billion in 1987, and a further decrease of SDR 1.8 billion was projected in 1988. Borrowed resources had been augmented by SDR 3 billion through the borrowing agreement with Japan. Uncommitted borrowed resources currently totaled SDR 5.6 billion, and uncommitted ordinary resources were considered fully adequate to meet projected demand through 1988.

That rosy picture of the Fund's liquidity position suggested that a certain relaxation of the restrictiveness on access to Fund resources might be warranted and that the possibility of more flexible and imaginative use of Fund resources to ease the debt problem could be explored, Mr. Jiang continued. The recent experience of some larger debtor members indicated that the international community was facing a new, aggravating, and dangerous phase of the debt crisis. The Fund should continue to play its central role, but Fund quotas had not kept pace with the growth of world trade and the role that the institition would have to play. The temporarily satisfactory liquidity position in no way suggested that efforts to obtain a substantial quota increase in the forthcoming Ninth General Quota Review could be relaxed.

With respect to the use of the resources borrowed from Japan, Mr. Jiang said that he could agree with the staff that no proposals needed to be considered at the present time. The use of the loan from Japan in financing purchases of ordinary resources should be introduced gradually and be subject to periodic review by the Board. He was pleased to learn that the effects of such use on charges were estimated to remain extremely small.

Mr. de Forges pointed out that, for the time being, the Fund's liquidity position seemed to be satisfactory, with uncommitted resources, particularly ordinary ones, being at a fairly high level. Furthermore, unless there were major changes in policy or in the world economic environment, the Fund did not seem to be faced with major difficulties in the foreseeable future. On the contrary, the available forecasts indicated that for 1987 and 1988, as in 1986, there would be an important reduction in the net use of Fund resources. In passing, he noted that his authorities had been surprised by the extent of the modification in the 1988 forecast compared with the figures presented in the world economic outlook. An estimated increase in the use of Fund resources of SDR 0.9 billion in two weeks' time was by no means insignificant. On the same practical ground, he had been puzzled by the presentation in Table 2 of the staff paper, showing expected financing under the structural adjustment facility but without indicating the repayments to be made on outstanding Trust Fund loans.

Thus, Mr. de Forges continued, favorable as the forecasts for the Fund's liquidity might be, they nevertheless remained a source of deep concern to his authorities since they manifested a lasting withdrawal of the Fund from its role, with all the consequences of such a development for the credibility and the effectiveness of the Fund's assistance to its member countries.

In a situation in which the Fund's liquidity did not constitute a constraint on its activities, the terms and conditions attached to use of the Fund's resources were a significant factor in the demand for Fund assistance, Mr. de Forges concluded. That was why his authorities considered that the terms and conditions attached to use of Fund resources were as important as their volume. For those reasons, and for the reasons he had elaborated at the Board's previous discussion of the Fund's financial position, his authorities did not favor a substitution of borrowed resources for ordinary resources. However, should resources be provided to the Fund on concessional terms, it would become possible to give member countries more effective help in tackling the problems they faced--for example, as through the modification to the compensatory financing facility proposed by Mrs. Ploix during the Board's recent consideration of issues relating to that facility (EBM/87/36 and EBM/87/37, 3/3/87).

Mr. Nimatallah said that although the Fund's stock of adjusted, usable ordinary resources had recently declined somewhat, it was clear from the staff's explanation that the overall liquidity position remained comfortable. He had also noted that in both 1987 and 1988, net credit outstanding was projected to be lower, a development that he knew was viewed with concern by some of his colleagues. It had to be recognized, however, that the projected decline in credit outstanding was a natural outcome of a cycle in the Fund's lending policies. The Fund had responded, since 1982, to the increase in members' needs for Fund assistance in light of the debt crisis in the developing countries and the recession in the industrial countries.

Furthermore, it was necessary to look at the source of financing of outstanding Fund credit, Mr. Nimatallah added. The Fund had had to borrow to finance the enlarged access policy; the resources it had used following the debt crisis in 1982 had not been only ordinary resources. With the declining sense of crisis and the relatively improved international climate, it appeared natural for the borrowed resources to return to the Fund to be repaid to its creditors. That pattern was part of a normal process of a return to quota-based lending. Therefore, in looking at the trends in Fund credit outstanding, it would make better sense to look only at outstanding use of the Fund's ordinary resources. It was clear from Table 2 that net use of ordinary resources to finance drawings by members would actually increase in 1988.

In general, over the past few years, average actual access under the enlarged access policy had fallen, reflecting the temporariness of the exceptional needs of 1982 and 1983, Mr. Nimatallah observed. However, the Fund continued to provide support to a broad range of the membership and, in particular, continued to be able to help those members in greatest need. In fact, about 30 members characterized as having special needs were projected to receive positive net financing from the Fund during both 1987 and 1988. Furthermore, the projected reduction in outstanding Fund credit financed by borrowed resources over the same two years would be partially offset by resources disbursed under the structural adjustment facility. More important, even if all those factors were ignored, he for one did not expect the Fund to continue to operate at an abnormal level during the current relatively improved climate compared with that of 1982 and 1983. The important matter at present was for the Fund to continue to be ready to respond, with flexibility, to the needs of its members under various and changing circumstances.

On the utilization of the Japanese loan, Mr. Nimatallah reiterated his view that the Fund would have more flexibility if it was enabled to use part of the loan to finance some purchases under Fund arrangements that would otherwise be financed totally by ordinary resources. He liked the approach proposed by the staff of synchronizing such partial financing from the Japanese loan with the magnitude of the mismatch so as not to exceed a certain fraction of the average mismatch over coming years. However, in case of an emergency, that guideline should be suspended, and the available loan drawdowns should be used. He would like the staff to look into that and other possible options for the next review of the Fund's liquidity position.

It was important for the Board to set a high value on the potential flexibility gained by approving such partial use of the Japanese loan, at least on a temporary basis until the increase in quotas was made effective, which might be three years away, Mr. Nimatallah remarked. After all, the Board would review the matter regularly when it reviewed Fund liquidity every six months, and it could reverse any decision it took whenever it was necessary.

As for the cost associated with using borrowed resources in combination with ordinary resources, Mr. Nimatallah commented, the staff had estimated that there might be a negligible increase in the rate of charge, perhaps of only one half of a basis point. For example, if the rate of charge on use of ordinary resources was 7 percent, according to the staff, it would become 7.005 percent. Given the potential gain to the Fund in the flexibility it would acquire using the resources made available by Japan, he wondered whether that factor made any difference, particularly for members which had no access to any other sources of finance.

Finally, Mr. Nimatallah said that he had noted that the selected ratios in Table 2 in the Appendix to EBS/87/56 continued to be satisfactory from his authorities' point of view. He had also noted that overdue payments to the Fund were beginning to be taken into consideration in the calculation of some ratios.

Mr. Grosche said that he shared the view that the Fund's liquidity position remained comfortable, although it was perhaps somewhat less strong than indicated at the time of previous reviews. According to the staff paper, prospects over the medium term had become more uncertain, particularly with respect to the adequacy of the Fund's ordinary resources, which were expected to show a marked decline by the end of 1988. There was a greater availability of borrowed resources because of the recently concluded borrowing arrangement with Japan.

With more borrowed resources available and with the prospect of a decline in ordinary resources, it was only natural and prudent for the staff to think of ways to protect the Fund's ordinary resources, Mr. Grosche added. But when it came to considering possible ways of using the SDR 3 billion made available by Japan, the position he had taken in December 1986 when the arrangement with Japan had been approved had not changed. His basic attitude remained that the Fund's resources should come in principal from quota subscriptions, and those quota-based resources should be used first, without of course depleting them to the extent that the Fund's liquidity could be called into question. To be sure, there were possible risks on the horizon, including not only potential large requests for Fund assistance but also possible delays in implementing the forthcoming quota review. For the time being, however, there appeared to be no immediate need for action to strengthen the Fund's liquidity position. He therefore suggested adherence to the approach taken in December 1986 with respect to the use of the loan from Japan and regular reviews of the situation.

However, if Japan agreed, he would not object to part of its loan being used to offset directly the mismatch between the repayment of Fund borrowing and repurchases, Mr. Grosche concluded. Should a drastic deterioration in the Fund's liquidity position surface by the time of the next liquidity review, contrary to present expectations, it would still be possible to consider alternative uses of the loan from Japan at that time.

Mr. Dallara said that the staff's projections did indeed show that the liquidity position, currently and for the foreseeable future, remained rather comfortable in spite of the anticipated reduction over the coming months in available usable ordinary resources that was clearly due in large part to the mismatch of repayments of Fund borrowings and scheduled repurchases. He appreciated Mr. Nimatallah's point that, in a sense, the repayment to the Fund's creditors was part of the natural evolution of the Fund's financial position. While the corollary of that evolution was perhaps the phasing out of the enlarged access policy, it did not move in step with the repayment of earlier borrowing, so that the mismatch effectively became something of a problem. The cooperative nature of the financial relations of the Saudi Arabian Monetary Authority with the Fund in recent years was greatly appreciated by his own authorities, as it was, he felt sure, by other members of the Board. He hoped that that cooperative approach would lead to a willingness on the part of SAMA to keep an open mind and perhaps consider further changes in the timetable for the repayment of its outstanding loans to the Fund since that would facilitate the effective management of the Fund's liquidity position during the period ahead.

For his part, he continued to have an open mind concerning the possibility of making flexible use of the loan from Japan, although not because of any real concern over the Fund's available usable ordinary resources, which struck him as being rather comfortable for the forseeable future, Mr. Dallara added. However, the fact remained that decisions on enlarged access were taken annually, and the future of the enlarged access policy was not known. Therefore, if the Fund was to use the Japanese loan effectively, it might need to do so outside the context of the enlarged access policy.

All that being said, Mr. Dallara added, he continued to believe, like Mr. Grosche and others, that the Fund's quota-based resources should be the main wellspring of the financial resources with which it financed its lending activities. His authorities were somewhat uncomfortable with the Fund's continued reliance on borrowing throughout recent periods, a reliance that had certainly been necessary in the early 1980s, as Mr. Nimatallah had pointed out, but that was no longer as clearly essential as it once had been.

Finally, Mr. Dallara recalled that his authorities had expressed the desire, when the Board had discussed the loan from the Japanese Government and in response to their own openness on the issue, that the Japanese authorities should keep open the possibility of somewhat more flexible terms to enable the Fund more effectively to meet the needs of some of its members, particularly those with protracted balance of payments problems.

Mr. Nimatallah stated that it would be very difficult for him to convince his authorities to consider extending the period of repayment of the loan by SAMA to the Fund if the Executive Board could not decide what use should be made of the loan from Japan. The Board had to decide first how to make effective and full use of the Japanese loan.

Mr. Dallara said that he appreciated Mr. Nimatallah's point. At the same time, it seemed to him that an indication by the Saudi Arabian authorities of their willingness to adjust further the repayment schedule would in fact facilitate earlier use of the Japanese loan. As he understood the staff's position, a factor pointing toward the relatively minimal use of the Japanese loan in the months ahead was the need to draw down the loan from Saudi Arabia in the context of the current agreement.

Mr. Nimatallah reiterated that with the current state of Fund liquidity, and with SDR 3 billion from Japan lying unutilized, he failed to understand what argument there was for requesting him to approach his authorities on the matter. The mismatch problem should not be a burden for Saudi Arabia; the burden should fall on the Fund and its members as well.

The Deputy Treasurer commented that the staff had argued for using both the Japanese loan in lieu of ordinary resources and to finance the mismatch, and for consideration to be given in due course by the Saudi Arabian authorities to extend the payment dates, as they had been most cooperative in doing in the past, all in the interest of preserving the Fund's ordinary resources. While both avenues were substitutable, each would help to conserve ordinary reserves and went in the same direction.

Mr. Salehkhou made the following statement:

The financial position of the Fund is projected to remain quite comfortable through 1988 in spite of the staff's usual conservative and prudent assumptions, including the adjustment of the stock of uncommitted ordinary resources by a factor of 4, which continues to be excessive. The present and prospective liquidity situation remains broadly in line with the projections and analysis reviewed by the Board last December. These projections continue to point, in particular, to the maintenance of a large stock of usable resources, to substantial net repayments to the Fund, in spite of a slight increase in members' expected total purchases, and to a further decline in the share of borrowed resources in comparison with both outstanding Fund credit and total quotas. The new loan from Japan would also ensure that no borrowing gap is likely before the end of 1988.

Except for a review of some of the issues raised by the use of the loan from Japan, the scope of the staff report is confined to the usual technical analysis of current and prospective Fund liquidity. Broader issues, however, are involved, and unless the staff projections are analyzed in the context of the overall policies of the Fund, taking into account the implications of underlying assumptions on the overall role of the Fund and on members' external positions, it would be meaningless and perhaps misleading to assess the adequacy of the Fund's liquidity. Concern in this regard is highlighted by the forthcoming regular review of Fund quotas which will require a more qualitative analysis of the Fund's financing needs.

A number of considerations need to be taken into account in today's discussion.

First, the strength of the Fund's liquidity normally indicates that the members are encountering little difficulty in financing external imbalances. It is unfortunate to note that, in the last three years or so, not only did the considerable improvement in Fund liquidity contrast with the severe constraints experienced by a large portion of the membership in financing external deficits, but the liquidity improvement itself has been achieved to some extent at the cost of sharply lower assistance to these members. The decline of such assistance has not been linked to reduced demand or lower balance of payments needs by the membership; rather, it reflected a deliberate policy of reducing effective access and of sharply tightening conditionality.

Second, the staff paper has projected that in 1987 and 1988, about 50 members will make net repurchases from the Fund, in amounts ranging from less than 25 percent to about 80 percent of their respective quotas. It would be helpful to learn from the staff how many of these members would still need exceptional financing in the form either of debt rescheduling or nonspontaneous new borrowing, and how many of them are projected to implement Fund programs, or to continue to need such programs but are assumed to be unable to adopt one either because of domestic constraints or the Fund's conditionality and access policies. I wish to note in this regard that while the experience of net repayments to the Fund appears to be consistent with the medium-term character of the Fund's financing and with earlier resource utilization trends, the global environment and the payments difficulties of the developing countries in the 1980s bear little comparison to those of the previous three decades. Any reference to earlier trends in the use of Fund resources to justify net repurchases is in contradiction with the wide recognition that the realities of the debt crisis in the 1980s are far from being of a cyclical nature and that exceptional remedies are indeed required to effectively deal with them.

Third, as I stated on earlier occasions, there appears to be both inconsistency and contradiction between the Fund's policies on use of its resources and the management of its liquidity. This is particularly true for the Fund's role in implementing a coherent and effective debt strategy and in using its own financial assistance as a catalyst for needed external flows toward members facing payments difficulties. Insistence on net repayment to the Fund by those members still in need of exceptional financing certainly undermines members' attempts to secure a level of external financing commensurate with their adjustment efforts. It also leads to an increasing perception among other creditors--private and official alike, including the World Bank--that additional assistance is sought not so much to help the members concerned, but mostly to secure repayment to the Fund. Such a perception is damaging both to the credibility and effectiveness of the Fund as well as to the concerned members since the other creditors are already threatening to cut their own financial contributions sharply.

There also appears to be an inconsistency between the Fund's call for more adequate terms in lending to the developing countries and a policy of liquidity management that, in spite of a large stock of uncommitted ordinary resources, continues the recourse to borrowed resources, thus unnecessarily increasing costs to users.

I am also concerned that the objective of saving ordinary resources through lower Fund assistance and through the higher mixing ratio adopted last December is rather inopportune at a time when the Board is to embark on the regular review of quotas. Notwithstanding the low and declining ratios of Fund quotas to world trade and to members' payments imbalances, the management of the Fund's liquidity could wrongfully give the impression that the Fund's resources are currently and prospectively adequate to deal with both systemic and members' difficulties.

Finally, with respect to the use of the loan from Japan, I wish to reiterate my appreciation to the Japanese authorities for their initiative. However, my overall position is that unless the objective is to restore more appropriate levels of effective access under the enlarged access policy, new borrowing by the Fund does not appear to be appropriate, especially in view of the cost to users and the availability of a large stock of uncommitted ordinary resources. This position has not been altered by the staff's new estimates indicating that given current interest rates, the effects of using the loan from Japan on the rate of ordinary charge would be minimal. Thus, among the uses suggested in the staff paper, while I could go along with a utilization that could ease the problem of the maturity mismatch, I do not support its use in lieu of ordinary resources.

Mr. Hassan made the following statement:

Like other Directors, I also note the main conclusion of the staff paper, namely, that the Fund's liquidity position should remain satisfactory at present and for the period immediately ahead. Let me stress that this situation, which may suggest a reduced demand for Fund resources, should not be taken to indicate a decline in members' financial need. Rather, the comfortable situation is a reflection of the unduly restrictive application of access limits and the gradual reduction in the Fund's financial involvement in support of adjustment policies in many countries in the last three years.

The apparent increase in projected new commitments in 1987 is mainly due to a shift of two large arrangements from end-1986 to early 1987, as stated by the staff. Current projections indicate that repurchases will substantially exceed purchases in 1987 and 1988, resulting in an overall decline in outstanding Fund credit in both years. As stated in the staff paper, 50 members are projected to make net repurchases to the Fund in 1987, with some of them making net repurchases of as much as 80 percent of their respective quotas. Even if this reduction in outstanding Fund credit is consistent with past cycles, as claimed by the staff, it is disturbing to note that many of those countries projected to make net repurchases are expected to do so when they are still experiencing difficult economic and financial situations. In fact, some of these countries are presently facing circumstances even more difficult than at the time when they made purchases; this is particularly true for low-income countries. For example, the distribution of purchases and repurchases by region in Appendix Table 3 shows that in 1986 African countries repaid SDR 1.5 billion to the Fund while their drawings stood at SDR 0.7 billion; again in 1987, repurchases were likely to be more than twice purchases. Such a relatively large reflow of resources from poor countries to the Fund at a time when they are facing exceptional hardship is alarming and should lead us to question the current Fund policy on the use of its resources, particularly in the case of low-income countries.

I note the staff's concern about the projected substantial decline in the stock of uncommitted usable ordinary resources during the remaining period of 1987 and in 1988 owing to the expected financing with ordinary resources of repayments of Fund borrowing as a result of the mismatch problem. This temporary projected decline in the stock of usable ordinary resources can be substantially reduced by convincing the Saudi Arabian authorities to accept a commensurate extension in the maturity of the drawdowns under the loans from SAMA. It is encouraging to note that the Saudi Arabian authorities have not ruled out the possibility but remain open to consider such an extension. I would, therefore, urge that management pursue the matter with SAMA at an appropriate time.

I do not agree with the staff suggestion to conserve ordinary resources by utilizing the loan from Japan to finance a portion of purchases that would otherwise be financed with ordinary resources, for the reasons stated at the time of the Board's discussion of the borrowing agreement with Japan last December. The proportion of ordinary to borrowed resources in financing purchases has already been reduced to a ratio of 1:2. However, I am still of the view that the loan from Japan can contribute substantially to the conservation of ordinary resources if it is used to repay earlier borrowings. The staff has indicated that such use will not be in violation of the agreement with Japan.

In conclusion, the projected decline in the stock of usable resources, despite the progressive compression of members' access to Fund resources and the reduction in the proportion of ordinary to borrowed resources in the financing of purchases, is a clear manifestation of the inadequacy of present quotas and the need for a substantial quota increase during the forthcoming Ninth Quota Review. This is a crucial point if the Fund is to play its role in supporting members' adjustment without excessive resort to borrowing.

Mr. Nimatallah stated that asking the Saudi Arabian authorities to extend the period of repayment would not solve the mismatch problem, which was a perennial one. The timing of repurchases simply could not be synchronized with the timing of repayments. It would be far better for the Fund to use its available resources to deal with minor problems of mismatching. The Fund had its own resources, SDR 3 billion from the Japanese Government, and the balance of the loans from SAMA. The issue of the availability of resources should not be confused with the mismatch issue.

Mr. Lim said that his chair was happy to note once again that the Fund's stock of uncommitted ordinary resources was considered to be fully adequate to meet projected demands through end-1988, and that the stock of uncommitted borrowed resources, taking into account the new borrowing agreement with Japan, would be ample to finance the enlarged access policy through 1988. He had also noted the concerns expressed by the staff about the drain on ordinary resources resulting from the mismatch between repurchases of those resources and maturities of borrowed resources.

It had occurred to him, Mr. Lim continued, to wonder whether the staff's point that the estimated effects on charges of using the Japanese loan in substitution for ordinary resources remained extremely small had been made with the intention of implying a preference for shifting toward greater reliance on borrowing as opposed to quotas in financing the Fund's operations. It must be made clear that any effort to maximize use of the loan from Japan should not be allowed to jeopardize the quota-based nature of the Fund. If any serious mismatch was expected, a quota increase should be sought rather than attempts to expand the substitution of ordinary resources with borrowed resources. Any unused borrowed resources should serve as a reserve against unforeseen contingencies.

It was only in December 1986, a bare three months ago, that the Executive Board had agreed to a change in the mix of ordinary and borrowed resources in financing purchases under the policy on enlarged access, Mr. Lim recalled. Given the projected liquidity position of the Fund, there was as yet no need to go beyond that change in the mix.

Mr. Foot said that the staff paper made it clear that forces were at work that would tighten the financial position over the coming 18 months or so. As always, financing needs in the months ahead would need to be examined in light of the uncertainties itemized in the staff paper.

On the loan from Japan, Mr. Foot said that his authorities remained willing, as mentioned during the Board's discussion in December 1986, to give further consideration to using part of the loan in substitution for ordinary resources if that proved necessary and if there was a consensus in that direction. Nothing had been said during the discussion to indicate that that consensus was emerging. Therefore, while he would like to see guidelines along the lines suggested on pages 16 and 17 of EBS/87/56, it was probably premature to ask for preparatory work in that respect at the present time.

As for the priority that should be attached to the use of borrowed resources, Mr. Foot continued, he endorsed the intention of the staff, as stated on page 13, to give primary emphasis to drawdowns on the SAMA credit lines in the period ahead. Mr. Nimatallah's point with respect to the extension of the drawdown period of the SAMA loans was valid. He was more concerned about average rather than marginal costs, despite the fact that most economists took decisions at the margin.

Finally, Mr. Foot said that he remained as concerned as ever about the inexorably rising arrears. It was clear from the paragraph on overdue obligations on page 5 of the staff paper that current overdue obligations, together with the forthcoming overdue obligations of members currently in arrears, represented in total an amount equal to about 10 percent of the Fund's stock of adjusted usable ordinary resources, a very high figure indeed.

Mr. Kyriazidis remarked that despite the uncertainties mentioned in the staff paper, and given the demand for Fund resources until the end of 1988, the liquidity position seemed to be satisfactory.

As his chair had pointed out during the discussion in December of the liquidity position and the Japanese loan, it had not been convincingly demonstrated that it was either necessary or in the best interests of the Fund to change the practice with respect to the use of ordinary resources. The Fund was an intergovernmental institution, based on quotas, and any shortage of ordinary resources should be analyzed within that framework. Furthermore, the proper forum to consider such problems, if they existed, was the Committee of the Whole on the Ninth General Review of Quotas. In light of the overall satisfactory liquidity position in the period ahead, any change in the quota-based character of the Fund should be scrutinized and thoroughly discussed in the context of the quota review. The loan from Japan should be used in the coming period only to finance enlarged access, as decided by the Executive Board in December 1986.

Mr. Vasudevan made the following statement:

> It is clear from the staff paper that the Fund's liquidity position, both at the present time and in prospect, remains relatively comfortable. Projected commitments in 1987 are higher—by SDR 1.4 billion—than was projected in the last liquidity review, mainly because of the shift of two large arrangements from end-1986 to early 1987. Purchases of ordinary resources in 1987 under arrangements are, however, expected to be lower than in 1986, which is out of line with the nature of the balance of payments problems that developing countries have been facing since early 1986. Purchases of ordinary resources under the compensatory financing facility in 1987 are likely to be higher, at SDR 2 billion, than in the preceding year, when they were SDR 0.6 billion. This increase is understandable in view of the decline in primary commodity prices and the deteriorating terms of trade of many developing countries. But considering the magnitude of this deterioration, we are not sure how far the projected compensatory financing purchases have been limited by existing access limits on use of that special facility.
>
> Repurchases of ordinary purchases would peak in 1987, with the result that net use of ordinary resources by members would in fact be a negative sum of SDR 0.7 billion. At the same time, it is expected that the Fund will use ordinary resources to the

extent of SDR 1.2 billion to repay loans undertaken to finance the enlarged access policy and supplementary financing. For that reason, and because of larger use of reserve tranche positions, net use of ordinary resources will be about SDR 1.5 billion. However, as the staff has noted, it is possible that reserve tranche purchases may not be as high as estimated, and actual net use of ordinary resources could be much less than currently estimated.

We are concerned at the rise in purchases financed with borrowed resources. They will amount, in 1987, to SDR 2.2 billion or more than twice the amount of such purchases in 1986. Of the total amount, SDR 0.4 billion is on account of the change in the mix of borrowed and ordinary resources in financing purchases under the enlarged access policy. The staff considers the impact of the change in mix as reflecting the conservation of ordinary resources of an equivalent amount. While this is the statistical result, we do not consider that the change in the mix of resources is warranted as yet by the liquidity position.

We have noted that repayments of loans by the Fund will have to be financed by ordinary resources because of the mismatch of the maturities of Fund borrowing and related repurchases. This point was made in the last review, as well as at the time of our consideration of the extension of the drawdown period of the loans from SAMA. At the latter meeting, it was argued that SAMA could not extend the maturity of the drawdowns in the loan extension periods mainly because the Saudi Arabian economy has been gravely affected by the low price of oil. Since then, however, oil prices have improved considerably. We agree with the staff that it should pursue the matter with SAMA, if it finds that the present rebound in oil prices is likely to continue.

We found the section in the staff paper on issues relating to the managment of the Fund's liquidity in the context of the Japanese loan to the Fund to be of great interest. The "mismatch" problem is cited as a good reason for evolving approaches that conserve the use of ordinary resources. On page 16, the staff points out that the cumulative mismatch could rise to some SDR 5.5 billion by end-1989, and the average annual mismatch will be around SDR 2.5 billion during 1986-95. The mismatch problem suggests the need for increasing quotas at an early date. However, the staff did not provide any arguments for raising the size of quotas as a fundamental solution to the problem. As we see it from Table 1 of the Appendix, the mismatch does not appear to create a liquidity problem till end-1988, the period up to which the staff can project the likely magnitudes of commitments, purchases, and repurchases. In the circumstances, it is not clear either how the mismatch would itself provide a basis for the staff proposal that some utilization of the loan from Japan would conserve ordinary resources, or how the staff can argue that its proposal will be "consistent with the quota-based nature of the Fund." The proposal is not viable unless it can be proved, with figures, that future commitments and likely purchases or repurchases are such that there will be a serious liquidity crunch unless the present stock of ordinary resources is supported by borrowed resources. This is a difficult exercise and, we suspect, cannot be undertaken without making an assumption that there will be no increase in quotas under the Ninth General Review, even five years after the last quota increase.

The staff also argues that use of the loan from Japan in substitution for ordinary resources should raise charges on ordinary resources only moderately. This, however, may not be true, for the present level of rates of interest need not hold. In any case, an attempt should be made to provide ordinary resources at concessional rates, since the objective is to encourage members to approach the Fund at an early stage of their balance of payments difficulties. We favor the enhancement of quotas because the Fund's lending activity should be based on quotas rather than on borrowed resources.

Finally, the review should have raised the question whether, in 1987, it would be necessary to maintain the changed mix of resources in financing purchases under the enlarged access policy that came into effect in December 1986, since the mismatch is not serious in the current year, and since the liquidity position is comfortable. We consider that this question should be addressed every time the Fund liquidity position is reviewed, as indicated in the Chairman's summing up on December 19, 1986. We would urge that beginning with the next review, the question of the mix in respect of the financing of purchases under the enlarged access policy should be considered in the context of the Fund's liquidity position.

Mr. Santos remarked that like previous speakers, he had noted from the staff paper that the Fund's liquidity position would remain satisfactory through 1988. Indeed, according to the projections, the stock of uncommitted usable resources--ordinary and borrowed--while declining somewhat at the end of 1988 would be fully adequate to meet projected demands through the end of that year. However, he shared the staff's view that the medium-term outlook was not so reassuring, given the uncertainties surrounding the world economy and the likely substantial external financing needs of many developing countries in the near future.

In that context, Mr. Santos added, while borrowed resources could be a useful supplement to ordinary resources, the Fund should remain quota based. It was therefore appropriate for the Fund to accelerate the quota review process in order to increase its available ordinary resources.

With respect to the suggestions put forward by the staff on page 14 of EBS/87/56 relating to the use of the loan from Japan, Mr. Santos reiterated the position of his chair as stated during the discussion in December on the subject of borrowing by the Fund from Japan and the management of Fund liquidity. The loan from Japan should not be used as a substitute for ordinary resources in financing purchases under members' arrangements with the Fund. His chair continued to believe that those additional resources should be used to supplement the Fund's borrowed resources, thereby enhancing its ability to provide assistance to member countries. In that context, and as stated by Mr. Ismael and other Directors, it would also be appropriate to introduce some flexibility into the policy on access to the Fund's resources.

Mr. McCormack said that he concurred with the staff assessment that the Fund's present and immediately foreseeable liquidity position was satisfactory. However, general uncertainties in the current economic environment suggested a continued prudent approach to the use of Fund resources. The adjustment to the stock of usable currencies by a factor of one quarter seemed appropriate. While he recognized the difficulty of predicting the demand for use of Fund resources, an obvious element affecting the supply of those resources at present and in the future was the high incidence of overdue obligations to the Fund. A further buildup of arrears would clearly have an impact on the stock of usable currencies and affect the staff's assessment of the inflow of net repurchases being offset by repayments of Fund borrowing.

The staff's proposed approach to utilization of the SAMA borrowing agreement and the Japanese loan seemed to be in keeping with the decision of the Board in December, particularly in view of the reservations of his chair at that time concerning use of borrowed funds as a substitute for ordinary resources, Mr. McCormack concluded. However, the problem of mismatching of maturities of borrowed funds and repurchases did give rise to concern. The matter called for further review in the hope of finding an acceptable solution, and he encouraged the staff to examine alternatives for consideration by the Board.

Mr. Alhaimus said that he shared the view of previous speakers that the Fund's liquidity position was comfortable and likely to remain so in the foreseeable future. Attention had been drawn during the discussion to the trend of negative net credit to member countries. Of course, that trend was partly cyclical but it also reflected constraints on access to the Fund's resources, signifying that the financing prospects for many weaker countries would remain difficult, if such a net transfer of resources from those countries continued.

On the suggestion to make use of the Japanese loan to finance drawings normally financed by ordinary resources, Mr. Alhaimus noted that although the likely impact on charges was small, he shared some of the doubts that have been expressed on that option and he therefore saw no strong financial reasons for such a procedure in the present circumstances.

Mr. Hospedales made the following statement:

The Fund's liquidity, according to the staff paper, continues to be broadly adequate in terms of present access policies. But our access policies are not adequate. They are, possibly, even more restrictive than they need to be in the light of our limited resources. We remain convinced that in the prevailing adverse global economic environment, given the magnitude of the financing required, the resources the Fund can provide--including borrowed resources--have fallen far short of what is needed, a conclusion drawn by the staff on page 13 of its paper on External Adjustment, Financing and Growth--Issues in Conditionality (EBS/87/48, 3/2/87). In other words, the mix between adjustment and finance has not been optimal in the context of the progressively deteriorating international economic environment as well as the fact that many of our members have had difficulties in maintaining external viability and have been forced to pursue policies which are having a deflationary impact on the world economy.

The staff suggests that while the near-term liquidity position is satisfactory in terms of present access policies, prospects over the medium-term, and particularly the adequacy of the Fund's holdings of ordinary resources, are considerably more uncertain. Their concern stems from the continued difficulties that some of the membership is experiencing in balance of payments and reserve positions. The optimal response implied by this conclusion is a heightened level of Fund activity; but an overall decline in Fund credit outstanding is projected for 1987 and 1988, as well as a large scale repayment of credit lines that will reduce the proportion of Fund credit financed with borrowed resources to levels lower than at any time since the 1970s. Clearly, it seems that the Fund must be endowed with additional resources of its own to discharge its obligations and return to an effective quota-based institution.

In the interim, ordinary resources are being conserved through the change in the mix of ordinary and borrowed resources in financing purchases under the enlarged access policy. Yet the drain on these resources continues as a result of the use of these resources in repayment of loans used to finance purchases of borrowed resources under the enlarged access policy. The staff projects that this mismatch will, on average, approximate SDR 2.5 billion a year during the 10-year period 1986-95. This will represent a sustained commitment of ordinary resources in the financing of the enlarged access policy.

For this reason, and in the context of the modest impact it will have on ordinary charges, we can support consideration of a gradual utilization of the loan from Japan in substitution for ordinary resources. We note, however, that the staff indicates that this initiative will result in a relatively limited reversal in the use of ordinary resources in financing enlarged access. We wonder whether the staff could provide us with firm estimates of the impact of different levels of use of the Japanese loan on the average annual mismatch that has been projected. The adoption of operating guidelines, including limits on use and procedures for review of ordinary charges, to avoid any implication of a shift toward reliance on borrowing as opposed to quotas in financing the Fund's operations should also be considered during the review by the Board.

The Deputy Treasurer said that the differences between the estimates in the staff paper on the review of the Fund's liquidity and financing needs and those in the papers prepared for the world economic outlook were essentially differences of timing. The data on the world economic outlook, which had been compiled earlier, would be brought up to date for purposes of publication, and the two sets of figures would be made consistent.

The staff believed that most of the 50 countries that were expected to make net repurchases in 1987 and 1988 were subject to considerable balance of payments difficulties and potentially to debt rescheduling, the Deputy Treasurer said. Although most of them were in strained financial situations, not all of them were, and the staff had perhaps been pessimistic in describing their net repurchase situation in 1988. The uncertainty of the data for that year should be underscored. Although it was not known which of those countries would seek Fund assistance, some had already indicated their intention to do so and no doubt the estimates of use of Fund resources by those countries would rise in the course of the two years ahead. The use by some countries of the structural adjustment facility, which was not reflected in the liquidity estimates presented to the Board, would also affect the overall situation. If the guidelines on the operation of that facility were observed, there would be two more years of disbursements under the ten existing structural adjustment arrangements, which would more than double the amount of resources made available so far under the facility. Based on that tentative estimate, the overall financing provided by the Fund--aside from ordinary resources--would be altered substantially.

In response to a remark by Mr. Lim that he hoped that the Japanese loan was not an indication of a shift toward further use of borrowed resources, the Deputy Treasurer emphasized that the staff worked on the assumption, often repeated by the Executive Board, that the Fund's financing was a quota-based system. It was true that the Japanese loan had been extended on relatively inexpensive terms; it was also regarded as a major contingency element in financing the Fund in the event there was a sudden deterioration in the Fund's liquidity position. Those terms were a reflection of Japan's cooperation with the Fund. In no way could the loan agreement with Japan be interpreted as a shift in policy away from the use of quota-based resources toward borrowing over the longer term.

As the staff had indicated in its previous papers, the mix of borrowed and ordinary resources would continue to be kept under review, the Deputy Treasurer concluded. Because of the change in the mix in December, there had been no reason to take up the matter in the paper now before the Board, as there had been no fundamental changes in the situation.

The Acting Chairman noted that in responding to the question posed directly to them in the staff paper, most Directors, while reiterating their great appreciation to the Japanese authorities for the loan to the Fund, had felt that there was not adequate justification at the present time for substituting resources obtained under that loan for the Fund's ordinary resources. The matter could however be reconsidered in future liquidity reviews.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/56 (3/27/87) and EBM/87/57 (3/30/87).

2. NINTH GENERAL REVIEW OF QUOTAS - ESTABLISHMENT OF COMMITTEE OF THE WHOLE

In accordance with Rule D-3 of the Fund's Rules and Regulations, a Committee of the Whole for the Ninth General Review of Quotas with the Managing Director as Chairman is hereby established. Committee action shall not be binding on the Executive Board. Minutes of meetings shall be prepared and circulated for approval of Committee members. (EBD/87/85, 3/20/87)

Adopted March 27, 1987

3. ADMINISTRATIVE BUDGET FOR FY 1987 - SUPPLEMENTARY APPROPRIATION AND TRANSFER OF APPROPRIATIONS

The Executive Board approves the supplementary appropriation and transfer of appropriations between categories of expenses in the Administrative Budget for FY 1987 as set forth in the memorandum attached to EBAP/87/66 (3/24/87).

Adopted March 27, 1987

4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/87/67 (3/26/87) is approved.

APPROVED: October 30, 1987

LEO VAN HOUTVEN
Secretary