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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/161

10:00 a.m., December 17, 1982

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

Executive Directors

Alternate Executive Directors

J. Anson

B. de Maulde
A. Donoso
R. D. Erb
M. Finaish
A. H. Habib
T. Hirao
R. K. Joyce

G. Lovato
R. N. Malhotra
Y. A. Nimatallah
J. J. Polak
A. R. G. Prowse
G. Salehkhau
F. Sangare

J. Sigurdsson
Zhang Z.

A. B. Diao, Temporary
C. Taylor
L. E. J. Coene, Temporary
A. Le Lorier

C. Dallara

Jaafar A.
T. Yamashita
M. Casey
C. Robalino
G. Grosche
C. P. Caranicas
A. S. Jayawardena
J. E. Suraisry
T. de Vries
K. G. Morrell
O. Kabbaj

E. Portas, Temporary
L. Vidvei
Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

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Also Present

African Department: F. d'A Collings. European Department: B. Rose, Deputy Director; A. Arimo, E. O. C. Brehmer, W. L. Hemphill, A. Knobl, A. Leipold, S. Mitra, H. O. Schmitt, M. Schulze-Ghattas. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director. External Relations Department: C. S. Gardner, Deputy Director. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; Ph. Lachman, A. O. Liuksila, J. M. Ogoola, S. A. Silard. Middle Eastern Department: G. Tomasson. Research Department: W. C. Hood, Economic Counsellor and Director; N. M. Kaibni, G. Khatchadourian. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; A. M. Al-Samarrie, D. S. Cutler, D. Gupta, T. M. Tran, G. Wittich, P. K. Woolley. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, C. J. Batliwalla, S. El-Khoury, M. A. Janjua, P. Kohnert, H.-S Lee, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, L. Barbone, R. Bernardo, T. A. Connors, R. J. J. Costa, I. Fridriksson, G. Gomel, A. Halevi, M. Hull, Jiang H., J. M. Jones, M. J. Kooymans, P. Leehtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, M. Z. M. Qureshi, J. Reddy, J. Schuijjer, D. I. S. Shaw, H. Suzuki, P. S. Tjokronegoro, Zhang X.

1. ICELAND - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a request by Iceland for a purchase equivalent to SDR 21.5 million under the compensatory financing facility (EBS/82/209, 11/23/82; Cor. 1, 11/29/82; and Sup. 1, 12/3/82).

Mr. Sigurdsson made the following statement:

Iceland is requesting a purchase of SDR 21.5 million under the compensatory financing decision. The request is made in respect of the 12-month period ended September 30, 1982, for which the staff has calculated a shortfall in Iceland's merchandise exports of SDR 27 million. No estimates have been made of exports in the shortfall year in this calculation, as trade statistics regularly become available with a lag of less than a month. The export shortfall for the calendar year 1982 is tentatively projected to be twice as large as the calculated shortfall for the year ended September 1982.

The shortfall in export earnings is due primarily to a fall in fish catches and in aluminum exports. The fall in exports is caused by a coincidence of supply constraints in the fishing industry--considered to be temporary--a cyclical slack in world demand for Iceland's exports, and the virtual closure of the most important markets for stock fish.

The export shortfall has seriously aggravated Iceland's economic problems in 1982, resulting in a rapidly widening current account deficit, rising inflation, and a domestic financial imbalance.

The authorities have responded to these problems with a set of economic policy measures, most of which were described in the Article IV consultation documents issued for the Board discussion on September 27, 1982 (SM/82/144 and Supplement 1; SM/82/153) and in my statements at that meeting. The principal measures enacted after the middle of the year were a 14.3 per cent devaluation, a substantial curtailment of wage indexation, and selected tax increases, all of which entail a reduction of real incomes, which by the end of the year will amount to some 6 per cent in comparison with the average level of 1982. The authorities intend to continue through 1983 the previously adopted policy of restraining public investment expenditure. Furthermore, on November 1, interest rates on nonindexed financial instruments were raised by 6-8 percentage points, and the rules governing the access of deposit money banks to the Central Bank were tightened sharply.

The current account deficit, which equaled 5 per cent of GNP in 1981, is projected to reach 10.5 per cent this year. However, a limited recovery of exports and a fall in imports, due to the measures described, are expected to reduce the deficit by the

equivalent of 4-5 per cent of GNP in 1983, and it is the stated aim of the Government to bring the external deficit down to a sustainable level in 1984/85.

Movements in gross foreign exchange reserves do not fully reflect the setbacks suffered this year, as the Central Bank has undertaken substantial short-term borrowing in recent months in order to maintain a satisfactory gross reserve level. The net reserve figures, however, better demonstrate the drastic effect of the export shortfall on the balance of payments, as the staff report brings out clearly.

Iceland has previously made three purchases under the compensatory financing facility. The first purchase, of SDR 3.75 million, was made in November 1967; the second, of the same amount, a year later; and the third, of SDR 11.5 million, in March 1976. All were repurchased promptly.

The present request meets all the requirements for a purchase under the compensatory financing decision. The requirement of need is satisfied, the shortfall is of a temporary character and largely attributable to circumstances beyond the control of the authorities, and the authorities have demonstrated their commitment to finding--in cooperation with the Fund--appropriate solutions to Iceland's balance of payments difficulties.

In concluding, I would myself, and on behalf of my authorities, like to thank the staff for its highly professional work and pleasant cooperation.

Mr. Lovato noted that the request of the Icelandic authorities met all the requirements of the compensatory financing facility decision. The current account deficit--equivalent to 10.5 per cent of GNP--showed that the country certainly had a balance of payments need. Also, the shortfall--which was due to factors largely beyond the control of the authorities--had been caused mainly by supply constraints in the fisheries; hence, he was confident that the balance of payments problem was temporary and reversible, and he could therefore support the proposed decision. In passing, he inquired about the reasons behind the decrease in cheese production and exports in Iceland. It was easy to understand the reasons for the shortfall in Iceland's main exports, namely marine products; the decrease in cheese production and export was less clear.

Mr. Casey remarked that he also could support the request, which seemed reasonably straightforward. However, he wondered why the request was for the equivalent of 49.4 per cent of quota rather than for the easily rounded-up figure of 50 per cent. Noting that an extension of the shortfall year until December would have allowed the authorities to request a significantly larger purchase under the compensatory financing facility, he wondered whether their decision not to request a larger purchase at present could be taken as a signal that they intended to request another purchase later on.

The case of Iceland was unusual in that the international recession was not mainly responsible for the shortfall in exports of marine products, Mr. Casey continued. Indeed, the tendency in a recession was for people to shift from meat consumption to fish consumption, which should increase rather than decrease the demand for Iceland's main exports. The shortfall in marine products was in fact almost entirely volume related, and he suspected that it had been caused mainly by overfishing in earlier years. Between 1978 and 1980, Icelandic exports of marine products had grown by 14 per cent a year in volume terms, a rate sufficiently high to suggest the possibility of overfishing. Of course, that was not to say that the shortfall had been within the control of the authorities; the overfishing that had taken place had probably not been regarded as such by the authorities at the time, since fishing was based on forecasts by marine biologists about the likely sustainable level of the catch. Still, he wondered whether, with the benefit of hindsight, the authorities felt that some overfishing had taken place in the past and whether thought was being given to ways of avoiding such a problem in the future. It was possible that temporary export shortfalls might be more easily avoided if diversification of the productive base were to proceed at a faster pace.

The postshortfall projections seemed conservative, Mr. Casey remarked. They had been provided by the Icelandic authorities themselves on the basis of certain assumptions by marine biologists and, therefore, had probably not been subject to challenge by the staff. The approach taken seemed to highlight the technical difficulties involved in making shortfall projections when certain types of commodities were involved. On a related point, what assumptions had been made about the Nigerian market for Icelandic exports over the medium term?

He had noted with interest that per capita income in Iceland was in excess of \$10,500, which placed Iceland in the company of countries like the United States and Canada, Mr. Casey said. He wondered, in passing, what the implication would have been for the Fund's liquidity if all eligible high-income countries had chosen to apply for purchases under the compensatory financing facility over the past year or two. Finally, he wished to commend the Icelandic authorities for the recent adjustment measures that they had taken, including the devaluation and the tighter monetary and incomes policy. More needed to be done, of course, in light of the still high rate of inflation in Iceland; there also remained a number of exchange restrictions that should be removed at an early date.

Mr. Grosche said that, like others, he could support Iceland's request for a purchase under the compensatory financing facility. There was certainly a balance of payments need, and Iceland's willingness to cooperate with the Fund had been well demonstrated in the past. The possibility that some overfishing might have occurred could lead to questions about whether the total shortfall was in fact largely beyond the control of the authorities. However, he assumed that the authorities had relied on the projections of marine biologists for fish stocks and the level of sustainable fishing, and he could therefore go along with the staff judgment. He would only urge caution with respect to fishing policy in future.

Mr. Malhotra stated that his chair could also fully support Iceland's request for a purchase under the compensatory financing facility.

Mr. Suraisry remarked that he could go along with the proposed decision and could agree with Mr. Sigurdsson and the staff that the request met all the relevant requirements. He took note of the fact that the request was for less than 50 per cent of quota and that the calculations were based on actual exports, thus eliminating the risk of overcompensation. While there might be some doubt that the shortfall was largely beyond the authorities' control, he was willing to give Iceland the benefit of the doubt.

Mr. Dallara commented that he too could support Iceland's request, which met all the relevant requirements under the compensatory financing facility decision. However, he wished to reiterate a point he had made on earlier occasions in connection with other compensatory financing facility requests. At issue was whether or not it was appropriate for members to use the facility when a shortfall in export earnings was embedded in a broader balance of payments problem that called for comprehensive adjustment action. The compensatory financing facility had been designed to help members to deal with temporary shortfalls in export earnings that were largely beyond their control; in other words, it should be used to help them finance temporary payments imbalances that arose in circumstances that did not call for major adjustment efforts. When there were clearly other more serious and fundamental problems underlying a payments deficit, the compensatory financing facility did not appear to be particularly well suited.

In Iceland, a number of significant adjustment actions had been taken, Mr. Dallara continued, including changes in the exchange rate and monetary and fiscal measures designed to reduce domestic demand. In particular, the recent increase in interest rates on nonindexed financial instruments seemed to be an appropriate and much-needed move, and he encouraged the authorities to strengthen monetary policy further in order to restrain domestic demand and reduce inflationary pressures. In general, it was not clear from the papers that the broad stance of policies in Iceland provided a sufficient basis for restoring the balance of payments to a sustainable position, and he would appreciate comment from the staff or Mr. Sigurdsson on the adequacy of adjustment measures in place together with some indication of whether any additional measures were being considered.

Mr. Hirao stated that, like others, he could fully support the proposed decision. Iceland seemed to meet all the requirements for a compensatory financing facility purchase. The shortfall appeared to be temporary and attributable largely to factors beyond the control of the authorities. Iceland's balance of payments had deteriorated significantly over the previous two years, and the current account deficit for 1982 was projected to increase to 10.5 per cent of GNP. Moreover, the authorities appeared to be cooperating with the Fund to eliminate the deficit. In addition to the exchange rate devaluation and the efforts to curtail

wage indexation and to tighten monetary policy, continued restraint of public investment outlays in 1983 was intended. He hoped that such measures--together with a recovery in exports--would contribute significantly to reducing the current account deficit in future.

Mr. de Maulde remarked that he too could support Iceland's request for a purchase under the compensatory financing facility. The nature of the estimated shortfall and the circumstances surrounding it were fully in line with the requirements of the compensatory financing facility decision. There was no doubt about the existence of a balance of payments need, and it was clear that a large part of the deterioration in the external accounts in 1982 was the result of significantly lower export earnings. He was also satisfied that the shortfall in export earnings relating to marine products and aluminum was temporary. In response to a point raised by Mr. Casey, he did not consider per capita income to be a consideration relevant to Iceland's case.

He welcomed the Icelandic authorities' increased determination to strengthen demand management policies in order to alleviate current pressures on the external position, Mr. de Maulde continued. As a number of Directors had indicated on the occasion of the 1982 Article IV consultation with Iceland, the continued buoyancy of imports in the context of a sharp slowdown in exports could not be sustainable over the medium term and thus required prompt action. In that regard, the expected reduction in the current account deficit for 1983 was a positive development.

Mr. Prowse agreed with others that Iceland's request was fully justified on its own merits. He was not troubled by the per capita income level in Iceland; indeed, it was important that countries across the spectrum of income levels should use the Fund's resources in a timely and appropriate manner. In any event, it would not be good practice to bring to a discussion on a compensatory financing facility request a de facto criterion that was not part of the agreed framework of the facility.

With respect to the forecasts on which the request had been based, Mr. Prowse noted that the aluminum plant was operating well below capacity, and production was forecast to remain unchanged between 1982 and 1983 and to increase only slightly--from 77,000 tons to 81,000 tons--in 1984. The staff paper had suggested that "this (the aforementioned increase) corresponds to an average capacity utilization of about 95 per cent." It was unclear whether the statement by the staff could be reconciled with the forecast; since the increase projected was not large, it was not evident that the plant could move from operations "well below capacity" to "95 per cent" capacity. He had observed that the forecast for the increase was based on an export volume increase of 12 per cent and a value increase for aluminum of 10 per cent. He would be interested in staff elaboration on the basis for its forecasts for 1983/84.

Mr. Donoso stated that, like others, he could support Iceland's request for use of Fund resources under the compensatory financing facility.

Iceland's current account had worsened significantly over the previous two years, and, at least in 1982, the deterioration appeared to have been due largely to circumstances beyond the member's control. Export volume of marine products had suffered a strong setback, mainly because of supply constraints but also because of a deterioration in market conditions for stockfish. In addition, weak external demand and low prices had contributed to significant shortfalls in other exports such as aluminum and agricultural products.

The authorities had faced the adverse developments by taking decisive action to correct domestic imbalances and address the external situation, Mr. Donoso continued. The exchange rate devaluation coupled with a restrictive incomes policy and a curtailment of public expenditures in the context of a tighter monetary policy should bring relief to the balance of payments position, provided there was no further weakening of external demand for Iceland's exports. In the circumstances, he welcomed the demonstration of the commitment by the authorities to cooperate with the Fund in finding appropriate solutions to Iceland's external difficulties.

Mr. Zhang indicated that he also could support Iceland's request.

Mr. de Vries said that he too could support the request. Like Mr. Casey, however, he would be interested in the amount of resources that would have been involved if all high-income countries with an export shortfall had drawn on the compensatory financing facility in 1982.

With respect to the more general concerns that had been raised by Mr. Dallara--and by Mr. Erb on a number of previous occasions--Mr. de Vries wondered how the Executive Board should deal with what was apparently a fundamental issue.

Mr. Diao noted that the case of Iceland was of interest to the countries in his constituency, especially since marine products accounted for an increasingly large share of export earnings in some of his countries. Iceland's eligibility for a purchase under the compensatory financing facility had been adequately established, and he therefore had no difficulty supporting the request.

Mr. Prowse considered that, if the staff was going to conduct a background study on the amount of resources that would have been needed if all high-income countries with export shortfalls had come to the Fund with requests for purchases under the compensatory financing facility, it should perhaps also suggest what the result might have been if all such countries had used Fund resources and adopted adjustment programs of the sort that might have been expected of them.

The staff representative from the European Department recalled that Mr. Casey had wondered why the Icelandic authorities had requested a purchase equivalent to 49.4 per cent of quota, rather than, say, an even 50 per cent. The authorities had felt that, in conjunction with

their purchase of the remainder of the reserve tranche, the amount in question would meet their current needs. He could not speculate on whether any requests for further purchases might be forthcoming.

With respect to Mr. Dallara's inquiry about whether the measures already taken by the Icelandic authorities were sufficient to deal with the adjustment problem, the staff representative observed that the measures in question had already led to a curtailment of demand, as evidenced by the recent significant fall in imports. Nevertheless, it might well be that additional adjustment measures would be necessary in future, particularly in the monetary field; more important, it was possible that the authorities would need to implement adjustment measures for a longer period. Certainly it was clear that, in 1983, adjustment would not be sufficient to reduce the current account deficit to a sustainable level.

The staff representative from the Research Department noted in response to a question by Mr. Lovato that a change in policy had led to a declining trend for cheese exports in recent years. Subsidies on both cheese and mutton had been undergoing gradual reductions, and the volume of exports of those items had followed a similar pattern.

With respect to Mr. Casey's question regarding assumptions about the Nigerian market for Icelandic exports over the medium term, the staff representative remarked that the staff was projecting a significant decline in exports of stockfish in 1983, with some recovery in 1984. It was assumed that there would be exports of stockfish to Nigeria, perhaps at some time in 1983, and the authorities were exploring the possibility of exporting stockfish to other countries as well. Regarding questions on the aluminum sector, projections for aluminum exports were based on information provided by a subsidiary of the foreign company involved in aluminum operations in Iceland. It was his understanding that the volume projections had been based on orders placed by the parent company; but those projections envisaged a substantially higher volume of exports from the subsidiary operating in Iceland than the staff itself had assumed in its calculations.

Several Directors had referred to Iceland's dependence upon a highly uncertain source of export receipts--namely, marine products--the staff representative from the Research Department recalled. Although the fish catch had been extremely heavy in the previous two or three years, it had been substantially less than the maximum sustainable level suggested by the marine biologists. When it had been determined in the autumn of 1981 that spawning of capelin had been significantly lower than expected earlier, the authorities had banned capelin fishing altogether. The ban remained in effect and was unlikely to be lifted until the latter part of 1983. It was uncertain precisely what had caused the drop in spawning in Iceland's fishing waters; however, forecasting of capelin stock was subject to more than the usual degree of uncertainty since it rested essentially on the capricious behavior of fish. The latest estimates by the marine biologists was for a maximum sustainable catch of capelin in

the range of 600,000-800,000 tons a year, while staff projections--based on the authorities' intentions--envisaged a catch of 250,000-500,000 tons a year for the next two years.

Mr. Dallara confirmed Mr. de Vries' recollection that the United States had, on a number of occasions, expressed various concerns relating to the operation of the compensatory financing facility, including those involving the adequacy of the test of cooperation with respect to the lower 50 per cent and the need to safeguard the Fund's resources. It might well be that, at an appropriate time in future, the Board would wish to turn its attention to the more general policy issues relating to those concerns.

The Chairman, elaborating on a point raised by Mr. Casey, wondered whether, when estimating drawings on the Fund under the compensatory financing facility arrangements for the purposes of liquidity projections, the staff took account of potential export shortfalls for all countries--including the United States and other high-income countries--or for a more limited number of countries.

The staff representative from the Research Department indicated that the staff did not include in its calculations the 14 industrial countries that had, in 1975, declared their intention not to seek purchases under the compensatory financing facility. All members had a right to request purchases under the compensatory financing facility; the 14 countries in question had come to a "gentlemen's agreement" not to do so. Since 1975, the list of industrial countries had been expanded to 21 Fund members, including Iceland.

Mr. Sigurdsson observed that the compensatory financing facility was important to all countries--regardless of income level--whose export base was exposed to the vagaries of nature and of the international markets. Iceland had used the facility on earlier occasions, as had other high-income primary producers, and that fact should be seen as an example of the principle of uniformity at work.

He could agree with Mr. Dallara that, in general, Iceland's shortfall was part of a larger balance of payments problem and that further policy action toward adjustment might be required, Mr. Sigurdsson continued. The current stance of policy was appropriate in present circumstances, although some of the policies in place might need to be continued or replaced in 1983. That was particularly true for incomes policy, but there might also be a need to strengthen policies in other areas. Still, the fact that a comprehensive policy program for 1983 and beyond might be needed was no reason to suggest that the compensatory financing facility request was inappropriate.

On the likelihood of further requests by Iceland for Fund financing, Mr. Sigurdsson noted, first, that the authorities had indicated in the request under discussion that they would cooperate with the Fund in finding solutions to the balance of payments problems. Since the present

Government was nearing the end of its term and did not have an assured parliamentary majority, it was unlikely that any new economic policy program of the sort that could have solid political backing would be forthcoming until after the elections in March and April 1983. Nonetheless, there was a general recognition by the authorities of the seriousness of the economic situation in Iceland and a clear understanding on their part that the proposed compensatory financing facility purchase, if agreed, might aid in the initiation of an adjustment program with the Fund.

As to the amount of the requested purchase, Mr. Sigurdsson observed that the authorities felt that it would not have been prudent for them to have requested an amount of resources from the Fund--including the reserve tranche drawing--that was greater than the amount of the shortfall as defined on the basis of actual data for the first three quarters of 1982. The reserve tranche drawing in November had been for SDR 9 million, and the requested purchase under the compensatory financing facility was for SDR 21.5 million. Together, the amounts were consistent with the Icelandic authorities' estimation of the shortfall.

A number of Directors had questioned the projections for cod and capelin stocks on which catch quotas were based, Mr. Sigurdsson recalled. Because the relationship between those projections and the actual fish catch in given years touched on the difficult question of the extent to which the shortfall was within or beyond the control of the authorities, it might be helpful if he were to provide Directors with some further details on the fishing situation. In recent years, the capelin catch had been determined on the basis of the recommendations of the Institute of Marine Biology, and the actual catch had never exceeded stipulated quotas. With the benefit of hindsight, it seemed possible that the stock size might have been overestimated and that overfishing might have taken place. However, until late 1981, there had been no indication that the capelin stock was being overfished; as soon as such indications had been confirmed, capelin fishing had been banned completely. The latest available information indicated that the stock of one-year-old capelin could be quite strong, which gave rise to some optimism regarding the resumption of capelin fishing in the future. Capelin was a short-lived fish, which grew to spawn in only three years; as a consequence, the rebuilding of the stock should not take long, especially since capelin fishing had already been banned for almost 12 months and would continue to be banned for at least another 8 or 9 months.

On cod fishing, the mainstay of Iceland's exports, the Institute of Marine Biology had recommended in late 1981 a cod catch of 450,000 tons for 1982, Mr. Sigurdsson observed. In fact, the actual catch would turn out to be substantially lower for a number of reasons. First, the behavioral patterns of codfish were unpredictable; the customary migration of a substantial segment of the stock between fishing banks had not taken place during 1982. Second, since capelin was part of the cod's diet, the sharp decline in capelin stock might well have dispersed the stock of cod, making it more difficult to catch. Third, the ocean temperature

had been low during 1982, causing the cod to move to warmer areas and away from the bottom of the sea toward the surface, which made them more difficult to catch. The low temperature had also led to a decline in plankton, on which the cod fed. Finally, the 1976 cod spawn had been thought a successful one and, therefore, should have figured importantly in the catch for 1982. However, for unexplained reasons, that spawn had not been important in the catch thus far in 1982; in fact, it had accounted for a significantly smaller share of the total cod catch than had been anticipated. Moreover, the latest indications were that the cod stock in general was declining somewhat. The success rate of all spawns since 1976 had been below average, although it was unclear to what extent that trend had affected the catch in recent years.

Overfishing of cod had not appeared to present any difficulty at the beginning of 1982, on the basis of recommendations of the Institute of Marine Biology, Mr. Sigurdsson continued. However, the catch since then had been a disappointment, and profits in cod fishing had fallen off sharply. While the data on fish catches had not been fully analyzed, they seemed to point to the need for greater caution in the fishing effort. Unfortunately, the year-to-year recommendations of the marine biologists had fluctuated considerably--according to the most recent analysis--and that must certainly have complicated the task of managing or guiding the cod fishing industry, which consisted of many small private firms. The maximum sustainable cod catch in the medium to longer term was currently thought to be about 450,000 tons per year, but that estimate was dependent on at least an average annual success rate of the spawn, and there was still some uncertainty regarding the current status of the cod stock. Nonetheless, a 1983 catch of roughly the same size as in 1982--about 380,000 tons--was anticipated. In that regard, it should be noted that the recommendations of the marine biologists for cod fishing were not translated into direct quantitative limits as they were for capelin; rather, the authorities aimed at a certain catch through indirect measures, with reference to the recommendations. In future, however, increased importance would be attached to the annual review of the overall size of the cod stock. Unfortunately, the outlook for 1983 and beyond was undeniably bleaker than expected earlier in the year; still, the fishing industry had in the past shown flexibility and responsiveness when traditional stocks had weakened or failed, and he was certain that the industry would continue to do so.

Mr. Prowse, returning to Mr. Casey's point regarding the use of Fund resources, observed that it was not surprising that the industrial countries were excluded from calculations on possible use of the compensatory financing facility. The decision on compensatory financing of export fluctuations stated that "the financing of deficits arising out of export shortfalls, notably those of primary exporting member countries, has always been regarded as a legitimate reason for providing Fund resources." The decision went on to state that "the Fund has reviewed its policies to determine how it could more readily assist these members (the primary exporting member countries) encountering balance of payments difficulties."

The Chairman remarked that, despite Mr. Prowse's observations, industrial countries were included among possible users of Fund resources, when making such calculations, to the extent that the staff felt that they might come to the Fund.

Mr. Casey stated that, in making his point, he had been trying only to justify his view that the Icelandic authorities should, as a matter of policy, look more closely at the process of industrial diversification in future.

Mr. Sigurdsson responded that, in the long run, industrial diversification might offer some hope of reducing Iceland's exposure to fluctuations in its exports. However, the record showed that Iceland had diversified its exports considerably over the years; unfortunately, the industries that had been added did not offer much protection from fluctuations in exports. They tended to be energy-intensive metal production plants with very steep cycles that often coincided with other fluctuations and thus had not helped to stabilize exports. Moreover, the new industries were unfortunately unprofitable at present, which tended to discourage the authorities from further diversification. Perhaps a better approach would be to strengthen the traditional industries in the hope that they would become profitable and have stabilizing effects in future.

The Executive Board then turned to the proposed decision, which it adopted.

The decision was:

1. The Fund has received a request by the Government of Iceland for a purchase of the equivalent of SDR 21.5 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).
2. The Fund notes the representation of Iceland and approves the purchase in accordance with the request.

Decision No. 7270-(82/161), adopted
December 17, 1982

2. GENERAL ARRANGEMENTS TO BORROW (GAB) - POSSIBLE REVISION AND ENLARGEMENT

The Executive Directors considered a paper containing a communication from the Chairman of the Deputies of the Group of Ten on the principal conclusions reached by the G-10 Deputies at their meeting of December 10, 1982 (EBS/82/232, 12/13/82). They also has before them a staff paper entitled "General Arrangements to Borrow - Structure and Basic Features" (SM/82/217, 11/17/82).

Mr. Erb recalled that, during earlier discussions on the size of the Fund, he had indicated that it was important for the Fund to be in a

position to respond to periods of stress in the international monetary system. During 1982, serious systemic stresses had arisen, and all countries had been forced to focus greater attention on the role of the Fund in such circumstances. At the Annual Meetings in Toronto, the United States had suggested that one way of dealing with the problem would be to establish an additional borrowing arrangement and, in more recent discussions of systemic threats to the system, he had put forward the view of the United States that a modification of the General Arrangements to Borrow (GAB) might be the best way in present circumstances of expanding the resources available to the Fund to enable it to respond to periods of systemic stress.

The Deputies of the Group of Ten had, at their December 10 meeting, called for a significant increase in the size of the GAB, together with continued application of its general principles to participants, Mr. Erb continued. Under the proposal, supplementary resources could be provided to the Fund when two general criteria were met. Those criteria were clearly explained in paragraphs 4(i) and (ii) of EBS/82/232; they referred to an inadequacy of Fund resources in association with requests from one or several countries with serious balance of payments problems that might pose a threat to the stability of the system. The judgment of whether the GAB should be activated for nonparticipants would be made in the first instance by the Fund in submitting a request for such activation to the GAB, and then by the GAB participants themselves. It was important to note that judgments with respect to the specific programs concerning the use of Fund resources for nonparticipants would remain the responsibility of the Executive Board of the Fund; it was not the view of the Group of Ten or of the United States that GAB participants should replicate the decisions of the Executive Board in accepting or rejecting specific Fund programs. Of course, another element in the judgment of whether or not the GAB would be activated for nonparticipants was the necessity to pay attention to the possibility that calls on the GAB might be made by participants. That factor would need to be considered at the time when the requests were made.

With respect to questions on the rights of parallel lenders under the proposed General Arrangements to Borrow, it was the view of the United States--and agreed by the Deputies of the Group of Ten--that parallel lenders would have access to GAB resources similar to the access enjoyed by participants, Mr. Erb said. Such lenders should also be able to participate in decisions about whether or not to activate the facility.

Mr. Grosche considered that the Deputies of the Group of Ten had taken an important step forward in reaching agreement on the main elements of a revised and expanded GAB that would supplement Fund resources when necessary to deal with stresses on the international monetary system. He noted from the summary of the Deputies' meeting (EBS/82/232) that the precise figures for the size of the GAB referred to in paragraph 2 would depend on the size of the overall quota increase agreed under the Eighth Review. At present, an enlargement of the GAB to SDR 20 billion would seem to be more suitable than an enlargement to SDR 15 billion.

Regarding paragraph 3 of the summary, Mr. Grosche said that it was his understanding that there had been discussions in Paris on the shares of participants' credit commitments. In his view, an agreement on the matter would be easier for Germany to accept if the individual commitments tended to reflect the future quota shares in the Fund. In paragraph 4, the proposed procedures for activation of the GAB were, at first reading, appropriate and acceptable to his authorities.

Paragraph 6 made reference to the possible relationship between GAB participants and other potential lenders willing to provide resources, Mr. Grosche noted. That relationship needed further clarification and discussion, and current GAB participants would welcome the reactions of those countries that might be interested in concluding parallel arrangements with the Fund. Paragraph 8 referred to the legal aspects of implementing the approach suggested by the Deputies; he would appreciate some further elaboration by the staff on those matters. In concluding, he wished to re-emphasize that his authorities' interest in aiming at an expanded and revised GAB derived from their wish to strengthen the Fund's ability to deal with major strains in the international monetary system.

The Director of the Legal Department observed that the proposals in the summary of the meeting of the Deputies of the Group of Ten would require amendment of the GAB decision. Any amendments would need to be approved by the Executive Board and adhered to by all participants in the GAB. There had been a reference in paragraph 8 of the summary to the possibility that the criteria for activating the GAB for nonparticipants might take the form of an "understanding among participants" rather than an amendment of the decision. At a minimum, of course, the decision would have to be amended in order to provide that the GAB could be activated for the benefit of nonparticipants because, as currently formulated, the decision permitted activation only for the benefit of participants. However, the criteria for activating the facility could be incorporated into the decision or into a letter or some other form of understanding among the members of the Group of Ten; in any event, those members would have to agree to any proposal for activation. If it were decided to incorporate the criteria in the GAB decision, those criteria would have to be taken into account by the Managing Director and the Executive Board in approving proposals for activation of the GAB. If they were only part of an understanding among the members of the Group of Ten, the Managing Director and the Executive Board would probably wish to take that understanding into account in making a proposal, but they would not be legally required to do so.

Describing the changes that might be required, the Director of the Legal Department explained, first, that certain of the provisions of the GAB decision would need to be changed in order to denominate the credit arrangements in SDRs rather than in currencies. Second, provision would have to be made for parallel lenders. Third, the interest rate provisions would need to be reformulated in order to provide for a market-related

interest rate. Finally, the provision authorizing the use of the GAB by nonparticipants would make clear the types of transactions with nonparticipants that could be used and would specify the criteria for activation for nonparticipants that were parallel lenders and those that were not parallel lenders. As had been noted in EBS/82/232, parallel lenders and participants would be treated in a similar manner with respect to the financial aspects of the decision and the consultative process regarding activation of the facility. The amendments that he had mentioned were the minimum necessary; however, further changes could of course be introduced if it were desired to modernize the GAB decision.

Mr. Anson considered that it was clear from the conclusions in EBS/82/232 that considerable progress had already been made toward revising and enlarging the GAB. It was worth noting that the Deputies of the Group of Ten had underscored the fundamental principle that quotas should remain the principal source of IMF resources to meet the ordinary balance of payments financing requirements of Fund members; hence, early agreement on a substantial quota increase was of prime importance. Paragraph 9 of the summary had made clear the relationship between the quota review and the discussions on the possibility of revision and enlargement of the GAB. If it were decided to revise and enlarge the GAB, the Fund could be provided with sufficient resources to meet requests for drawings by GAB participants that might otherwise place an undue strain on the Fund's ordinary resources. Moreover, the GAB could provide the Fund with resources for drawings by nonparticipants through the concept of a "second window" of the sort that he had mentioned on previous occasions. The knowledge that such resources were available to the Fund should be useful in helping to sustain the confidence of the international banking system that the Fund would be able to meet requests for support for appropriate adjustment programs when the international monetary system was under stress, as at present.

The "second window" would, as he saw it, be available essentially to finance the policy of enlarged access, which was likely to be needed in some form after the Eighth General Review of Quotas was completed, Mr. Anson continued. However, such GAB loans would be, as at present, for a maximum of five years. Although it was unclear when the enlarged access policy would be phased out, it seemed reasonable to suppose that loans through the "second window" of the GAB would not be continuously revolving resources. The examination of particular country programs would remain firmly a matter for the Executive Board.

The "second window" of the GAB should not be the sole source of financing for enlarged access once the Eighth General Review was completed, Mr. Anson considered. The relationship between GAB loans for the benefit of nonparticipants and loans made by other potential lenders would need to be examined carefully in the coming weeks. The "associate" status of Switzerland provided one possible model for such a relationship but not the only conceivable one. Finally, the size of the GAB was to some extent contingent on the size of the overall quota increase. For example, if the quota increase were only 50 per cent--which he regarded

as a minimum--the case for expanding the resources of the GAB to the top of the range mentioned in paragraph 2 of EBS/82/232 would be strong. Indeed, a good case could be made for expanding the GAB to the top of the range merely to allow the facility to fulfill its present functions. The General Arrangements to Borrow had remained virtually unchanged since their inception, and the resources available under those arrangements had declined markedly in relation to Fund quotas as well as to participants' quotas and to participants' gold and foreign exchange reserves. The GAB had in fact become inadequate to meet concurrent drawings on the Fund by even two or three participants with large quotas. An increase in the resources of the GAB to SDR 20 billion could be justified on the grounds that it would ensure that the arrangements could effectively fulfill their existing function.

Mr. Nimatallah inquired whether it was Mr. Anson's view that the "second window" arrangements should last for five years only.

Mr. Anson replied that the duration of the arrangements was based to some extent on the same conditions that called for the policy of enlarged access. How soon those conditions would cease to exist was not at present very clear, although it was to be hoped that the current strains in the international monetary system would not last for another five years. If the enlarged access policy were phased out in, say, five years, there would probably be no need for access by nonparticipants to GAB resources because the Fund's ordinary resources would, in such a situation, be adequate to meet their requests for drawings on the Fund. At the moment, the Fund needed to meet the requirements of nonparticipants under the enlarged access policy and was therefore subject to a much greater demand for resources than it normally would be. If there were no need for an enlarged access policy, then the ordinary resources of the Fund should be sufficient to meet the demands of nonparticipants. The General Arrangements to Borrow in their present form had originally been established on the understanding that the Fund's ordinary resources were sufficient for most purposes and that problems might arise only when participants in the GAB needed to make large drawings from the Fund. If the Fund, from its ordinary resources, could normally expect to finance members' drawings with access limits of 100-165 per cent of quota, there would be no need for borrowing and therefore no need for the Fund to seek resources from the "second window."

The Chairman observed that a situation could arise in which, even if the enlarged access policy had been phased out, the Fund might have to make heavy repayments to unwind previous borrowing agreements. At the same time, heavy borrowings scattered throughout the Fund's membership might create a need for resources on a more permanent basis of the sort contemplated by the revised and enlarged GAB.

The Treasurer noted that the question of the amount that the Fund could finance from ordinary resources without having to rely on borrowing had been discussed at some length in the Executive Board. The answer was closely tied to the total size of the increase in the Fund's quotas,

the duration of the enlarged access policy, and the question of whether and in what proportion access would be increased relative to the quota increase. All such matters were under discussion and would need to be taken into account in any decision whether or not at some future date to phase out the proposal under consideration. Moreover, Executive Directors would have to look closely at projections for the balance of payments of both deficit and surplus countries. As noted by the Chairman, it was possible to envisage a concentration of surpluses in countries with relatively small quotas, which might necessitate--as had happened in the past--large-scale borrowing arrangements. It was therefore difficult to be precise about how much access to ordinary resources the Eighth General Review would allow.

On a point raised by Mr. Anson, the issue of whether or not the lapsing of the "second window" should be related to the possible lapsing of enlarged access had been covered in paragraph 7 of EBS/82/232. The Deputies of the Group of Ten had indicated that the revised and expanded GAB would be reviewed at the time of the Ninth General Review of Quotas; they had come to no conclusion that the arrangements would lapse and had made no reference to reducing or eliminating the enlarged access policy.

Mr. Erb agreed with the Treasurer that the Deputies of the Group of Ten had not been explicit in tying the expanded and revised GAB to enlarged access. It also was the view of the United States that the expansion of the GAB to potential use by nonparticipants was not necessarily related to enlarged access. The enlarged access policy might be continued, and the use of the GAB by nonparticipants might never take place; on the other hand, even if enlarged access were at some stage phased out, GAB resources would continue to be available for use by nonparticipants. The language in paragraph 4(i) referred only to an inadequacy of resources and did not specify whether those resources were ordinary or borrowed. In effect, that paragraph provided the Fund with flexibility in treating resources from the GAB as if they were ordinary resources or borrowed resources. In that respect, the proposed GAB would be different from other borrowing arrangements specifically designed to finance enlarged access. In sum, there should be no automatic phasing out of the use of GAB by nonparticipants; reviews of the arrangements would be held, and any changes in them would require a decision by the Executive Board.

Mr. Anson remarked that he continued to have difficulty with a philosophical issue raised in previous staff papers. It had been suggested that the quota increase per se would not necessarily restore the financial balance of the Fund because, while it would increase resources, it would also increase the quotas on which access was based. It had been argued by the staff that what was crucial for the financial balance of the Fund was the amount of access in relation to quotas. If the staff was correct, there would logically be no need for the use of the GAB by nonparticipants if enlarged access were phased out.

The Treasurer observed that the Fund would call on credit only if it needed to do so to finance legitimate demands. However, the absence of demand at any given time would not necessarily lead to the conclusion that borrowing arrangements like those proposed for the GAB should be eliminated. A more important question to be considered was the need of members to finance balance of payments deficits and the extent to which the Fund should respond to that need. In other words, the focus should be on the nature of the Fund's credit policy, on the degree and duration of enlarged access, and on other lending policies of the Fund. The staff could of course make certain assumptions about the lending policies of the Fund and the Fund's involvement in financing the deficits of its members, but the results would have limited use because any estimate of future needs would fall within necessarily wide margins. For example, research on a possible size of the Fund for the Eighth General Review of Quotas had showed differences of opinion ranging from the need for a 25 per cent increase in quotas to the need for a tripling of quotas.

Mr. Salehkhov recalled that, at the previous meeting of the Interim Committee in Toronto, most Governors had welcomed the proposal to assess the adequacy of existing arrangements to deal with major strains in the international financial system. They had also stressed that any strengthening of existing arrangements should in no way be a substitute for the needed substantial increase in quotas under the Eighth General Review. Unfortunately, recent developments--as well as positions taken by major industrial countries in the Executive Board and in more restricted meetings--seemed to confirm what had been only an apprehension in September 1982 about major strains on the system.

The relationship between the proposed enlargement of the GAB and the increase of quotas under the Eighth General Review was clearly stated in paragraph 9 of EBS/82/232, Mr. Salehkhov continued. Paragraph 7 of the same paper called for a review of the proposed enlargement of the GAB at the time of the Ninth General Review of Quotas; and that seemed to give the relationship between the GAB and quota increases--which had thus far been separate operations--a quasi-permanent character. He continued to feel that any strengthening of existing GAB arrangements should in no way be a substitute for the increase in quotas. The nature of the present crises in the international financial system called for a greater strengthening of the Fund through a straightforward doubling of its quotas. Such an increase would cover all the activities of the Fund and would benefit the entire membership indiscriminately.

He had a number of questions related to the conditions and procedures for activation of the GAB for use by nonparticipants and to the broad definition of nonparticipants' access to the GAB, Mr. Salehkhov said. In recent examinations of the distribution of the overall increase in quotas, some Directors had appropriately recalled that the principle of uniform treatment was central to the Articles of Agreement and that, as such, it covered all Fund operations and relations with the membership. The establishment of the GAB had obviously ignored that principle, although the Executive Board had pragmatically adopted the GAB on the grounds

that such arrangements would alleviate the strain on the Fund's ordinary resources. Under the proposed enlargement of the GAB, however, the facility would no longer be simply a "self-insurance" mechanism; the discriminatory character of the GAB would be increased, since only a few nonparticipant Fund members would enjoy access to its resources.

The proposed revision and enlargement of the GAB was even more undesirable because the access of nonparticipants was loosely defined and because decisions on eligible beneficiaries would be taken not by the management and the Executive Board of the Fund but through an ad hoc agreement among the members of the Group of Ten, Mr. Salehkhrou commented. So long as the use of GAB resources was limited only to participants, the arrangements might be considered acceptable; however, the changes contemplated by the amendment to the procedures for the activation of the arrangements would create a quite different situation, which many Fund members might be less willing to accept. In that regard, it might be useful to recall that lenders under other borrowing arrangements with the Fund--e.g., the oil facility, the supplementary financing facility, and enlarged access--had never participated in decisions to activate those arrangements; all decisions had been taken exclusively by the Executive Board. The revision and enlargement of the General Arrangements to Borrow should not result in a special or additional facility reserved for use by a few member countries loosely defined as those with balance of payments problems of a character that could "pose a threat to the stability of the international monetary system," because that would exclude a large majority of Fund members.

With respect to the possibility for parallel arrangements with potential lenders outside the Group of Ten, Mr. Salehkhrou said that he would welcome clarification of what the status of such lenders would be and what incentive would be offered them to provide resources through the GAB. He would also be interested in hearing staff comment on the present status of Switzerland as an "associate" of the GAB and where it would stand in relation to the proposal for parallel lenders.

The expansion of the GAB to cover nonparticipants would apparently be accompanied by an important increase in the interest rate on loans provided to the facility, thus raising the question of whether it might not be preferable for the Fund to have direct recourse to private markets for borrowing, Mr. Salehkhrou remarked. Moreover, the list of nonparticipant countries that might have access to the enlarged GAB seemed quite small, and the largest members on that list were already in the process of approaching the Fund and would be drawing heavily on the Fund's resources before the new GAB became effective. In the circumstances, it was likely that the GAB resources would be called upon only marginally in future and that the bulk of the assistance to other eligible nonparticipant countries would be directly supported by the Fund. Perhaps the Executive Board should consider ways of enabling the Fund to provide assistance to countries like Mexico, Brazil, and Argentina temporarily from its own resources and later to recoup the amounts of that assistance from the GAB resources when they became available. Such an approach would free

large amounts of resources for use by those countries that would be ineligible to benefit from the enlarged GAB. It should be recalled that a somewhat similar operation had been effected earlier in the year with respect to purchases under the supplementary financing facility and enlarged access. He would appreciate hearing staff comment on the feasibility of his proposal.

The Director of the Legal Department observed that parallel lenders would not be participants in the GAB. The decision establishing the GAB contained a provision under which other members of the Fund could become participants, but what was envisaged in the proposal by the Deputies of the Group of Ten was a separate agreement between the Fund and nonparticipants in the GAB under which those nonparticipants would undertake to lend to the Fund in the same way that participants did. Those lenders would then be able to count on Fund financing through the GAB if needed; in other words, the GAB could be activated for the benefit of purchases by parallel lenders in the same way that it could be activated for participants. If parallel lenders wished to make reserve tranche purchases, for example, the Fund would be able to activate the GAB for the purpose in the appropriate circumstances. The Fund would also be able to resort to GAB resources in order to finance an early repayment requested by a parallel lender in relation to resources that had been made available under the parallel agreement to participants or others.

There would in addition have to be some arrangement whereby the parallel lenders could be involved in the decision-making process in connection with the activation of the resources of the GAB for the benefit of members, the Director continued. The association of Switzerland with the GAB was different in various respects. For example, Switzerland was not a member of the Fund and therefore could not use the Fund's resources.

The suggestion by Mr. Salehkhov to retroactively apply the proposed arrangements to requests currently before the Executive Board by Argentina and Mexico would be possible under appropriate amendments to the arrangements, the Director noted. However, such an approach had not been envisaged in the conclusions of the Deputies of the Group of Ten at their meeting of December 10, 1982.

With respect to the relationship between the GAB and the principle of uniform treatment of members, the Director of the Legal Department observed that the question had been considered several years previously, at the time of the negotiation of the GAB, and the Fund had determined that the fact that the GAB resources could be used only to finance purchases by GAB participants did not make the arrangements inconsistent with the Articles. Since the current proposal was to make the General Arrangements to Borrow even less restrictive--in the sense that the resources could be made available, in certain special circumstances, also to nonparticipants--it would surely be less plausible to argue that, as revised, the GAB would be inconsistent with the principles of the Articles of Agreement.

Mr. Kabbaj remarked that it was up to the Executive Board to determine whether or not the latest proposal was consistent with the principle of uniformity of treatment of members. However, the criteria were such that the list of members eligible to use GAB resources was quite small so that, even if the arrangements were de jure consistent with the Articles of Agreement, they were de facto discriminatory.

Mr. Joyce said that it was his understanding of the conditions outlined in paragraph 4(ii) that there might be a group of countries--rather than an individual country--whose need placed a strain on the system and could therefore serve to trigger the activation of the GAB. In that sense, the list of countries to which Mr. Kabbaj had referred seemed to protect the entire membership of the Fund and not just a few very large countries.

The Treasurer agreed with Mr. Joyce that paragraph 4(ii) of the conclusions of the Deputies of the Group of Ten had been drafted to cover either a single request by a fairly large country or a series of requests or potential requests that, together, could materially worsen the Fund's liquidity and therefore trigger the activation of the GAB.

Mr. Erb agreed that the judgment of whether a situation posed a potential threat to the international monetary system would have to take account of the possibility that one or several countries might be faced with a balance of payments need of sufficient magnitude to trigger the GAB. The proposed GAB would not affect any member's ability to use Fund resources, whether or not it was a participant or a nonparticipant in the arrangement. Access to Fund resources by participants or nonparticipants in the GAB was determined on the basis of Fund criteria and procedures for conditionality. The GAB served only to enhance Fund resources in a way that would allow the Fund to respond to the needs of all members.

Mr. Kabbaj stated that, although, in principle, all members would continue to have access to the Fund, he was worried that their access might be reduced. The additional amounts to be made available under an expanded GAB were only comforting if all Fund members had access to them; but it was obvious that all members would not have access to those resources and that what was available to them might not be sufficient. Others had suggested that, should the need arise for more resources, the quotas could be increased; in his view, a larger increase in quotas could be justified at present.

The Treasurer replied that it was possible to envisage circumstances in which the conditions stipulated in paragraphs 4(i) and (ii) did not prevail but the Fund's liquidity was nevertheless under some pressure. The Fund was not in such circumstances prevented from replenishing its liquidity in other ways. The GAB, even if expanded, would not be the only arrangement under which the Fund could replenish its liquidity in extreme circumstances.

Mr. Finaish remarked that he had understood the concerns of Mr. Salehkhrou and Mr. Kabbaj in a different way. The steps for the activation of the GAB were such that the Managing Director would first need to make a judgment whether the criteria in paragraphs 4(i) and (ii) were evident, and he would then consult with the ten participants in the GAB. Afterward, the participants would decide among themselves whether the criteria had been met. Perhaps the fear of Mr. Kabbaj and Mr. Salehkhrou was that the participants might not agree with the Managing Director's assessment of the situation and that the arrangements might therefore not be activated. The problem was that the Executive Board would not be in full control of the situation, and accurate liquidity projections would therefore be difficult.

The Chairman observed that even if the participants decided not to activate the General Arrangement to Borrow, he would still bring members' requests to the Executive Board and would propose that those requests be financed. If the Fund's ordinary resources were insufficient to meet those requests, other sources of financing would have to be tapped, and, as noted by the Treasurer, the Fund was able to acquire resources in a number of ways.

Mr. Nimatallah asked whether Switzerland would participate in any decision on whether or not to activate the GAB.

The Director of the Legal Department replied that Switzerland was not, strictly speaking, a member of the Group of Ten and therefore had no vote in the Group's deliberations. However, it did attend meetings of the Group of Ten as an observer.

On the procedures for activating the General Arrangements to Borrow, one point had not been clarified in the conclusions in EBS/82/232, the Director noted. In consulting with the participants before bringing a proposal to them, the Managing Director would need to have an idea about potential demands on the Fund's resources. What was not clear was whether the Managing Director could make proposals for calls only in connection with requests actually received or also in regard to requests that he expected to receive.

Mr. Coene asked for clarification of whether the reference in the criteria to "an inadequacy of resources" referred only to owned resources. It was his understanding that the Fund did not need to exhaust all its borrowing possibilities before the GAB could be activated.

The Chairman confirmed Mr. Coene's understanding.

Mr. Prowse noted that the final sentence of paragraph 4 of EBS/82/232 stated that "activation of the GAB for the benefit of nonparticipants would need to pay due regard to potential calls on the arrangements for the purpose of financing purchases by participants." He assumed that the statement meant that participants would have some priority claims on the resources of the GAB. While not questioning the reasonableness of

such claims, he wondered how the amount of the potential calls on the arrangement would be determined, especially given the concern of some of his colleagues for the principle of uniformity of treatment.

The Treasurer replied that the requirement to pay due regard to potential calls on the arrangements for the purpose of financing purchases by participants did not mean that a distinction would be introduced with respect to purchases by Fund members who were participants or nonparticipants in the GAB except with respect to the source of Fund financing of their requests. It did not mean that participants in the GAB had a priority claim on GAB resources; it only meant that potential or pending purchases by a participant would have to be taken into account in any assessment of the Fund's liquidity and in any assessment of the amount that might be needed for a proposal by the Managing Director to activate the GAB. It also meant that, presumably, not all the assets could prudently be used for financing nonparticipants, although there would be a fair degree of leeway within the overall ceiling of SDR 15-20 billion. It was of course possible to envisage a situation in which no calls by GAB participants for the Fund's resources were expected, so that the Fund could make almost total use of the GAB resources for refinancing purchases of nonparticipants. If a participant should later approach the Fund for resources, the Fund would have to make provision for meeting that request from its own resources or through other arrangements.

Mr. Prowse said that he had not intended to suggest that the proposed revision and enlargement of the GAB was more discriminatory than the existing arrangements. The proposal was clearly one that would mean broader access to larger amounts of resources than at present, but that was not to say that the proposal was the optimum one. If a proposal to activate the GAB were rejected, the Managing Director would still bring a member's request to the Executive Board to be financed from the Fund's ordinary resources. The problem was that there might not be any ordinary resources available. Also, it was possible that the Group of Ten might reject a proposal for activating the GAB for use of resources by a nonparticipant by arguing that account had to be taken of potential calls from participants. In that respect, it was clear that participants did have a priority claim on GAB resources.

The Chairman observed that, in the circumstances described by Mr. Prowse, it would be up to the Executive Board to address the problem of the scarcity of the Fund's resources by revising its access policy in a way that would maintain the principle of uniformity.

Mr. Sigurdsson noted that the criteria in paragraph 4 differed in at least one respect from the current rules for activating the GAB in the sense that the use of GAB resources by nonparticipants was limited to requests for conditional financing. He wondered whether such a limitation was, strictly speaking, necessary; it seemed unlikely that any unconditional or low-conditional drawings by countries outside the Group of Ten would lead to the necessity for supplementing the Fund's resources. If that were to happen, some unnecessarily cumbersome bookkeeping might

be required. For example, a large country might wish, in certain circumstances to draw on its reserve tranche, in the first credit tranche, and under an extended arrangement. The Fund might then have to finance part of the requests from its own resources and part from the GAB.

The Chairman remarked that there was some logic to the approach taken by the Group of Ten. In a case in which a nonparticipant drew only its reserve tranche, it was unlikely that the criteria in paragraphs 4(i) or (ii) would be met, since the amount of the drawing would be unlikely to place a great strain on the system. It was true that participants would continue to be able to trigger activation of the GAB for the financing of reserve tranche purchases; however, their quotas were much larger. While the bookkeeping difficulty of the sort suggested by Mr. Sigurdsson could arise, no fundamental problems would be created.

Mr. Erb recalled that the language in paragraphs 4(i) and (ii) had been adopted after much discussion. Since countries would probably have to be using Fund resources in the upper credit tranches for the system to suffer any stress, one might argue that it was unnecessary to emphasize the point by referring to conditional financing. Indeed, at one point in the discussion, it had been suggested that the words "exceptional situation" would be sufficient. However, the response had been that the words "conditional financing" conveyed a sense of the importance of the criteria for activating the facility.

On the issue of uniformity of treatment, Mr. Erb noted that there was nothing preventing a GAB member from coming to the Fund and requesting a purchase under the extended Fund facility. As the General Arrangements to Borrow were currently defined, the resources of the GAB could not be used for an extended Fund facility program, although that did not prevent a GAB participant from negotiating such a program with the Fund. Still, such participants might have more reason to be concerned about their access to normal Fund resources than nonparticipants should have about access to GAB resources.

The Chairman wondered whether Mr. Erb's point would not justify a change in the GAB that would allow participants to activate the facility if they made requests for purchases under the extended Fund facility.

Mr. Erb replied that the Deputies of the Group of Ten had generally agreed not to change the GAB decision as it related to participants in order to avoid too many amendments to the decision. Still, the adjustment suggested by the Chairman might be useful at some stage.

The Director of the Legal Department recalled that the decision establishing the General Arrangements to Borrow permitted activation of the facility when any exchange transactions were involved. If, in the course of financing an extended arrangement, it was discovered that the Fund was unable to come up with the resources required, the Fund could approach the GAB participants and ask that they agree to utilize the GAB for particular exchange transactions.

The Executive Directors, after agreeing to continue their discussion later in the afternoon, adjourned at 12:55 p.m.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/160 (12/15/82) and EBM/82/161 (12/17/82).

3. BOLIVIA - 1982 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/82/308 (12/10/82). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1982 Article IV consultation with Bolivia until not later than January 10, 1983.

Decision No. 7271-(82/161), adopted
December 15, 1982

4. VANUATU - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII,
SECTIONS 2, 3, AND 4

The Fund notes that Vanuatu has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement as of December 1, 1982.

Decision No. 7272-(82/161), adopted
December 16, 1982

5. APPROVAL OF MINUTES

The minutes of Meetings 82/90 through 82/94 are approved.
(EBD/82/306, 12/9/82)

Adopted December 15, 1982

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/82/433 (12/14/82) and EBAP/82/435 (12/15/82) is approved.

APPROVED: May 20, 1983

LEO VAN HOUTVEN
Secretary

