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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/142

10:00 a.m., November 16, 1981

FILES

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

Executive Directors

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Y. A. Nimatallah
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A. R. G. Prowse

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J. S. Mair, Temporary
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F. Sangare
G. Winkelmann
C. P. Caranicas
A. Le Lorier
A. Alfidja

S. El-Khoury
T. de Vries

L. Vidvei
Tai Q.

L. Van Houtven, Secretary
J. A. Kay, Assistant

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Range of Potential Lenders Page 19
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Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; N. Abu-zobaa, Buu Hoan, J. A. Clement, A. G. A. Faria, C. A. François, E. K. Martey, B. R. H. S. Rajcoomar, S. L. Rothman, E. Sacerdoti, D. E. Syvrud, A. Tahari. Asian Department: J. Schulz. European Department: R. P. Kronenberg. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; A. Abisourour, S. Kanesa-Thanan, A. Pera. External Relations Department: H. Hartmann. IMF Institute: C. Tognetti; O. Kassogue, Participant. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; S. A. Silard. Middle Eastern Department: F. Drees. Research Department: W. C. Hood, Economic Counsellor and Director. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; R. J. Familton, Deputy Treasurer; D. Williams, Deputy Treasurer; A. W. Lake, M. A. Tareen, G. Wittich. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: C. J. Batliwalla, C. Bouchard, A. B. Diao, G. Jauregui, P. D. Peroz, F. A. Turrelles, Wang E., F. Yeo T. Y. Assistants to Executive Directors: M. J. Callaghan, L. E. J. Coene, R. J. J. Costa, M. K. Diallo, F. G. Guena, J. M. Jones, P. Kohnert, S.-W. Kwon, J. E. Leimone, M. Michelangeli, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. D. Pedersen, J. Schuijjer, D. I. S. Shaw, H. Suzuki, O. Üçer, J. F. Williams, A. Yasserli, A. A. Yousef.

1. COMOROS - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV Consultation with the Comoros (SM/81/188, 9/24/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in the Comoros (SM/81/189; 9/28/81, and Cor. 1, 11/13/81).

The staff representative from the IMF Institute, leader of the mission, mentioned that the Comorian authorities had requested the use of Fund resources, and that a staff team would be leaving Washington within a week.

Mr. Alfidja made the following statement:

On behalf of this chair and of my Comorian authorities, I would like to thank the staff for the excellent and concise papers before us.

As we stated during the discussion of the 1979 Article IV consultation last year, the staff deserves special credit as the Comoros, like many other newly independent countries, has a very serious lack of up-to-date basic statistical data. We are confident that this handicap will be overcome as time goes by, particularly since the Comoros are benefiting from very efficient and dedicated technical assistance from our institution and from friendly countries. I have been instructed to convey to the management of the Fund and to the representatives of these friendly countries the great appreciation of my Comorian authorities. The staff report is a very fair presentation of recent economic and financial developments in the Comoros; it also describes the considerable physical, climatic, and geographical constraints against which the Comorian authorities have to struggle for economic development.

After a remarkable performance in 1979, the economy has been experiencing very serious difficulties in 1980 and 1981. During these two years, the growth in real GDP has fallen noticeably to levels hardly allowing for any significant increase in the standard of living of the population (4 per cent for the rate of growth of GDP against 3 per cent annual increase of the population). This poor performance is mainly traceable to adverse weather conditions in an economy essentially based on agriculture, as well as to unfavorable developments in world market prices for the Comoros' main export crops and some of its vital imports.

The widening of the resource gap (in fact its quasi-doubling between 1979 and 1980) is of particular concern for my authorities since they are fully aware that such dependence upon external financing cannot be sustained in present circumstances. They are therefore committed to introducing the necessary adjustment measures to improve the domestic financing of their economy by increasing domestic food production and by diversifying the economy.

On the fiscal side, where the bulk of revenue remains dependent on developments in foreign trade, the authorities agree that no significant change can be achieved unless they implement measures tending to widen the tax base, to fight tax evasion, and to improve tax administration and collection within the federation and the governorates.

On this latter point, my authorities do not share the staff belief--expressed throughout the report and in its appraisal--that unifying tax administration and collection would be a major step toward a substantial improvement in fiscal revenue. Not only might such a move raise some constitutional questions under the federal organization of the archipelago, but it also seems to the authorities too early to pass judgment on a system that has operated for only two years. They believe, and rightly so, that at this juncture what is really needed is a strengthening, and in particular adequate staffing, of the present units at both federal and regional levels.

Despite the crucial necessity of rebuilding the administrative infrastructure, the austerity measures already undertaken in 1981 and those contemplated under the 1982 budget indicate clearly the authorities' determination to contain expenditures at a level compatible with the prospects for revenue and external financing. The Comorian authorities agree with the staff that improvement in the performance of public enterprises is crucial to any adjustment process. They have therefore asked all public enterprises to draw up a complete statement of claims and indebtedness to serve as a basis for their settlement. They have also initiated actions to improve the staffing, the management, and the pricing policies of these enterprises.

The implementation of all these policies, together with the establishment of an a priori control over all federal government expenditures, will make it possible for the authorities to stabilize the level of internal and external arrears with a view to eliminating them as soon as possible.

The credit and monetary policies, which have been somewhat expansionary during recent years, are expected to follow a more restrictive and orderly stance in the years to come, thanks to the timely establishment of the new Central Bank and the improvement in the functioning of the banking system. The authorities intend to make full use of this new institution as well as of the whole set of monetary and credit instruments now available to them. In this regard, they are seriously considering the present interest rate structure in order to make it conducive to the more efficient allocation and mobilization of resources. They will thus, to some extent, encourage local business to repatriate funds currently being held abroad and stimulate financing savings.

As far as the external sector is concerned, the Comoros constitutes a typical example of a country that has to revamp its whole export sector because of increasingly stiff competition from artificial substitutes in the developed countries. Such a process will take time and can only be achieved with the help of heavy and sustained capital inflows. Without any doubt, our institution has a significant role to play, not only in terms of the technical assistance to which I referred earlier, but also in terms of financial resources.

Miss Le Lorier stated that she welcomed the Article IV consultation with the Comoros, which provided the Fund with a good opportunity to review the economy of the country. It was clear that the country was one of the least developed, and that it was beset by all the problems often found in developing countries. In addition, it consisted of a number of separate islands and was remote from trading centers. There were also a number of domestic difficulties that had seriously hampered previous efforts at breaking the vicious circle of underdevelopment. Population growth--one of the highest in the world--was among them, but over the medium term the most serious seemed to be the instability of export earnings, derived almost entirely from vanilla, ylang-ylang, and copra, which together made up more than 90 per cent of total exports. The staff had given a good account of the variability of export earnings in Table 15 on page 45 of SM/81/189. In view of the fluctuations in world commodity prices, the objectives of the present medium-term development program, which included the establishment of self-sufficiency in food production, the diversification of exports, and the improvement of communications, seemed entirely appropriate. Unfortunately, domestic resources could make no more than a marginal contribution to the implementation of the development plan, and the country would remain largely dependent on external aid. Two positive steps had been the enactment of the investment code and the establishment of a new development bank. It did seem clear however that development efforts could be significantly enhanced by a rapid improvement in the efficiency of the economy and the mobilization of resources.

The staff had mentioned several steps designed to improve efficiency, particularly in the fiscal field, Miss Le Lorier noted. However, it was not always easy to discover the extent to which the measures were expected to improve the situation or the time in which they were expected to do so. She wondered, for instance, what was expected from the circular distributed by the Minister of Finance setting guidelines and emphasizing austerity and realism in limiting expenditure growth and in estimating revenue. She also wondered about the role of the new General Directorate of Taxes, which the authorities appeared to consider as an essential element of any efficient fiscal system. More forceful action in that field was certainly essential, particularly in view of the permanent weakness of the public finances, which had traditionally relied on a high level of external grants. She would be interested to know whether any technical assistance from the Fund was contemplated at present. Just as important as technical efficiency was the need for political will. The

maintenance of four independent tax collection agencies implied administrative costs that no economic rationale could justify; it was rather disappointing that no corrective action seemed to be envisaged in the near future.

On the monetary side, Miss Le Lorier observed, the Comorian authorities maintained an exchange system that was free of restrictions on payments and transfers for current international transactions, and for that they should be commended. Nevertheless, the authorities had decided to liquidate the single existing commercial bank and to establish a new one. Further information on that point would be welcome. Following a surplus in 1978 and 1979 the overall balance of payments had fallen into deficit in 1980 and would do so again in 1981, when there would also be a substantial amount of payments arrears. In view of its balance of payments problems, the Comoros would do well to seek the use of Fund resources by establishing an appropriate financial program.

Mr. Abiad considered that the staff paper had made it clear that the Comorian authorities had been making determined efforts to reduce the economic and financial imbalances in the economy, and to lay the groundwork for a viable and sustainable growth in the long run. The attainment of those objectives was made more difficult by the country's narrow resource base and the lack of essential infrastructure. These circumstances underlined the need for a careful allocation of scarce resources. The authorities' awareness of that need was made evident by the emphasis they had been placing in recent years on promoting agricultural production as a way of reducing reliance on imports. While some progress had been made, much remained to be done in terms of offering production incentives and improving marketing techniques. However, success in those fields would largely depend on improvements in infrastructure, which were also required if the best possible use was to be made of the potential in fishing and tourism. The realization of those improvements depended in turn on the availability of adequate financing; in view of the limited resource base and the low level of domestic income, most of it would have to be secured from external resources on concessional terms.

So far as public finances were concerned, Mr. Abiad went on, the authorities had announced vigorous measures to arrest the fiscal deterioration experienced in 1979 and 1980, through exerting greater control over expenditure and improving the tax collection system. In addition to the recent establishment of a General Directorate of Taxes, they had brought about the introduction of a turnover tax. It was not clear, however, whether those measures were part of the recommendations formulated by the Fund mission in early 1980, and he would welcome an explanation of precisely what those recommendations had been. In any event, a considerable gap in the Government's financing remained and would unavoidably have to be filled at least in part by external grants.

On the monetary side, Mr. Abiad observed, the inauguration of the Central Bank and the restructuring of the banking system were expected to contribute to enhancing the effectiveness of monetary policy and

credit allocation. Moreover, an improvement in banking services was, in the country's circumstances, at least as important in mobilizing domestic savings as any change in the interest rate structure.

Developments in the external sector in 1980 had included the deterioration of the overall balance, reflecting a serious decline in the country's terms of trade, Mr. Abiad noted. The staff expected a similar situation at the end of 1981. Available data suggested that the need to establish the viability of the external position in the longer run called for intensive efforts to encourage import substitution, diversify production, and expand export markets. He had noticed with interest the staff's remark that use of Fund resources was being discussed. He hoped that the discussion would open the way for fruitful cooperation with the Fund.

Mr. El-Khoury observed that the Comoros was a country with a very limited resource base, and that both its budget and its balance of payments were heavily dependent on foreign aid. The authorities had taken steps within the medium-term development plan to reduce that dependency, to develop their domestic resource base, and to promote exports and reduce the growth in imports. On the fiscal side they had, during 1981, taken measures aimed at strengthening revenues and limiting the growth in expenditures, for which they were to be commended. Nevertheless, he agreed with the staff that more needed to be done in the fiscal area.

Given the scarcity of managerial skills and the limited statistical data base, Mr. El-Khoury went on, he was glad to note that the Fund had an active technical assistance program with the Comoros. He hoped that the program could be maintained for some considerable time and, if need be, intensified. The Comoros was a small developing country that was experiencing structural bottlenecks, which imposed a heavy burden on the balance of payments. It was, for instance, mainly the lack of port facilities that was causing some import payments to be so high, although geographical location was also a problem. Table 14 on page 42 of SM/81/189 showed that freight and insurance on merchandise amounted to some 40 per cent of imports f.o.b., and to more than two thirds of the country's exports. That seemed rather a high burden for any country to pay. He hoped that the authorities could achieve rapid progress in their efforts to improve the port facilities and the means of transportation.

Concerning the tax administration, which was clearly causing some concern, Mr. El-Khoury inquired whether the Fund's technical assistance mission had reviewed the problem, and whether it had concluded that the administration of the various governorates should be incorporated into one. Second, he noted that the state enterprises were to submit financial statements to the Government by September 1, 1981, and he wondered whether they had in fact done so.

Mr. Prowse observed that much of what Mr. El-Khoury said reflected his views also. He welcomed the Comoros' desire to make use of the Fund's resources and the forthcoming departure of a mission to Moroni. He welcomed the positive steps already taken by the Comorian authorities;

the tax administration was clearly a fundamental problem, but equally clearly it was already receiving consideration. Among other matters that might require attention was pricing policy in relation to the stimulation of agricultural output, a point on which the staff had not given much information. There was also a dearth of information on interest rate policy, although that was a matter of evident concern.

He noted, Mr. Prowse went on, that the authorities intended to establish a new commercial bank. He also noted from page 7 of SM/81/188 that the staff considered it essential to review the use of monetary policy instruments and to exert more control over the expansion of credit. He would therefore be interested to know how the authorities proposed to control the creation of credit and the lending policies of the proposed new commercial bank. As to the country's external finances, he noted that the Comorian franc was pegged to the French franc. Insofar as the Comoros was an extension of the French economy, such an arrangement might cause no particular difficulty. However, the Comoros did have to trade in world markets and the question of a more flexible independent exchange rate might well be considered for the future.

The staff representative from the IMF Institute, leader of the mission, replying to questions, explained that the aim of the authorities was to try to achieve a rough balance in the 1982 budget between expenditures and resources available, and thus to avoid increasing net arrears. The Minister of Finance had therefore reduced the budgeted rate of increase in expenditure estimates for 1982 quite considerably. The establishment of a General Directorate of Taxes and the unification of the tax system had been one of the recommendations of the Fund technical assistance mission in 1980. Like Mr. Alfidja, he recognized that the proposal for a unified tax system was a delicate matter, particularly at the present point in the Comoros' history; but the staff believed that the unification of the tax system would contribute substantially to an improvement in the fiscal situation. Another recommendation of the 1980 technical assistance mission had been the establishment of a turnover tax, which had in fact been introduced; in due course, this tax should furnish substantial amounts of revenue. The present commercial bank had suffered from weak management and undertrained staff, and had accumulated a substantial volume of unrecoverable loans. The Comorian authorities had invited a foreign bank to establish a new commercial bank. The delay in so doing had been caused by failure to agree on which agency would pay for the unrecoverable loans contracted by the existing bank. Although the estimates of their volume varied substantially, agreement seems now to have been reached on a specific amount; available information indicated that the Government was putting up CFAF 120 million to pay for part of irrecoverable loans.

An Executive Director had raised the question about pricing policy in the Comoros, the staff representative recalled. The staff had said very little on that point because pricing policy was hardly enforceable either for consumers or for producers. Communication problems not only existed between Comoros and the outer world, but also within the islands.

Without the provision of a great deal of infrastructure, it was difficult to see either how crops could be properly marketed or how pricing policy could be enforced. The statute of the new Central Bank contained provisions which allowed very strict control over the supply of credit, so that it did not seem likely that the establishment of a new commercial bank would lead to undue credit expansion. The policy of financing certain crops and essential imports may at times give rise to temporary excessive credit expansion; the mission had suggested the use of reserve requirements to lessen this possibility.

Mr. Alfidja explained that the federal budget for 1982 had already been completed, and that one of the tasks of the Fund mission about to leave for the Comoros would be to review it. The budget contained major changes and had already been submitted to the National Assembly. Its implementation would, however, await the arrival of the mission.

He had mentioned the matter of tax unification in his opening remarks, Mr. Alfidja explained, because it was a sensitive political issue and not merely a technical problem. The inhabitants of the Comoros Islands had adopted a federal constitution, and they were negotiating for the return of another of the islands to the federation. Moreover, the existing tax collection system had been in place less than two years. It was really impossible to say at present that it was not working well. Given the limited resources of the country it would not be reasonable to exclude the possibility of going over to a unified tax system; but it was a proposal that would be very difficult to promote in some parts of the archipelago. Consequently, in documents that would be distributed outside the Fund he hoped that particular care would be taken to avoid using language that gave the impression that the Fund was pushing in one direction or the other. It would be unwise for the Fund to become involved in the issue and he hoped that it would not be found necessary to push too hard on the matter in the forthcoming negotiations. The remarks by Executive Directors had been most valuable, and he would certainly transmit them to his authorities in the Comoros.

After some discussion, the staff representative from the Exchange and Trade Relations Department remarked that it would not seem proper or practical for the Fund to offer suggestions that went against provisions enshrined in the constitution of any Fund member. In the present instance, there had apparently been a ruling by the Supreme Court of the Comoros to the effect that any proposal to unify the tax system would be in contravention of the constitution.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the views expressed in the staff appraisal for the 1981 Article IV consultation with the Comoros. Directors commended the Government for efforts being made to improve the economic infrastructure and the administrative machinery of government. But they noted that the

existing internal and external financial imbalances are unsustainable and stressed the importance of adopting comprehensive measures to correct the financial disequilibria, particularly in government operations.

To this end Directors emphasized the need to reinforce tax administration and collection. They considered that on technical grounds there was a case for simplification of the system of tax administration and collection.

They also stressed the need to put in place effective machinery to control expenditures within and outside the budget, and to improve the management and pricing policies of the public enterprises.

Directors supported the provision of Fund technical assistance in the areas of its competence. A tightening of monetary policy, including the adoption of more realistic interest rates, was also recommended by some. Directors agreed that the economy will have to continue to rely substantially on external resources on concessional terms because the Comoros is among the poorest countries in the world. But they also emphasized that complementary domestic resources will need to be mobilized.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with the Comoros, in the light of the 1981 Article IV consultation with the Comoros concluded under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that the Comoros continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 6988-(81/142), adopted
November 16, 1981

2. MALI - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Mali (SM/81/206, 10/29/81) together with a proposed decision concluding the 1981 Article XIV consultation. They also had before them a report on recent economic developments in Mali (SM/81/216, 11/9/81).

Mr. Alfidja made the following statement:

At the outset and on behalf of my Malian authorities, I would like to thank the staff for its clear and concise presentation of the current economic and financial situation in Mali. My authorities and I are in broad agreement with the staff analysis and appraisal, which we find to be well balanced and thoughtful. I would like to point out before going any further that the excellent staff reports before us today must be seen in the context of regular contacts and long and frank discussions between the Fund management and staff on the one hand and the Malian authorities on the other. These contacts and discussions have led to the elaboration of a stabilization program, which hopefully will be submitted shortly to the Board for approval; to this end, my Malian authorities are awaiting the arrival of a Fund staff mission in Bamako next week, with a view to finalizing the program. As a matter of fact, and as is clearly stated in the staff report before us, the authorities have already adopted and started implementing measures that adequately address the country's current economic and financial difficulties. By so doing, the authorities strongly wish not only to express their determined efforts to tackle the difficulties in a strong and up front fashion, but also to ensure that some shortcomings in implementing programs in the past do not undermine confidence in the country and lead to an unfavorable prejudgment on the country's ability to make the required adjustment efforts in the future.

The economic and financial difficulties plaguing the Malian economy over the past several years are rather well known to the Board and are clearly stated in both the paper on recent economic developments and the staff report before us. These difficulties have rightly been attributed to the adverse Sahelian climate and unfavorable trends in the international economy on the one hand, and to the economic and financial policies of the Malian authorities over the period under review on the other. The authorities are fully aware that the country's current financial imbalances cannot be sustained and that strong remedial action is called for to bring about the required structural adjustment in the national economy. While adhering to their fundamental objective of bringing about a rapid and equitable socioeconomic development in Mali, the authorities have had the political courage to recognize that some of the policy instruments adopted in the past with a view to achieving that objective failed to yield satisfactory results, and thus were inadequate. Accordingly, the authorities did not hesitate to take remedial action. They have reassessed their economic policies and priorities and since 1980 have taken serious and concrete measures with a view to bringing about the realization of an acceptable rate of economic growth and a sustainable medium-term balance of payments position. This would at the same time allow Mali to consolidate its economic weight and fully play its important role in the region.

The new policy orientation is spelled out in the Five-Year Development Plan covering the 1981-85 period and stresses efficiency in resource allocation and in overall economic management. It gives a clear indication of the determined intention of the authorities to strike a balance between the roles of the public and private sectors in the national economy. The authorities are of the view that the private sector should be encouraged to play a determinant role in the country. Actions to this end are high on the authorities' priority list.

Regarding growth and development, the stated overall objective calls for a substantial increase in investment outlays with a view to expanding the productive base of the economy. Utmost priority will continue to be given to the agricultural sector so as to increase agricultural output for domestic consumption as well as for export. In this field, the authorities' goals are to bring about self-sufficiency in foodstuffs, to achieve an adequate control and development of water resources, to consolidate and set up the efforts aimed at rebuilding the livestock herd, which suffered heavy losses during the protracted Sahelian droughts, and finally to keep under check the advances of the Sahara desert. The authorities expect to significantly raise agricultural production through positive pricing policies and improved extension services and marketing networks. Indeed, they already have brought producer prices in line with the prevailing levels in neighboring countries and are fully committed to ensuring that these prices stay at levels that are sufficiently remunerative to stimulate agricultural production. Government monopoly over the marketing of cereals will be abolished shortly, and trade in these commodities has been liberalized since February 1981 while further increases in official retail prices to better reflect market conditions are under serious consideration. Another important measure taken by the authorities relates to the restructuring of the agricultural marketing board (OPAM - Office des Produits Agricoles du Mali) with technical assistance from the World Bank. The objective is to have OPAM play a buffer stock role, stabilizing prices at reasonable levels and ensuring that supplies are made available from surplus to deficit regions of the country. The World Bank is also providing technical assistance in the reorganization and restructuring of all agencies relating to rural development with a view to increasing the efficiency of the different activities of these agencies. Another corrective action undertaken by the authorities in 1980 relates to the program to restructure the entire apparatus of public enterprises so as to re-establish financial equilibrium by 1985. The authorities have made significant progress in the implementation of this program and more positive results are expected.

With respect to domestic financial policies, the Malian authorities concur with the staff that improvement in the financial situation hinges upon positive results being achieved on the fiscal front. It is in this regard that the all-out efforts to restructure the public enterprises have been undertaken.

In the fiscal field, the authorities are fully committed to the creation of all the conditions that are necessary for a strong fiscal performance. On the revenue side, measures have been taken and others are being contemplated with a view to making the tax system more buoyant, efficient, and equitable. Efforts are aimed at improving tax collection and administration, and the authorities have made necessary arrangements with France for the training of tax specialists and tax inspectors. The authorities have also received appreciable technical assistance from the Fund in the fiscal field, which they will undoubtedly put to good use. On the expenditure side, the authorities recognize the need to centralize the different elements of the national budget so as to allow the sound utilization of the budget as an effective instrument for economic management. The authorities recognize that strict demand management policies are called for, and they are fully prepared to adopt and implement such policies. Emphasis has been and will continue to be placed on cutting down subsidies to public enterprises. The authorities are optimistic that this objective will be met through the process of restructuring the public enterprises and through the liberalization of the pricing system applicable to these enterprises. The educational system and the policies related to it exert a heavy burden on the Malian budget. The authorities have taken corrective measures to minimize this burden. Indeed, scholarships will now be allocated on the basis of a predetermined budgetary outlay, contrary to past practice whereby the number of scholarships determined the amount allocated to them in the budget. The authorities also intend to keep government expenditures at practically the same nominal level as in 1980 through a tighter control of government outlays and government hiring.

On the monetary side, the authorities are committed to following a more cautious policy stance. The accommodating credit policies of the past have been replaced by a much stricter stance in order to alleviate pressures on the balance of payments. Indeed, the tighter monetary policies initiated in 1980 are continued in 1981 with total credit to Government being allowed to expand by only 10 per cent and total net domestic credit by 12 per cent.

On the external front, Mali has been experiencing acute payments imbalances, the causes of which have been identified in the staff papers. The authorities are fully determined to tackle the structural weaknesses of the external sector in a strong and up-front fashion. The restructuring of the agricultural agencies and other relevant public enterprises will without doubt help to revitalize the exports sector. Moreover, the pending membership to the West African Monetary Union will also help alleviate the payments difficulties Mali has faced over the period under review.

With respect to the payments and trade system, Mali remains committed to pursue and maintain a liberal system. The delays in external payments being experienced are simply due to the restrictive credit policy of the Central Bank and thus do not reflect official restrictions on payments.

Mr. Sangare commented that the picture of economic affairs in Mali given by the staff was not a particularly happy one. Although gross domestic product had grown at a compound rate of 4.6 per cent between 1972 and the end of the decade, the growth rate had been negative in 1980 and was expected to be so in 1981. The growth of expenditure had far exceeded that of revenue, and the country's reliance on external sources for budget support had been increasing almost yearly. The external payments position remained weak. The position was aggravated by a weakening of the tax administration, the devotion of a disproportionate share of budget expenditure to the payment of government officials, and weak performance by the parastatal organizations. There were of course also factors over which the authorities had no control, including higher import costs, continued worsening of the terms of trade, and recurring adverse weather conditions. He was glad that the authorities had become aware of the situation and that they had begun to adopt policies aimed at putting the economy on an even keel. In the Development Plan for 1981/85 private sector participation in all economic activities was to be permitted, a number of public companies would be allowed to revert to private ownership, and--more important--the share of public expenditure relative to aggregate demand would be reduced.

The authorities' decision to increase agricultural producer prices sharply to the levels prevailing in neighboring countries was a welcome step in the right direction, Mr. Sangare observed. The action should reduce the incidence of smuggling agricultural commodities across the borders, thus not only increasing foreign exchange earnings but also boosting output. The restructuring of the parastatal organizations, and the possible closure of those that were not economically viable, would not only improve their efficiency and reduce the burden of the budget, but ultimately strengthen the Government's financial position. While he noted the authorities' intention to reduce the budget deficit by cutting expenditure, his own view was that in view of the pressing need for sustained growth in the economy, the authorities would need to spend more of the available resources on productive investment. In order to be able to do so, they should take a hard look at their recruitment and remuneration policy. He therefore welcomed the intention to limit the recruitment of new employees to essential services. Additional efforts were also called for in connection with tax administration, including a broadening of the income tax base in order to bring the self-employed into the tax net. A situation where the bulk of the income tax burden fell largely on wage earners could hardly be sustained for long, particularly when real wages were falling. Nor could such an arrangement be expected to generate sufficient revenue to meet the present financial needs of the Government. The staff mentioned that the authorities

intended to rely very largely on specific rather than on ad valorem taxes, and that they had thus robbed the tax system of any elasticity. The authorities ought to take a serious look at that matter.

Mali's external payments arrears had stood at SDR 37.6 million in 1980, Mr. Sangare commented. Given the current economic and financial situation, it would be asking too much to expect a quick rundown of those arrears in the absence of external financial assistance. He therefore hoped that the international community would appreciate the problems and provide Mali with financial assistance to allow the authorities to buy time, during which the measures already adopted might start to show positive results. It was particularly satisfactory that the Fund intended to enter into negotiations with Mali with a view to the establishment of a stabilization program.

Miss Le Lorier remarked that the staff paper gave a clear description of Mali's economic and financial problems at a time when the authorities had begun to take significant steps designed to improve the efficiency of an economy that had been growing at a rate well below its potential for a number of years. It was also appropriate to hold a consultation with Mali when the country was about to become a member of the West African Monetary Union.

During the past few years Mali had been experiencing an increasingly difficult time, largely due to matters beyond the control of the authorities, such as frequent droughts, Miss Le Lorier stated. On the external side, the current account deficit had reached 19 per cent of GDP in 1980, while the overall balance of payments deficit had reached some 25 per cent of annual exports by the end of December 1980 and was partly being financed through the accumulation of arrears. There seemed little chance of an improvement during 1981, so that the external constraints on development could hardly be expected to ease for some time to come. It was therefore unfortunate that the allocation and mobilization of domestic resources should have been rather weak. The revenue performance had been disappointing and there had been a lack of controls over expenditure. For instance, expenditure on the compensation of employees seemed to be equal to total budget revenues. Similarly, there had been a growing lack of liquidity in the Treasury, which at times had been so bad that it had prevented public entities or private firms from making use of the funds they had deposited with the Treasury or with the postal checking system. It was against such a background that the new policies aimed at reviving agricultural production, rehabilitating key public enterprises, and reducing the treasury deficits to sustainable levels ought to be examined. Among the steps already taken, she had noted with satisfaction the provision of better incentives and an improvement in extension services and marketing arrangements for agriculture. The recent increase in official agricultural producer prices to levels that were consistent with those prevailing in neighboring countries and the liberalization of the marketing of cereals were both welcome.

In the fiscal sector, Miss Le Lorier commented, she had noted the introduction of a number of measures during 1981 intended to reduce the treasury deficit from 4.3 per cent to 2 per cent of GDP. While the measures did seem to be having the desired effect, further progress seemed to require additional reforms that could only be carried out with external assistance. She only hoped that the reforms could be carried out reasonably soon. What was worrying was that the economy as a whole did not seem likely to make much progress without major reforms in agriculture, public enterprises, and investment planning, and that such reforms seemed to be still some way off. Decisive action in all the fields she had mentioned was vital.

She welcomed the intention of the Government of Mali to join the West African Monetary Union as a means of improving monetary discipline, introducing a stronger financial structure, and maintaining an exchange system that was free of restrictions on current international payments and transfers, Miss Le Lorier said. The financial steps that her authorities were in the process of completing would enable Mali to join the monetary union in a smooth and timely fashion. In view of the efforts already made by the authorities, she hoped that in due course the Fund could make its resources available to Mali, and that the negotiations between Mali and the Fund would be completed soon.

Mr. El-Khoury recalled that the previous Article IV consultation with Mali had taken place more than two years previously. Throughout almost the whole of the 1970s Mali had suffered from economic and financial difficulties, and the corrective policies that had been introduced since 1980 were welcome. Of particular importance were the policies relating to the reform of the financial operations of the public sector. He was particularly glad to see from the staff report that the authorities intended to encourage more private participation in the economy, and to convert certain public enterprises into mixed or private companies. In general, he agreed with the staff appraisal to the effect that the corrective policies taken so far were commendable and that the authorities' efforts would have to be sustained, if not increased in the future. He had been glad to hear Mr. Alfidja say that the Fund and the authorities were near an agreement for a stabilization program.

He noted that the staff seemed to be quite positive about the advantages of Mali joining the West African Monetary Union, Mr. El-Khoury went on. Without wishing to discuss the general issue of monetary unions at the present time, he would welcome hearing the pros and cons of the step from the staff. It would be particularly interesting to know what made the Malian authorities decide to join the union.

The staff representative from the African Department observed that the decision by the Malian authorities to join the West African Monetary Union should be viewed as a step in a fairly long historical process. As early as May 1967 Mali had decided to re-enter the French franc zone. It had done so at a time when the country was experiencing difficulties as a result of its attempts to manage an independent monetary and exchange

policy during the previous five years. It had encountered acute balance of payments difficulties, capital outflows, intensive and inefficient exchange restrictions, and a 50 per cent devaluation. The bilateral monetary arrangement with France, entered into in May 1967, was intended to be temporary, and both the Malian and the French authorities agreed that the time had come for Mali to join the West African Monetary Union. The present decision by the Malian authorities represented therefore only a shift from a bilateral monetary union into a multilateral monetary union. The staff believed that Mali's participation in the West African Monetary Union would ensure, first, adherence to a certain degree of monetary discipline, and second, the maintenance of an exchange system that was free of restrictions for current transactions. Moreover, in order to be in a position to accept the necessary monetary discipline, the Malian authorities would have to accelerate their program for rehabilitating public enterprises, reducing the role of the public sector, and cutting down the budget disequilibrium. Once Mali was in a position to respect the rules of the West African Monetary Union, it would receive substantial assistance in enlarging the capital base of some of the private enterprises and shoring up the banking system.

Some Executive Directors, the staff representative went on, might have reservations with respect to certain of the current policies of the West African Monetary Union, notably the exchange rate and the interest rate. So far as the exchange rate was concerned, the staff believed that the rate for the Mali franc was appropriate, and that Mali's export performance over the past two years had been quite satisfactory. Indeed, Mali's share of total exports of cotton and livestock had increased despite a cooling off of the world prices. Moreover, the authorities in Mali had been able to increase producer prices domestically by freezing the profit margins of the public enterprises that handled the marketing. It was true that the interest rate not only in Mali but in the whole of the West African Monetary Union might not be high enough. It was certainly lower than the interest rate prevailing in France. Nevertheless, when Mali joined the union, the interest rate in Mali itself would increase substantially, and that was an important step: for instance, the discount rate would rise from 6 per cent to 10.5 per cent.

Mr. Alfidja stated that the negotiations for Mali to join the West African Monetary Union were going smoothly; he expected the Heads of State of the union to meet before the end of 1981 to finalize the agreement, which had already been the subject of accord on the technical level. He hoped that, after such an exhaustive discussion, the forthcoming Fund mission to Mali would make it possible to conclude an arrangement between the authorities and the Fund.

The Chairman noted that Mali had for several years been a member of the franc zone through its bilateral relationship with France. The Malian Central Bank had been jointly managed by Malians and French franc authorities, and Mali had had an operational account with the French Treasury. Thus, while Mali had not been part of the multinational system embodied in the West African Monetary Union, it had been attached to the

same intervention currency. However, throughout the period of bilateral association with France, Mali had been accumulating a considerable debt vis-à-vis the French Treasury. One of the advantages for Mali in joining the West African Monetary Union was that the French authorities would wipe out the accumulated debt, which amounted to SDR 171 million, or twice Mali's quota. Moreover, the financial discipline that would apply within the West African Monetary Union would be different from that which had applied in the bilateral relation with France. In particular, the deficits incurred by one country were scrutinized carefully by all the other members. But in general terms, Mali's monetary affairs would not be handled in a very different manner by the West African Monetary Union from the way in which they had been handled during the period of the bilateral agreement with France.

The Chairman made the following summing up:

Executive Directors generally concurred with the thrust of the views contained in the staff appraisal for the 1981 Article IV consultation with Mali. While recognizing that Mali has been adversely affected by recurrent droughts and a sharp deterioration in the terms of trade, they commented that the persistent economic difficulties stemmed also from unsatisfactory economic and financial management over a number of years, particularly in the areas of public finance, state-owned enterprises, and pricing policy.

Directors noted with satisfaction that the authorities, in cooperation with the Fund and the World Bank, have conducted a comprehensive re-examination of their policies and have embarked on a major effort to reduce financial imbalances and to promote a sustainable rate of growth over the medium term through substantial improvements in economic and financial management, domestic savings, and investment planning.

Directors commended the authorities for effectively implementing adjustment policies and reforms during 1981, for pursuing a moderate credit policy, and for having increased producer prices, especially in the agricultural field.

Directors felt that in order to achieve the stated objectives of government policy, it was essential to restrain further public expenditures other than for productive investment, to introduce greater effectiveness in the operations of public enterprises and government agencies, to adopt realistic pricing policies, and to encourage private initiative. The importance of gradually eliminating current payments arrears was also stressed.

Given the structural character of the existing difficulties and the social constraints, the authorities would have to show great resolve over a number of years in implementing the necessary reforms. Major structural adjustment measures would need to be

implemented. Directors hoped that the authorities would be in a position during 1982 to implement comprehensive and reinforced adjustment measures, which could in the end be supported by the use of Fund resources.

The prospective reintegration of Mali into the West African Monetary Union was noted.

The Executive Board then took the following decision:

Decision concluding 1981 Article XIV Consultation:

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with Mali, in the light of the 1981 Article IV consultation with Mali conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Mali continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions, and urges the authorities to take early action to terminate the remaining bilateral payments agreements with Fund members.

Decision No. 6989-(81/142), adopted
November 16, 1981

3. BORROWING - CENTRAL BANKS AND MONETARY AUTHORITIES - RANGE OF
POTENTIAL LENDERS

The Executive Directors considered a paper on the range of potential lenders in connection with the Fund's borrowing program (EBS/81/217, 11/2/81).

The Treasurer explained that Executive Directors had put a number of questions to him prior to the meeting. One of those had been how much would be involved, and how many members would be affected. While it was difficult to be precise on either point, there were a number of members who were indebted to the Fund or whose currency was at present not judged by the Executive Board to be sufficiently strong for inclusion in the currency budget that would be willing to enter into borrowing arrangements with the Fund. The total figure might be somewhere between SDR 200 million and SDR 750 million. The amount was not very large in comparison with the Fund's needs; but in view of the Executive Board's preference for borrowing from official sources, it was not to be ignored. There was one oil exporting country whose balance of payments and reserve positions might not be considered strong enough to allow it to be included in the operational budget which would yet be able and willing to lend the Fund a considerable amount. Another question that had been raised was whether

the Fund did at present have borrowing arrangements with members whose balance of payments and reserve positions were not considered sufficiently strong to be included in the operational budget. The Fund did indeed have four short-term borrowing arrangements and at least three long-term borrowing arrangements with members in that position. In addition, there were two other members, indebted to the Fund, that made resources available to the Fund either directly or indirectly. One was considered sufficiently strong for inclusion in the operational budget, and the other lent resources to the Fund through the Bank for International Settlements.

Mr. Erb said that he understood the staff's interest in having as broad a range of potential lenders to the Fund as possible; and he recognized that members, including those using Fund resources, would hold reserves and would need to invest them. However, the staff proposals that the Fund should borrow from members that were not in a position to allow their balances to be used in the operational budget, or that might be using Fund resources, raised a number of problems. There was broad agreement that quotas should remain the principal source of Fund financing, and that the revolving character of the Fund should be maintained. It was in that context that Fund borrowing was intended to provide a temporary supplement to the Fund's resources to meet a liquidity shortage. The Fund had therefore borrowed primarily from members with relatively strong financial positions that were able to provide resources to the Fund in excess of quotas. For operational purposes a strong financial position had generally meant members whose currencies could be included in the operational budget and the designation plan.

He was worried lest any significant deviation from that policy produce a number of adverse implications, Mr. Erb went on. For instance, the cooperative and revolving character of the Fund was predicated on the obligation of all members in a position to do so to make their currencies available for use in financing Fund operations. The staff proposal, however, would create an undesirable incentive for members to lend to the Fund instead of having their currencies included in the operational budget, if only because by lending to the Fund a member would earn a higher rate of interest than it would from accepting the prevailing rate of remuneration. It would be difficult to provide a rationale as to why a member should be able to lend to the Fund in one way but not in another. A similar problem would arise with respect to the Fund borrowing from members using its resources. What would be the rationale for allowing a member with a balance of payments need to lend resources to the Fund? The impression would be created that the sole purpose would be to allow the member to profit from the difference between IMF charges and the interest rate on lending to it. There was, moreover, a more significant concern. If the Fund were to borrow from members using its resources, a problem would arise regarding the Fund's liquidity since such members would be more likely to encash their claims on the Fund, and possibly drain the Fund of liquidity at a time when its resources might be under pressure. In other words, such a borrowing policy on the part of the Fund would further complicate the difficulty of coming to a judgment about the adequacy of its liquidity, as well as about the magnitude and quality of total world liquidity and the Fund's proper contribution to it.

In conclusion, Mr. Erb stated, the United States took the view that the Fund should primarily limit its borrowing to countries in a strong financial position, and that the countries lending to the Fund should also allow their currencies to be used in the operational budget and the designation plan.

Mr. Narasimham stated that he fully supported the staff analysis which suggested that there should be no limitation on the group of potential lenders, although primary attention should be paid to a country's reserve position. He had made a similar point on the last occasion on which the Executive Board had discussed the issue, and some of his language seemed to have found its way into the staff paper at the top of page 2, where an Executive Director was reported as having expressed the view that the Fund should be free to borrow from any member.

Mr. Kabbaj remarked that, important and original as were the points made by the staff in EBS/81/217, the paper embraced some of the points discussed by the Board during its September deliberations on the subject of Fund liquidity and financing needs (EBM/81/119 and EBM/81/120). The underlying trend that had emerged from those discussions was that, first, there was a need, and certainly an urgent need, to enhance the liquidity and the financial capacity of the Fund. The events of the past two months, and especially the recent commitments undertaken by the Fund under the extended Fund facility together with future projected commitments, pointed to the urgency with which that topic should be tackled. It was at least theoretically possible that the Fund could receive simultaneous requests from a number of potentially deficit countries for the urgent use of its resources, and that, with the present ratio of drawings under the extended Fund facility to quotas, such an event would produce severe strains on the Fund's liquidity. Even in the absence of such an extreme situation, some sort of gap might emerge as early as February or March 1982. Second, a clear and unambiguous preference for official borrowing had been expressed during the Executive Board meeting on September 4, and reiterated in the communiqué of the Interim Committee issued after its meeting on September 26-27, 1981.

It therefore went without saying, Mr. Kabbaj continued, that the range of potential lenders should be as wide as possible. Countries willing to lend to the Fund should be welcome. Of course, certain minimum requirements regarding the level of reserves and the external situation of the potential lender, which should be consistent with overall Fund criteria, should be taken into account. But flexibility should be the rule; after formulating broad criteria along the lines proposed by the staff, the Fund should discuss each potential lender's case on its own merits. For instance, a temporary balance of payments deficit should by no means disqualify a country from becoming a lender. There were a number of member countries that traditionally maintained a high level of reserves irrespective of their external position. They would normally invest their reserves, mainly in the form of international bank deposits or other market instruments, while borrowing to meet their balance of payments or other financial needs. The Fund should accept such loans or

investments. Indeed, as the staff had pointed out, balance of payments situations could change drastically even within the two-year period considered; and there was no certainty that a lender in surplus or deficit would continue to face the same situation after extending a line of credit to the Fund.

A degree of flexibility would be called for, Mr. Kabbaj considered, even if a potential lender were to regard its claim on the Fund as a first line of defense in the event of a balance of payments need arising after the conclusion of a loan agreement with the Fund. Such an eventuality should not, per se, exclude a potential lender from consideration, since the number of such cases would not be large compared with the full range of potential lenders. In any event, simultaneous encashment by such lenders would be unlikely, and a "run on the Fund" would be hard to imagine. Consequently, although he tended to agree with the staff that the likelihood that claims on the Fund would be reasonably firmly held by a member was a factor to be taken into account, undue emphasis should not be placed on it. While judgment would have to be exercised, it could of course be invalidated by a change in the political climate or even the existing mood of a country. Whether a claim on the Fund should be regarded as a first line of defense would also depend on the rules and regulations in effect in the lender country at the time, something that it might not be possible to change. Flexibility with regard to borrowing should therefore be the long-term aim. Without sacrificing its standards, the Fund should attempt to attract investment by potential lenders. As he understood it, indeed, some members had already expressed a desire to invest in SDR-denominated claims on the Fund.

Experience showed, Mr. Kabbaj observed, that countries were constantly looking for suitable ways in which to invest their reserves, irrespective of whether they had a surplus or deficit balance of payments position. For many such countries, security and stability were the most important criteria when placing resources in the international financial markets. With the inevitable fluctuations in foreign exchange markets, the central banks were increasingly tending to look for safe and stable avenues of investment, even at the risk of smaller projected returns or lower interest rates. The Bank for International Settlements, which accepted ordinary term deposits from central banks, was an excellent example of a favored haven. The Fund was a sound institution for investment and the special drawing right a stable medium; he therefore hoped that in the near future a broader role would be allotted to the type of borrowing under discussion.

Miss Le Lorier recalled that the Interim Committee in May 1981, the Group of Ten, and the Annual Meeting of Governors in September 1981 had stressed that the normal way of financing the Fund would be through its quotas; they had therefore expressed the hope that the preliminary work on the Eighth General Review of Quotas would be accelerated in order to allow the Fund to expand its activities. During the discussion on September 4, 1981, while it had not seemed that the Fund would be faced with major liquidity difficulties until FY 1984, Executive Directors had

agreed to adopt a flexible attitude toward any possible commitment gap on a yearly basis. Consequently, the proposals set out in EBS/81/217 did not seem to call for any immediate decision.

There were a number of questions that she would like to raise for information, Miss Le Lorier stated. She was by no means certain that just because various monetary authorities had shown an interest in investing in an SDR-denominated claim on the Fund, regardless of their balance of payments positions, that was in itself a sufficient argument for the Fund undertaking borrowing arrangements with those authorities. Borrowing by the Fund should not be looked at in the same manner as borrowing by ordinary financial institutions, which were always trying to attract new resources by launching new savings instruments. The Fund's borrowing arrangements had been established as a bridging device to meet urgent needs for liquidity, but they were intended to be no more than temporary until the completion of the Eighth General Review of Quotas.

On the more technical aspects, Miss Le Lorier noted that monetary entities would be asked to lend for two years at least. She was by no means certain that a two-year maturity would match the usual length of investment by central banks. Such institutions usually invested in shorter-term assets; even if in practice they were of a revolving character the banks tended to consider them as callable whenever the need arose. In general terms, central banks preferred to invest in assets that were traded in such a volume that they could be considered perfectly liquid, without requiring any prior notice on withdrawal or implying any risk of a capital loss.

Another major concern of the central banks, Miss Le Lorier stated, was that there should be complete discretion if large transactions did have to take place. The Fund's loan agreements included provisions for an early termination of a commitment undertaken by the lender or an early repayment of its claims. She was not certain whether that provision would actually meet the needs of central banks, but it was certainly realistic as it was impossible to forecast changes two years hence.

One way of solving the issue of the liquidity of claims on the Fund, Miss Le Lorier noted, was to include provisions by which bearer notes could be issued with a view to negotiating them with private lenders. The volume of finance involved was such that it would not provide for any active market in such notes, even if such an arrangement was desirable. The risk that the notes might be traded at a significant discount was not to be taken lightly, however, and she would appreciate hearing the staff view on whether the circulation of depreciated claims on the Fund in private hands would or would not adversely affect future Fund borrowings and create an unfavorable image of the Fund's creditworthiness.

In general terms, the provisions relating to negotiability did not mean that the Fund should go beyond the inevitable uncertainty affecting balance of payments forecasts in agreeing to run the risk of an early

termination of loan agreements, Miss Le Lorier commented. The same provisions had tended to indicate that in the event of external payments difficulties, the Board had wished to allow the lender to free itself from its obligations rather than having to fulfill them, perhaps by drawing on the Fund. Naturally, a commitment to lend by a member could not in any way affect the rights of that member to use the Fund's resources; while not wishing to discuss that principle, she did hope that the Fund would look carefully into the capacity of a potential lender to make a loan for the whole two-year period. One way of dealing with that problem would be to examine the ratio between the amount of the possible commitment and the level of a country's reserves. However, if that arrangement were accepted, a decision would need to be taken, first, on whether it was the net reserves or the gross reserves of the member that should be counted, and second--if loans were only accepted when the ratio between commitments and reserves was fairly low--on whether the amount for which a loan was accepted might not be too small to be of much use to the Fund.

A number of important questions were raised by the staff in treating a member's reserve position in the Fund and possible loan claims as being parallel, Miss Le Lorier stated. The two types of assets were quite different, both from a legal and from a financial standpoint. The reserve position in the Fund had for instance no fixed duration; it was of varying size and there was an agreed procedure for remuneration. A loan claim, however, was an additional commitment on a fixed-term basis, implying new obligations both for the Fund and for the lender; remuneration would be closely market related and the resources would be made available to the Fund for a given period. She wondered whether the staff had properly considered the situation of a member using Fund resources at a given rate of interest while holding a claim bearing a higher rate of interest. It was by no means certain that a member would not try deliberately to exploit such a situation; in any event, members could well be passive beneficiaries. She wondered whether in parallel with the rights granted to lenders, a possible way out might not consist in leaving the door open in such a situation for an early repayment by the Fund of its debt. In other words, should it be entirely up to the member to decide the early termination of its commitments or claims, even if it was to decide to utilize its reserve tranche or not, as a first line of defense in the event of external payments difficulties. In conclusion, while she agreed with the staff that "the order, timing, and amount of use of unconditional or conditional liquidity available from the Fund would remain completely at the member's option and would not be affected by such Agreements," that did not imply that the Fund would not be expected to assess as accurately as possible at the time of the negotiation the prospects of the use of its resources by a potential lender.

Mr. Polak commented that on the first page of the paper the staff raised the question of whether the Fund should be prepared to enter into a loan agreement with any member that was prepared to do so. It then argued that some objective restrictions, which might be thought of as barring the Fund from following that course, were not particularly valid. It argued that members not in the operational budget should not be

excluded and that members with drawings outstanding from the Fund should also not be excluded. He generally agreed with that approach. In particular, Mr. Erb's argument that countries would stay out of the operational budget because they would rather lend to the Fund was not valid because it was the Fund that decided on the operational budget and not the members.

Moreover, the Articles of Agreement laid down that one of the objectives of the Fund was to make the special drawing right the principal reserve asset in the international monetary system, Mr. Polak said. One step on that road would surely be to make central banks as familiar as possible with SDR claims on the Fund, and to have them consider as a matter of course whether or not to hold such claims as part of their reserves whenever the Fund offered them. He could therefore not see any major reason for the Fund, as long as it wished to borrow, to refuse to accept loans from any member country or its central bank. Obviously, if the Fund decided after the Eighth General Review of Quotas that it did not need to borrow any further, it would clearly not do so.

It seemed to him that the staff had not drawn the logical conclusion from its own paper: the Fund should borrow from any member prepared to lend, Mr. Polak went on. In the second part of the paper the staff set up a battery of subjective judgments, including one that seemed very difficult to test, namely, the likelihood of the loan claim being closely held. He was by no means clear what test the staff was in fact proposing for the desirability of a member as a lender. In Section III(i) on page 5, the staff stated that the current and prospective balance of payments would enter into the judgment; but in Section III(ii) the staff stated that the member's balance of payments position, its inclusion or exclusion from the operational budget and designation plan, and any use of the Fund's resources would not be factors in arriving at the judgment. His own feeling was that the judgments were really not necessary and could become quite invidious. The Fund had made borrowing arrangements directly or indirectly through the Bank for International Settlements without necessarily applying all the tests. It would seem quite peculiar to turn down members that were interested in lending to the Fund because the staff believed on rather subjective grounds that they would not be solid creditors.

His own view was that it was difficult to imagine that a member would commit itself to lending to the Fund if it felt that it would probably wish to reverse the arrangement very shortly, Mr. Polak stated. It was true that Fund paper was attractive, but it was not so attractive that members would wish to hold it for a short period of time. He would therefore feel quite comfortable in allowing members to make their own choice on whether they would be prepared to participate in a lending program for the Fund. It was also important to pay attention to the other side of the issue, namely, that it should be clear that there was no obligation whatsoever on any member to participate in the lending program. It would be wrong to create any impression that members who drew on the Fund should cooperate, for instance, by keeping a small

proportion of the reserves they might have obtained from the Fund in the form of claims on the Fund. The staff should scrupulously refrain from putting pressure of that sort on members.

On page 4 of its paper, the staff had raised the question of the order in which members with claims on the Fund and reserve tranche positions in the Fund should be entitled to use their assets, Mr. Polak noted. The staff had stated that there was no legal requirement that a member should encash a loan claim before using its reserve tranche position. The statement was of course true, but there was a strong argument that the Fund should adopt a policy stance to that effect, and he completely agreed with the points raised by Miss Le Lorier. It was possible that members might arbitrage against the Fund in the way she had mentioned. Loan claims would have a comfortable rate of interest while part of the reserve tranche bore no interest at all. A member with loan claims and a reserve tranche position might feel itself tempted to use the reserve tranche first and the loan claims only if it felt that it needed more liquidity. He did not believe that such an operation was at all likely, but the Fund should not open itself to that kind of arbitrage. The Fund should adopt a clear policy that a member having loan claims of any sort--including claims under the General Arrangements to Borrow--should encash those claims before using its reserve tranche position.

Mr. Lovato stated that he welcomed the discussion, which would give an opportunity for widening the relationship between the Fund and its members. Recent changes in the international monetary system, characterized by an uneven distribution of balance of payments disequilibria, made it all the more important for the Fund to be able to count on an increasing volume of resources with which to support the adjustment efforts of its members. Since his authorities considered the enlarged access policy as an appropriate response by the Fund to the mounting problems of the world economy, they attached great importance to any efforts to secure the necessary funding.

While his authorities still maintained that quotas should be the central form of funding for the Fund's operations, they were bound to agree that borrowing was required to cover the gap between the present level of quotas and the demand for financial support from the Fund, Mr. Lovato continued. However, they believed that the cooperative character of the Fund should be preserved and that in particular the temporary nature of Fund borrowing should be stressed. They had therefore earlier stated a preference for medium-term borrowing from countries with strong balance of payments and reserve positions. Their view remained unchanged and they hoped that the Managing Director's efforts to obtain such medium-term financing would succeed. Naturally, borrowing by the Fund from central banks and monetary authorities could represent a useful way of supplementing the Fund's resources. In the circumstances, central banks and monetary authorities should be given a wide degree of freedom in deciding on whether or not to participate in a scheme of lending to the Fund; but the Executive Board should adopt criteria along the lines of those suggested by the staff to prevent the

degree of freedom for members that he would like to see preserved from having negative effects on the Fund's activities. Hence, although he well understood that it was difficult to establish in advance whether a member would tend to regard its claim on the Fund as a first line of defense, some form of quantitative criteria ought to be fixed as a safeguard against the risk of early claims for encashment.

More generally, Mr. Lovato went on, the bona fides of any member entering into a loan agreement with the Fund should be taken for granted. Similarly, an outstanding purchase should not be considered as an impediment to a country lending to the Fund. In other words, the idea that a member should be at the same time a debtor and a creditor was quite acceptable. Nevertheless, while loan agreements were a reasonable means of meeting the legitimate desires of member countries to hold an alternative reserve asset, every effort should be made to prevent them from becoming a short-term facility that would compel the Fund actively to match maturities.

On a more technical point, Mr. Lovato stated that he had some concern about treating loan claims like a reserve tranche position. He was disturbed by the adverse effect on the liquidity position of the Fund and on the costs of the resources that the Fund would be using if a member decided to liquidate its reserve position instead of encashing its loan claim. He would be interested to hear the staff view on that point. On the question of perception mentioned by the staff, he could agree with the staff that there was no reason to presume that any member would make a purchase from the Fund that it would not otherwise have made, as a result of making a loan to the Fund. However, if a loan was accepted from a country with a weak balance of payments position, it would not be difficult for that country to represent that it had a requirement of need. In brief, the best way of solving the "perception" problem was to try to evaluate the risk of early encashment ex ante, with the help of the suggested criteria. The most relevant quantitative criterion for judging the likelihood of claims on the Fund being firmly held would be the level of a member's international reserves in relation to the amount committed under the loan agreement. Finally, a member making a loan to the Fund should continue to have complete liberty of choice as to the way in which it made use of the Fund's resources.

Mr. Laske recalled that in May 1981 the Executive Board had decided that the Fund should be able to borrow from any member in order to provide it with resources under the policy on enlarged access. He had supported the decision at that time because he had held the view, which he continued to hold, that borrowing from official sources was highly preferable to borrowing in the private market, because it was more in line with the international character of the Fund. It did however seem that he had failed to be sufficiently clear regarding what he meant by the term "any member." The most important loan agreement that the Fund had so far concluded was that with the Saudi Arabian Monetary Agency, Saudi Arabia being a country in a strong balance of payments position. It was the view of his authorities that borrowing should be undertaken

mainly from countries in such a position. It was worth noting that a country in a strong balance of payments position and with large reserves had recently resumed lending to the World Bank. It was hopefully a good omen for Fund borrowing from the same country shortly.

His authorities believed that Fund borrowing was a financing method that should be used only temporarily, in other words, for the period for which the policy on enlarged access would apply, Mr. Laske observed. Borrowing should not become a permanent feature of Fund operations. When the enlarged access policy was being reviewed, the Fund's borrowing policies would have to be included. The Fund was a financial institution based on member country quotas, and not a financial intermediary covering part of its lending operations by permanent borrowing. Naturally, lending by monetary authorities to the Fund should always be voluntary; but not every offer to lend to the Fund should be accepted. The criteria spelled out by the staff seemed to cover all the considerations that ought to be taken into account when making a judgment as to whether it would be advisable for the Fund to accept a loan offer. However, the staff put the main emphasis on the level of a member's reserves, while relegating consideration of the current and prospective balance of payments positions to second place. He was by no means sure that that was the most appropriate way to proceed.

All the loan agreements so far concluded by the Fund contained provisions for the mobilization in case of a balance of payments need by the lender, Mr. Laske noted. The staff mentioned that it was very desirable that the loans obtained by the Fund from monetary authorities should have a high degree of stability. If loans were accepted from countries when the chance of encashment was relatively strong, the Fund would have to hold extra liquidity, and the potential gain for the Fund from a loan might not therefore be at all great. He would therefore advocate rather strict standards for use by the Fund in accepting loan offers from countries in current or prospective weak balance of payments positions.

The staff had not discussed the possibility that monetary authorities making loan offers to the Fund might be carrying a substantial amount of external indebtedness, Mr. Laske observed. There was a wide difference between gross and net reserves, and a loan offer by a country with large gross reserves might be less secure than one from a country with little or no foreign debt. He would be interested to hear the staff view on the point.

Another question might also be raised regarding the staff suggestion that the Fund should accept loans from countries with purchases outstanding from the Fund or with an active stand-by or extended arrangement with the Fund, Mr. Laske considered. The meaning of the term "active arrangement" had not been discussed. He assumed that it meant that the country concerned was able to make drawings on its arrangement, while it did not cover the case in which a country had fully drawn on a Fund facility and had entered the repurchase phase. He would not wish to prevent a country with outstanding purchases and a strong balance of payments position from

making a loan to the Fund. His own preference would however be for early voluntary repurchase. Similarly, he had strong reservations against the Fund accepting loans from countries with an active Fund arrangement. The use of Fund resources carried discretionary charges, while loans to the Fund would carry a market rate of interest, thus leaving the Fund with a negative margin. It would be an anomaly if members could draw net income from involvement with the Fund when they found themselves on both sides of the balance sheet.

He could not agree to the rather general way in which the last sentence of Section III(ii) was written; it would need redrafting and refinement. As to Section III(iii), he was not clear whether the language reflected the current legal situation or was meant to constitute a policy guideline. While he did not wish to exclude the possibility of simultaneous borrowing from and lending to the Fund, he would like to see it confined to exceptional situations, rather than being accepted in the general way outlined in the staff paper.

Mr. Nagashima stated that, like some of the previous speakers, he thought that the question regarding the range of potential lenders to the Fund was related to the nature of the Fund's borrowing from official sources. So far, a number of central banks and monetary authorities had helped the Fund to meet its liquidity needs by extending credit, a procedure that was considered to be a reflection of the nature of the Fund as a cooperative financial institution. Although the terms of the credit were market related, the spirit of financial cooperation was reflected in the fact that no commitment fee was charged. It would also be reasonable for the Fund to accept financial assistance from members as a bridging action until the Eighth General Review of Quotas came into effect. Official lending to the Fund was therefore quite different from ordinary investment activities by central banks and monetary authorities, which often invested reserves in various financial instruments such as U.S. Treasury bills. Loans to the Fund should cover a reasonable length of time, such as two years, since encashment prior to maturity might cause liquidity problems for the Fund. Consequently, the primary criterion should be the strength of a member's reserve position, or the size of the country's reserves in relation to the amount of lending. The current and prospective balance of payments positions should also be taken into account.

Every effort should be made, Mr. Nagashima considered, to include a country extending credit to the Fund in the operational budget and the designation plan. He therefore had doubts about the view that the Fund should enter into borrowing agreements with members using the Fund's resources or negotiating with the Fund to do so. If a member was drawing money from the Fund, involving the use of ordinary resources, while lending to the Fund, it would be difficult to avoid the perception that the member was obtaining a financial advantage from the Fund. A country with purchases outstanding under the oil facility, however, might reasonably make loans to the Fund because it would not thereby obtain any financial return at the expense of the Fund. Even so, it would be preferable if a

country were to make an early repurchase of its outstanding balance with the Fund. For the same reason, he had reservations about the criterion in Section III(iii) on page 6 of the staff paper. If a country had a balance of payments need to such an extent that it required use of the Fund's resources, it would generally be expected first to request the repayment of its existing claims on the Fund.

Mr. Kharmawan stated that he would have preferred to have discussed the paper entitled "Guidelines on Borrowing by the Fund - Further Considerations" (EBS/81/227) before the present paper because it would clarify the position with regard to the rights and obligations of lenders to the Fund. Meanwhile, while he could support the thrust of the staff argument, like Mr. Polak he would go much further on the grounds that once it was decided to open up the way for every member to lend to the Fund, the attempt to take precautions would lead the Fund into difficult situations. It would therefore be better not to try to enforce them. Unlike Mr. Polak, however, he did not wish to compel a country to liquidate its claims on the Fund before using its reserve tranche position. As matters stood at present, if a country that had invested its reserves in certain instruments asked to take advantage of its right to draw its reserve tranche position, the Fund did not require it to use its reserves first and only to draw its reserve tranche second. It was essential to give prospective lenders the fullest possible freedom.

He hoped that there would be no disagreement that a country that had lent to the Fund should not be barred from making use of Fund resources if the country's situation made it necessary to do so, Mr. Kharmawan went on. Similarly, he did not see that it would be reasonable to deny a country that had already made use of the Fund's resources an opportunity to invest in instruments issued by the Fund; even countries in a weak balance of payments position usually still had some reserves, and a need to invest them. Countries could not keep their reserves at home; they had to invest in monetary instruments, and it would be unreasonable to exclude loan claims on the Fund from the paper they could hold. In developing countries one argument used by the opposition against the monetary authorities was that they tended to buy U.S. Treasury bills, thus apparently financing the Government of the United States. The answer was of course that the monetary authorities were simply investing and trying to safeguard the nation's monetary reserves; in other words, every country large or small had a need to invest, and he could not see why they should not buy the monetary instruments issued by the Fund.

It would be preferable to leave discussion of the question of encashment before the end of the proposed two-year period until after the discussion of EBS/81/227, Mr. Kharmawan considered. Meanwhile, a country investing in the instruments of the International Monetary Fund would know that it had the obligation to continue to hold its claims until the end of the two-year period. Executive Directors should have confidence that in general that obligation would be observed.

There was no real fear that a country would object to participating in the operational budget because the rate of remuneration was lower than the rate of interest that could be obtained by lending to the Fund, Mr. Kharmawan maintained. As Mr. Polak had said, it was not open to a country to decide whether it would or would not appear in the operational budget. Executive Directors knew how difficult it was to remove a country from the list of those included in the operational budget once the staff had put it there. One way of dealing with the problem, however, would be to look at the rate of remuneration on reserve positions in the Fund. He had long advocated making the rate of remuneration identical to the rate of interest on special drawing rights because he did not see that there was much difference between a reserve position in the Fund and a holding of special drawing rights.

At the time when the Executive Board had been discussing the substitution account, Mr. Kharmawan recalled, he had taken the position that the substitution account was not meant for stronger countries only; weaker countries also had a need to diversify, and the substitution account would have given them an opportunity to do so. The opportunity to purchase monetary instruments from the Fund should be seen in the same light. It would however be interesting to know what the position was in the World Bank, which was in the daily business of borrowing in the market. It seemed unlikely that the World Bank would prevent any monetary entity from buying its bonds in the open market.

Mr. Ainley stated that, unlike Miss Le Lorier, he believed that it was time for the Fund to take a decision on the particular aspect of borrowing under discussion, especially in the light of what the Treasurer had said at the beginning of the meeting. In taking such a decision the Executive Board should bear in mind two objectives: first, that the Fund should be in a position to meet current and prospective demands under the policy on enlarged access in a prudent fashion, and second, that the Fund should try to ensure that loan claims on itself should be firmly held. He could generally endorse the criteria set out on page 5. In particular, he agreed with the staff that the Fund should take a cautiously flexible approach, and that borrowing from the central banks or monetary authorities of deficit or debtor countries should be a matter of judgment in each case. Insofar as the proposed criteria were concerned, anything more formal or more restrictive would be difficult to establish or to apply, as well as running the risk of discriminating unfairly against potential lenders. Naturally, the criteria would have to be interpreted prudently, especially when deciding how firmly a loan claim on the Fund was likely to be held. However, the staff and the Managing Director were well placed to make such judgments, and the safeguards outlined in the paper should be adequate. Individual agreements should of course continue to be circulated for Board approval.

More generally, Mr. Ainley continued, he had no difficulty with the proposal that the Fund should be able to borrow from a central bank or monetary authority of a member whose external position was not considered sufficiently strong for it to be included in the operational budget or

the designation plan. The Fund had been asked by the Interim Committee to borrow from official sources to the greatest extent possible, and there was no doubt that there were relatively few countries at present with a strong external position in the sense used by the staff on page 2 of its paper. He would however expect that borrowing from the weaker countries would be kept relatively small in relation to surplus countries. In any event, such borrowing should be a supplement to, rather than a substitute for, medium-term arrangements on terms similar to those incorporated in agreements with members in structural payments surpluses or with large reserves. He continued to hope that the bulk of the Fund's borrowing would come from countries in that position. It would be helpful if the Managing Director could provide further information on any discussions he might be having with the group of countries in structural payments surplus or with large reserves.

He also had no objection in principle, Mr. Ainley observed, to the Fund borrowing from the central bank or monetary authority of a member that was using or might use the Fund's resources. Like the staff, however, he recognized the presentational difficulties and he wondered how those compared with the essentially presentational problems of a Fund approach to the private market. He agreed with the staff that lenders should not be debarred from access to Fund assistance, nor should existing or prospective users of Fund credit be prevented from lending, provided that the lending was clearly part of their normal investment policy. At the same time, lending to the Fund should not affect the scale of any subsequent use of Fund credit or SDR holdings by the member. The way in which the transactions were perceived, both by other members and by those outside the Fund, would be very important.

Finally, Mr. Ainley remarked, he agreed with the staff that lending to the Fund should not prejudice the freely usable reserve asset nature of a member's reserve tranche, which had been emphasized by the decision of April 1981 (Decision No. 6831-(81/65)) to allow the reserve tranche to float in the credit tranches. A member with an existing loan claim and an existing reserve tranche should be free to draw down its reserve tranche in case of need. However, he agreed with Miss Le Lorier that it would be undesirable, in principle, for a member to switch its reserve tranche into a high-yielding loan claim on the Fund. While it was unlikely that any country would do that, he would expect that when the staff was assessing the appropriateness of new or augmented loan agreements, they would take into account a member's likely use of its reserve tranche. In brief, he could support the recommended criteria; the questions he had raised were only designed to establish appropriate safeguards for the Fund.

Mr. Iarezza stated that he supported the staff proposal as set out in Section III of EBS/81/217. He agreed that the decision regarding the appropriateness of any particular borrowing arrangement should be based on judgmental grounds and should take into account a number of criteria, the most important of which should be the present and expected size of the member's gross reserves compared with the proposed commitment of

resources to the Fund. Such a criterion seemed quite appropriate seeing that the borrowing under discussion was only one of the alternatives for investment open to central bankers. Neither a member's balance of payments position nor its inclusion or exclusion from the operational budget or the designation plan should be an impediment for arriving at a decision. Similarly, the existence of prior lending to the Fund or investment in claims on the Fund ought not to affect a member's subsequent use of the Fund's resources. After all, the Fund had already entered into borrowing agreements with members whose currencies were not considered sufficiently strong for inclusion in the operational budget or the designation plan. In view of the desirability of filling the gap in the Fund's available resources, the necessity of uniform treatment, and the preference expressed by the majority of the Board for using official resources, the criteria already in use should be supplemented by those set out in the staff paper.

The so-called perception problem, Mr. Iarezza observed, ought not to take up much of the Executive Board's time. After all, the terms attaching to the paper that the Fund might be offering central banks were not so appealing that every central bank would immediately rush to buy it. Moreover, it was not one of the conditions of borrowing from the Fund that a country should have no gross reserves; consequently, it could be admitted that any country with reserves would wish to invest them. In the circumstances, he saw no reason to discourage any Fund member showing a willingness to cooperate with the Fund by buying some of its paper, even if that member was using the Fund's resources.

Mr. Kafka stated that he felt that the Fund might need to borrow more resources in the near future. Consequently, it should be prepared to borrow officially as well as in private markets, a view that implied that the Executive Board should take a decision as soon as possible. Moreover, whether borrowing or using subscribed quotas, except on a narrow and rather legal definition, the Fund was clearly a financial intermediary, as it had been since its inception.

Taking up the points made by the staff in its paper, Mr. Kafka remarked that the staff's proposals were well argued, and that Mr. Erb's thoughtful comments did not negate them. Great caution would be applied in any case, not only to countries that were indebted to the Fund or not included in its operational budget, but to all countries from which the Fund would accept loans. While he could understand Miss Le Lorier's concern about the effects of sales of the Fund's bearer notes at discount, he did not believe that any such operation would reflect on the creditworthiness of the Fund itself. It would rather reflect on the creditworthiness of the country selling the paper.

He did not believe, Mr. Kafka observed, that the Fund should have a policy of encouraging countries to encash their loan claims before they used their reserve tranche. Such a policy would be unnecessary, if only because countries did not wish to use their reserve tranche, feeling that to do so might be perceived as a sign of weakness. In any event,

even if a country encashed its loan claims, the Fund would be no worse off than if the country had never lent to the Fund; if it had not done so, the Fund would presumably have been borrowing from another country.

As had been stated by others, Mr. Kafka went on, the Fund should not restrict the use of the reserve tranche in any way beyond the requirement of need. Otherwise, the Fund would be discouraging countries from subscribing to quota increases. He had very great doubts whether it was at all significant that a country from which the Fund wished to borrow had foreign debts, large or small. However, he did believe that the Fund should encourage countries to repurchase under established policies whenever they were able to do so.

Mr. Prowse stated that he endorsed very much what Mr. Ainley had said and that he supported the conclusions in the staff paper. He did so in particular because members should be free to determine the composition of their own reserve holdings. There were of course two main implications of that view: the first was that there might be some possible risk to the Fund of borrowing from members that had obligations to it; the second being the perception that members that had drawn on the Fund and then lent to it might be making some commercial profit. In addition to all that had been said on those two points, it was worth bearing in mind that the actual amounts potentially involved were comparatively small. There did not therefore seem to be any substantial risk for the Fund, especially as views regarding the need for the Fund to cover the commitment gap had become rather less rigid than they had been earlier. The Fund was not obliged at all times and in every circumstance to have sources of funds at least equivalent to its commitments to lend.

On the matter of perception, the staff had recalled that a member could not make a purchase from the Fund or use its special drawing rights solely in order to change the composition of its reserves; a country always had to have a balance of payments need in order to use the Fund's resources, Mr. Prowse recalled. Naturally, that consideration applied not only to countries with reserve tranche positions, but also to those with an expired stand-by arrangement under which there might still be outstanding purchases.

He would offer only two qualifications, Mr. Prowse stated. The first was that when the staff was discussing a loan with a member, it should ensure that a member with an outstanding purchase under an expired stand-by arrangement should give the fullest consideration to an early repurchase before lending to the Fund through the purchase of paper denominated in special drawing rights. Second, when a member with which the Fund had concluded a lending agreement was considering entering into a stand-by or extended arrangement for balance of payments reasons, it should be encouraged to consider liquidation of its claim on the Fund before entering into a stand-by arrangement. However, he was not suggesting that in either case the actions he had proposed should be made an obligation; to do so would conflict with the freedom of action of members to dispose of their reserves as they saw fit. For the rest, the Executive Board should rely on the good judgment of management and staff.

Mr. Finaish observed that there had been general agreement, both at a number of Board meetings and at the two most recent Interim Committee meetings, on the primacy of quotas and the supplemental role of borrowed resources in Fund financing. However, even in a supplemental role, borrowing might become quite sizable. The Fund therefore needed a policy on borrowing, and it was appropriate for management and staff to ask for clear guidance on the proper range of potential lenders.

As he was in broad agreement with the thrust of the staff paper, Mr. Finaish remarked, he would make only a few brief comments. First, not only should the Fund be able to secure a sufficient volume of resources to sustain an acceptable level of activity, commitments to the Fund should be sufficiently firm to avoid the likelihood of strains on the Fund's liquidity or difficulties in meeting members' needs. The Fund was in the unique position of being sufficiently well acquainted with members' economic situations and prospects to be able to assess their potential. Consequently, he agreed with the conclusion that the primary criterion as to whether it would be appropriate to negotiate a loan agreement with a member country should be the strength of the member's reserve position. Using such a criterion would mean that the Fund would have to focus on countries that maintained a relatively high level of reserves but that might at any particular time be in some balance of payments difficulty. The range of potential lenders to the Fund should cover as broad a spectrum of the membership as possible, leaving it to the Fund to assess a member's ability to contribute to its resources.

The second criterion, namely, that loan agreements would normally amount to only a small part of members' international reserves, was also reasonable, Mr. Finaish commented. Naturally, the term "small" would have to be defined with some degree of flexibility. Already, the Fund's borrowing from one major creditor was reaching a substantial proportion of its total reserves. It would be helpful if the staff could give a rough indication of the range that it would normally deem appropriate. He would also endorse the third criterion, namely, that the existence of previous lending to the Fund or investment in claims on the Fund should not affect a member's subsequent use of the Fund's resources. That criterion might be especially important in cases where the circumstances of a member could change rather rapidly and unpredictably.

Mr. Schneider remarked that he had noted the hesitation of some Executive Directors to accept the staff's proposal. For himself, he would approach the question of borrowing by members, not so much from the standpoint of the balance of payments position of a given member, but rather from the position that the Fund required more flexibility in managing its short-term liquidity position, and that closer cooperation between the Fund and the monetary authorities of its members was desirable, whether they had used the Fund's resources or not. He also believed that borrowing by the Fund would provide a new investment opportunity for the monetary authorities, it being understood that it was the Fund and not the member that would decide on the desirability of a loan agreement on any particular occasion, a very important safeguard for the Fund. He

therefore saw no specific reason to limit the range of potential lenders to a few countries, or to restrict the Fund's flexibility in the management of its resources. The envisaged period of two years for the contemplated borrowing he saw as a temporary device, tailored to the short-term needs of the Fund and the monetary authorities together. Noting the careful language contained in the criteria set out in Section III of the staff paper, he could certainly endorse the proposal. He did however share Mr. Polak's view that, in case of need, a country should encash its claims on the Fund before using its reserve tranche position.

Mr. Conrado said that he was in broad agreement with the staff paper. He could fully support the conclusion that the Fund should be able to borrow from countries even if their external position was not particularly strong. Like Mr. Kharmawan, he would go rather further in making it clear that lending to the Fund was in no way required of members; it was an entirely voluntary act and should be seen as another way in which countries could invest their reserves. Moreover, claims on the Fund should not affect members' subsequent use of its resources, including their right to draw on the reserve tranche if necessary. Nor could he see the need to require encashment of loan claims before a country could draw on its reserve tranche.

Mr. Vidvei stated that he could go along with the staff proposal, although with some hesitation. His concerns were those put forward by Mr. Erb, Mr. Laske, and others. He therefore hoped that when management and staff had gained some experience in working with the proposed criteria, the Executive Board would be given an opportunity to discuss the whole matter, perhaps in the spring or early summer of 1982.

Ms. Mair stated that she could broadly agree with the staff that the Fund should adopt a relatively liberal policy regarding the countries that might lend to the Fund even if their balance of payments position was not strong. She took that view because of the preference of her authorities for the use of official sources of finance for the policy on enlarged access, and because of their belief that short-term claims on the Fund were no more than an alternative way of holding reserves. From the viewpoint of the Fund the main concern should be to ensure that countries lending to it were in a position to make their resources available over a two-year period, and that they were unlikely to make use of their right to encash claims. The criteria set down by the staff seemed appropriate, especially the emphasis on the firmness with which claims should be held. However, there would inevitably be qualitative limits in the appraisal, and lending by each country should be subject to judgment on a case-by-case basis. Her Irish authorities felt that in arriving at such a judgment, more emphasis should be placed on a member's current and prospective payments positions than was implied by the staff. In particular, they felt that a member's current balance of payments position was much more relevant than the ratio between claims on the Fund and reserves as a guide to the likely stability of claims. Like a number of others, her authorities believed that the existence of outstanding drawings on the Fund should not necessarily prevent the Fund from borrowing from a

given country. Similarly, a member should not necessarily have to liquidate its loan claim on the Fund before negotiating any borrowing arrangement with it.

Mr. Alfidja stated that he had no difficulty in endorsing the staff proposal, with the qualifications made by Mr. Polak and Mr. Conrado.

Mr. Nimatallah, Mr. Tai, and Mr. Sangare all stated that they would support the staff recommendations.

The Treasurer, replying to comments made during the discussion, noted that the intention had been to clarify the concept of "any member country" that had been used in earlier decisions of the Executive Board. The staff had wished for guidance from Executive Directors regarding their reaction if the staff were to bring forward a proposal to borrow from a member that was, for instance, indebted to the Fund. Naturally, the proposals contained in EBS/81/217 had been made within the general policy of the Fund that subscriptions were the preferred means of finance, and that the borrowing referred to was that required to implement the policy on enlarged access, not borrowing by the Fund in general.

At the moment, the Treasurer continued, there was a gap in the Fund's resources on a commitment basis, and some Executive Directors at least had shown some willingness to allow such a gap to exist. However, the gap would expand over the next several months, and prudent management of the Fund's liquidity would make it desirable not to allow it to become too large.

On the point that lending to the Fund should always be voluntary, the Treasurer explained that the staff was always most scrupulous not to use action by the Fund, or action by countries in connection with the Fund, as a leverage for lending. The staff had sent to member countries a general description of the borrowing process; it had not even asked countries whether they would be prepared to lend, except for those that were considered by the staff to be in a very strong balance of payments and reserve position. Other countries would have to decide for themselves whether it was in their interest to enter into a credit agreement.

Among the more difficult questions posed by Executive Directors was whether a member should be able to draw on the Fund if it had a loan claim outstanding, the Treasurer recalled. The staff guidelines had provided that there would be nothing to restrict such an arrangement. A number of speakers had proposed that a member should first liquidate its loan claims before drawing on its reserve tranche. If that position were adopted, by a logical extension it would mean that a member would have to liquidate its loan claims before drawing on the credit tranches as well, because there was no difference between the two uses of the Fund's resources. The staff view was that the Fund had so far not adopted any rule as to the sequence in which members should use their reserves, and it would be most unwise for the staff to suggest one. Some speakers had commented that it might well be possible for a country to arbitrage

between two positions in the Fund. A country certainly could use its special drawing rights to augment its foreign exchange reserves if it had a balance of payments deficit, and it could use any loan claim on the Fund to augment its foreign exchange reserves. To the question whether a country could arbitrage between a less well remunerated and a better remunerated position in the Fund, the answer was that there was a possibility that a country might do so, but the risk that a member would do so was not very great. In any event, it already existed because there were two sets of financial resources available in the Fund, those that were relatively cheap and those that were based on market-related rates. Furthermore, for a member to draw on the Fund, the Fund must be satisfied that it had a balance of payments need of a certain magnitude in order to obtain the Fund's cheaper resources.

Finally, the Treasurer noted, the question had been raised whether there was any difference between calculating a member's reserve position on a gross basis or on a net basis in determining whether it was in a position to lend to the Fund. His own view was that the important thing was the availability of gross reserves for investment purposes. But, as some Executive Directors had said, the Fund was not obliged to borrow from any member. Indeed, it was for that very purpose that the staff had proposed the criteria in the paper for endorsement by the Executive Board.

The Chairman, summarizing the discussion, noted that most Executive Directors could go along with the thrust of the criteria set out in EBS/81/217. Some Executive Directors would like more tests to be applied by the Fund before the Fund decided to enter into a borrowing arrangement with a member country. A few Executive Directors would like to curtail the freedom of action of a member that had lent to the Fund and then encountered balance of payments difficulties to use its reserve tranche before asking for repayment of its loan.

The Executive Board had reaffirmed its continued preference for official borrowing by the Fund to meet demands on its financial resources, the Chairman continued, and the present discussion ought to be interpreted in that light. The request for the endorsement of criteria for borrowing from central banks and official entities was not intended to imply that the Fund would enter into borrowing on a permanent basis. The borrowing under discussion was only intended to bridge the period until completion of the Eighth General Review of Quotas, to enable the Fund to meet its commitments under the policy on extended access to its resources in the meantime. The Fund had no intention of entering permanently into the business of issuing short- or medium-term paper as a means of increasing its liabilities. Management would be extremely prudent in any borrowing operations; he clearly understood that if the Fund went too far in that direction, the resulting liquidity problems could be damaging. Naturally, management would report to the Executive Board at appropriate intervals.

Mr. Erb commented that he had not understood that the Executive Board would be taking any formal decision on the conclusion of the discussion.

The Treasurer explained that the staff had not been seeking a formal decision, which would have involved word-by-word discussion of each of the criteria. What had been sought was endorsement of the staff proposals, on the basis of which the Managing Director would make a recommendation to the Executive Board for each borrowing agreement.

Mr. Erb observed that some Executive Directors had had doubts about the guidelines precisely because they feared that they might have to take up borrowing on a case-by-case basis, leading to the possibility that the Executive Board would have to accept loans from some countries and reject them from others. He had hoped that it would be possible to find a different outcome.

The Director of the Legal Department noted that, regardless of the action taken by the Executive Board at the present meeting, each loan agreement would have to be approved by the Executive Board. What management and staff were asking the Executive Board to do was to endorse a policy which would be followed by the staff on a uniform basis. On each occasion the Executive Board would have an opportunity to see whether the policy endorsed was being applied. Naturally, the purpose of the criteria under the policy was to ensure that certain features of the position of potential lenders were examined, and that the loans would be obtained on a nondiscriminatory basis. It would certainly be possible for the borrowing arrangements to be submitted to the Executive Board on a lapse-of-time basis. Management could arrange for a more general discussion and review of the policy to take place in the spring or summer of 1982, when experience with the procedure had been gained.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/81/141 (11/13/81) and EBM/81/142 (11/16/81).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/81/359 (11/12/81) and EBAP/81/160 (11/12/81) is approved.

APPROVED: March 29, 1982

LEO VAN HOUTVEN
Secretary

