04

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/7

10:00 a.m., January 13, 1987

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	
	Jiang H.
C. H. Dallara	M. K. Bush
	H. G. Schneider
A. Donoso	J. J. Dreizzen
	T. Alhaimus
	B. Goos
	J. Reddy
	H. A. Arias
	J. Hospedales, Temporary
T. P. Lankester	
	H. Fugmann
	D. McCormack
	K. Yao
Y. A. Nimatallah	I. A. Al-Assaf
	L. Filardo
H. Ploix	S. de Forges
G. P. Posthumus	
C. R. Rye	
	R. Msadek, Temporary
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	M. Sugita
S. Zecchini	

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

Also Present

African Department: S. N. Kimaro. External Relations Department: H. O. Hartmann, P. E. Gleason, H. P. Puentes. Legal Department: F. P. Gianviti, Director; H. Elizalde, P. L. Francotte, W. E. Holder, D. N. Lachman, R. H. Munzberg. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; W. L. Coats, D. Gupta, R. B. Hicks, A. H. Mustafa, A. Salehizadeh, G. Wittich. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; J. Ferrân, B. C. Stuart. Office of Managing Director: C. P. McCoy. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, L. P. Ebrill, A. Ouanes, G. Pineau, A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, F. Di Mauro, V. Govindarajan, M. Hepp, G. K. Hodges, O. Isleifsson, S. King, K.-H. Kleine, V. K. Malhotra, T. Morita, J. A. K. Munthali, C. Noriega, G. Seyler, H. van der Burg, E. L. Walker.

1. ARGENTINA - REPORT BY STAFF

The staff representative from the Western Hemisphere Department made the following statement:

> Over the past several weeks, the staff has been engaged in active discussions with the Argentine authorities in Washington on the design of an economic program for 1987. These discussions ended over the weekend, and the Managing Director indicated late yesterday that he was willing to support the authorities' economic program. The authorities' letter of intent and the accompanying memorandum of understanding on economic policy are soon to be circulated to Executive Directors. In support of their economic program, the authorities are requesting a 15-month stand-by arrangement in the amount of SDR 1,113 million, which on an annual basis would be equivalent to an 80 percent rate of access. The authorities are also expected to request a purchase under the compensatory financing facility in the amount of SDR 389 million, or 35 percent of quota, in respect of a shortfall in agricultural export earnings for the year ended September 1986, mainly related to a decline in agricultural prices.
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> As Directors will recall, the last stand-by arrangement with Argentina expired in the middle of 1986. At about that time, there was a surge in consumer price inflation as the rate of increase in consumer prices went up from about 4 1/2 percent a month in the period February to June to 6 3/4 percent in July and 8 3/4 percent in August. In an effort to regain control over inflation, at the end of August 1986 the authorities considerably tightened monetary policy, and they announced new price and wage guidelines consistent with a lowering in inflationary expectations. In reflection of these measures, there was a slowing in consumer price inflation to below 5 percent in the last quarter of 1986. The recent drop in inflation was accompanied by a certain slowing in the pace of industrial activity. Nevertheless, for 1986 as a whole, industrial production is estimated to have increased by an average of more than 10 percent over the preceding year, while real GDP is estimated to have increased by about 5 1/2 percent.
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> The Argentine authorities view their economic program for 1987 as a continuation of the stabilization effort initiated in June 1985 and adapted in August 1986, which has reduced inflation from the exceptionally high levels recorded in the first half of 1985. The main objectives of economic policy for 1987 remain those of reducing inflation and strengthening the balance of payments. In addition, the authorities attach considerable importance to securing a continuation of the economic expansion observed in 1986.
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> A key element in the authorities' economic strategy for 1987 is the pursuit of a prudent demand-management policy. To this end, the overall deficit of the public sector and the Central Bank is to be

reduced from an estimated 3.9 percent of GDP in 1986 to 2.5 percent of GDP in 1987; at the same time, the rate of growth of the monetary and credit aggregates is to be limited in line with the projected decline in inflation. The authorities' efforts at expenditure restraint are to be complemented by the continued use of wage price guidelines in order to slow inflationary expectations. Consistent with these objectives, quantitative limits have been set through the end of June 1987, and the program envisages a review of policies to be concluded before the end of June.

The program also envisages further efforts at structural reform aimed at strengthening the basis for economic growth over the medium term. These reforms include efforts to increase the efficiency of the public sector, to induce changes in the financial system, to reduce trade and payments restrictions, and to gradually remove wage and price controls. It is expected that many of these reforms will be supported by the World Bank.

Finally, it may be noted that exceptional financing will be required in 1987 from official and private creditors in order to finance the projected balance of payments deficit as well as to provide for a needed replenishment of the Central Bank's international reserves. To this end, the Government expects that it will soon begin negotiations with the Paris Club on rescheduling of all medium- and long-term debt service payments that fell due in 1986 and those that fall due in the period ahead. Similarly, the authorities are expected to seek agreement as soon as possible with Argentina's creditor banks on the rescheduling of maturities that fell due in 1986 and that become due over coming years. The authorities are in the process of finalizing the details of their financing request for 1987.

Mr. Nimatallah asked whether the Chairman was aware that the information reported by the staff had some days earlier been reported by the BBC in a number of countries, including his own. He wondered whether it had been made clear to the Argentine authorities not to release the details of the program until they had been approved by management and communicated to the Executive Board.

The staff representative from the Western Hemisphere Department replied that discussions between the Argentine authorities and the staff had ended on the morning of Saturday, January 11. The authorities had been apprised by the staff that the program was subject to ad referendum review and they had been advised not to release the information until approval from management had been obtained.

Mr. Nimatallah said that he was uncertain in the circumstances how the BBC and the Sunday Washington Post could have reported on the program in such detail. Something in the procedure was not working properly, and it put him in an uncomfortable position to be asked by his authorities for clarification of details that had not yet been reported to him.

The Chairman noted that as far as the Fund staff and management were concerned, matters had moved normally. The staff had been negotiating with the Argentine delegation through Saturday; the Deputy Managing Director had reviewed the package over the weekend; and he himself had given approval to the package late Monday. The process had gone forward in the strictest confidence. He was disturbed to hear that while proper procedures had been followed in the Fund, the press had announced details of the package in advance of its approval by management.

Mr. Dreizzen observed that the Argentine authorities had announced on Saturday that a tentative agreement with the staff had been reached and that a final agreement with management approval was expected in a few days. No details from the letter of intent had been released by his authorities.

Mr. Goos indicated that he shared the concerns of Mr. Nimatallah regarding the release of detailed information on the Argentine program. He himself had been asked on the previous Friday to brief his authorities in Bonn on the status of negotiations with Argentina because a high ranking official had been preparing to visit Argentina. His report had been based on what he had learned from the staff on Friday, which had given him the impression that the negotiations had not been near to completion. Over the weekend, he had received a telex from Germany noting that the details of an "agreed" program had been quoted in the German newspapers. It was not his intention to hold a discussion on how the information had reached the press, whether it had been prematurely released, or whether it was correct or incorrect. But it would help him, and perhaps others, in future cases if the management could circulate a brief notice to Directors as soon as tentative agreement between the authorities and the staff had been reached.

The Chairman replied that he would be happy to follow such a course; however, in the Argentine case, he would not have been able to circulate such a notice until 7 p.m. Monday, which was when he had finished reading the document, having received it earlier that afternoon.

As he understood it, the relevant detailed information had been given to the press as early as Saturday, at which time he himself had not yet seen the paper. If he had circulated an announcement at that time indicating that an agreement had been reached, although not at the management level, it would have been quite difficult for him to have provided appropriate input. That having been said, it was all the more important to ensure that leaks did not occur in the period between tentative agreement with the staff and final approval by management.

The Associate Director of the Western Hemisphere Department observed that the situation over the weekend with respect to the Argentine case was similar to that which arose when a mission returned from the field with an agreement reached on an ad referendum basis that still had to go to management and interested departments for clearance. The circulation of rumors or facts on the negotiations before approval by management was unfortunate, especially when it left Executive Directors feeling uninformed. However, there was little that could be done to resolve the problem by changing the procedures without compromising the authority of the management.

Mr. Nimatallah stated that it must be re-emphasized that countries should not release information, at least not in such detail as he had seen over the weekend, before coordinating with the Fund on the appropriate timing for the announcement of an agreement. While he understood the difficulties that might be created by the circulation of a memorandum from the management when tentative agreement with the staff had been reached, he wondered whether the relevant mission chief or department head could not be informally in touch with Directors to give them a clearer sense of the status of the negotiations, particularly as they neared completion.

The Associate Director of the Western Hemisphere Department said that he would be reluctant to indicate progress in or the status of negotiations with members at stages of that process. The negotiations often took many turns, and any such report could end up being misleading. The solution was to avoid premature release of details on the negotiations, and the concerns expressed by Mr. Nimatallah and Mr. Goos had served to emphasize the importance of working toward that solution.

2. OPERATIONAL BUDGETS - TECHNIQUES OF ADJUSTING RESERVE TRANCHE POSITION OF UNITED STATES TO MITIGATE U.S. SHARE IN BURDEN SHARING

The Executive Directors considered a staff paper on concepts and techniques of a possible adjustment of the reserve tranche position of the United States through the operational budgets to mitigate the U.S. share in "burden sharing" (EBS/86/280, 12/17/86).

Mr. Dallara made the following statement:

> The United States views this Board meeting as an important step in implementing the Board's understandings on burden sharing, since mitigation of the U.S. share is an integral part of the overall burden-sharing agreement. We hope that this discussion can result in a prompt implementation of a system of mitigation that will respond effectively to our concerns.
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> We welcome the staff paper on this subject, which reviews the various issues involved. The discussion in Section II of the paper provides useful background on the evolution of the U.S. position in the Fund in recent years. In our view, the key issue before the

Board is what approach should be taken to calculating the extent of mitigation. Three approaches to this question are reviewed on pages 13-15.

Before turning to this issue, however, it may be useful to review briefly the basic rationale for the United States seeking mitigation, and touch on some of the other issues raised in the paper.

First, let me assure the Board that in seeking mitigation, we are in no way attempting to avoid bearing our fair share of the burden under the burden-sharing arrangement. The fundamental principle underlying the burden-sharing decision reached last summer was that all members of the Fund share in the responsibility of safeguarding the financial position of this institution. Accordingly, all members should share in the temporary costs associated with overdue payments to the Fund by some of its members. The United States recognized the validity of this principle and, on that basis, agreed to the burden-sharing compromise reached last summer. This compromise involved an agreement that the "burden" be shared symmetrically and simultaneously by both creditors and debtors.

The sharing of the burden among creditors, however, was based on remunerated reserve tranche positions (RRTPs). Members with relatively small RRTPs would bear less of the burden compared to members with relatively large RRTPs. The United States' remunerated reserve tranche position is currently 38 percent of the total of such positions, while our quota share among creditors is only 25 percent. The relatively high share of the United States in RRTPs is due to a number of factors, including the ad hoc use of the dollar in operational budgets. We do not argue that use of the dollar in recent years has been excessive; it has been consistent with the principles which guide the operational budget. But use of RRTPs as the key for distributing the burden among creditors would have resulted in an unusually large and excessive share of the burden for the United States.

The Board has, of course, already endorsed the implementation of mitigation for the United States, "as practical...in the context of the operational budget." Two questions arise in that connection: how should the burden be measured; and what technique should be used to calculate the extent of mitigation.

On the question of measuring the burden (pp. 8-9), we agree with the staff that the appropriate concept of burden for this exercise is that relating to "the loss of revenue arising from the temporary reduction in remuneration." As the staff points out, this concept is more consistent with the approach followed under the burden-sharing decision.

The question remains, however, as to how much of this burden for the United States should be mitigated. The staff outlines three possible approaches, or techniques, for calculating the extent of mitigation. We believe that the appropriate approach, and the one the most consistent with our rationale in seeking mitigation, is the third approach, described on page 13 of the staff paper.

This approach calculates the amount of mitigation as the difference between the reduction in remuneration calculated on the basis of shares in RRTPs, and the amount calculated on the basis of quota shares. Thus, we would be mitigated on the burden that would arise from the difference in those two relative shares (currently 38 percent and 25 percent, respectively). While quota shares may not be a perfect indicator of the appropriate burden among creditors, they are a more long-standing and continuous indicator of relative economic and financial weight among Fund members. As such, we believe the United States's quota share can provide a very rough rule of thumb of what might be an appropriate share of the burden for the United States.

As the staff suggests, the use of our quota share for this purpose would not in any way suggest using quotas as a factor in determining the allocation of currencies under the operational budget. Indeed, this is not intended to alter in any way the basic method for determining the operational budget. I would also note that the amounts of mitigation calculated on the basis of this method are modest, and, as such, they would not distort the working of the principles underlying the operational budget. Furthermore, this approach would provide for a gradual reduction in the extent of mitigation for the United States over time, as the share of the U.S. RRTPs is reduced (See Table 1 of staff paper).

We recognize that there are a number of complex issues involved, and that the approach developed may not be technically optimum or perfectly equitable for all involved. I acknowledge these points, but believe that it may not be possible to develop the perfect solution, and considerable time has lapsed since the burden-sharing agreement was adopted without a program for mitigating the U.S. burden. Therefore, I hope that Executive Directors can today support the third approach outlined in the staff paper. We believe this provides a reasonable basis for implementation of the full range of decisions taken in connection with the burden-sharing agreement.

Mrs. Filardo made the following statement:

I understand that when the decision on burden sharing was adopted in July 1986 the discussion was a difficult but constructive one, and, as a compromise solution, it was agreed that the Board would consider different techniques of adjusting the share of the United States in the total remuneration position, with the aim of mitigating that share in the amount of burden sharing to be assumed by creditor countries.

We appreciate the contribution by the United States in agreeing to the cooperative notion of burden sharing; we understand that the issue of mitigation was an important factor in arriving at this solution, and in view of this, our chair is willing to endorse Mr. Dallara's proposal.

The arguments for our support are related to the reduction in remuneration and the special position of the United States as compared with other creditor countries.

As has been stated by the staff, the decision on burden sharing in July 1986 provides for a reduction in the rate of remuneration to help finance deferred income. The concept of burden has been defined in terms of the financial costs incurred by Fund members in operating the Fund. While this can be measured, it is not possible to make an allocation of cost because the financial burden is a matter for each individual member relating to its position in the Fund. Any change in this position, which can arise from the effect on members of the Fund's operations and transactions, shifts the burden of financing the cost of operating the Fund.

Since remuneration is paid according to the remuneration "norm" (75 percent of the member's quota as of April 1978, plus any increase in its quota), the amount of remuneration for each member depends on the size of the increase in its quota since April 1979. In the case of the United States, that increase has been below the average increase. This implies that it has a nonremunerated reserve tranche that is relatively large in terms of quota, so that the cost to the Fund for financing is relatively high in relation to those members with a relatively high norm. Therefore, the effective rate of remuneration for the United States is lower, if this consideration is taken into account. Furthermore, since 1981, the share of the United States in the net expansion of Fund credit financed by ordinary and borrowed resources has amounted to 25 percent of the total. Therefore, it would seem reasonable to consider the possibility of mitigation by the United States, taking into account the constraints stated by the staff, namely, the burden-sharing decision of July 1986, the harmonization principle governing the operational budget, and the fact that the loss of remuneration could be refunded when deferred income is discharged.

We agree with the staff that full compensation for the effective cost arising from the reduction in remuneration would be inconsistent with the concept of burden sharing itself. In the circumstances, the most appropriate mitigation approach seems to be that selected by the United States, which this chair is willing to support. Furthermore, we consider that the amount to be mitigated should be spread over four successive operational budgets and adjusted according to the adjustment in the rate of remuneration that stems from changes in new net deferred income.

Mr. Reddy made the following statement:

The Board has already agreed that the burden of newly deferred income should be shared equally between debtors and creditors. The issue before us today, therefore, is how the creditors should distribute their share of the burden among themselves, given the special position of the United States, whose average remunerated position amounts to 38 percent of the total. Let me state at the outset that the preference of this chair is to maintain status quo. This preference is based on three important considerations.

The first consideration is that the magnitude of the problem is simply too small to warrant a complicated change involving a mitigation and a subsequent reversal of that mitigation. For the first half of fiscal year 1987, the total creditors' share amounts to SDR 36.6 million, of which the U.S. share is 38.16 percent, which translates to SDR 14 million. (This figure is given on page 11 of the staff paper.) The United States feels that its share of 38.16 percent is too high. If we reduce the U.S. share of the burden from 38.16 percent to, say, 25.2 percent, which is the U.S. share in the quotas of creditor countries, the U.S. burden would amount to SDR 9.2 million. This means that by reducing the U.S. share from 38.16 percent to 25.2 percent of the creditor's share of the burden, the cost to the United States will decline from SDR 14 million to SDR 9.2 million, a gain of SDR 4.8 million during the first half of FY 1987. This amount of SDR 4.8 million represents the net gain to the United States. It is indeed a very small amount in the context of the United States, and I am surprised to learn from Mr. Dallara's statement that his authorities attach so much importance to this relatively small cost.

The second reason why this chair would prefer to maintain the status quo is that the problem is a temporary one and is likely to disappear in the next few years, as the U.S. share in the remunerated reserve tranche position of creditors declines from 38 percent to about 32 percent in 1988. It is also important to recognize that the loss of remuneration is refundable once deferred income is discharged.

The third reason for maintaining the status quo is related to the fact that the argument for a mitigation arrangement for the United States is an argument of equity--namely, that it is not fair for the largest creditor to assume a disproportionate share of the burden. I would submit that the equity argument is equally valid for the debtor group. The largest debtor countries, which are current in their obligations to the Fund, also have to bear a disproportionate share of the burden, and any change in the arrangements for distribution of the burden on the creditor side could also open the door for a similar request for redistribution of the burden among debtors. I believe this is an important consideration to be taken into account in reaching the decision today.

The problem of the very large remunerated reserve tranche position of the United States arises partly from the fact that, while the United States is excluded from the harmonization principle, the other reserve currency countries with strong balance of payments positions are sheltered under the same principle. I believe that in order to alleviate the problem of a very large U.S. reserve position, consideration should be given to introducing greater flexibility in the harmonization principle. We now have a multicurrency reserve system, and the time is perhaps ripe for consideration to be given to greater use of other reserve currencies in the Fund's operations than what might be justified under the harmonization principle, which, I believe, should continue to be applied only to nonreserve currency countries. I would appreciate the staff's comments on the feasibility of such an approach.

In conclusion, while this chair prefers to maintain the status quo, it can also go along with any consensus that might emerge among creditor countries, because the mitigation arrangement, which is the key issue today, is something which will directly affect only creditor countries, and we would be willing to go along with their wishes.

Mr. McCormack made the following statement:

As other speakers have already noted, the issue we are considering today, and the staff paper setting out that issue, is technically complicated. I must personally express trepidation about entering into this complex area. We have some doubts about the real need to mitigate the reserve tranche position of the United States, for reasons that I will set out in a moment. However, in the spirit of cooperation that characterizes the Fund, we would not object to some alteration in the rules on the use of currencies to reduce the burden on the United States.

Let me begin by pointing out that although the present system of determining the use of currencies for purchases and repurchases is operating in a relatively satisfactory fashion, that system is not engraved in stone. Part of the problem with the system is that the United States must be treated in a way different from other countries. My authorities have asked me to recall that when the present system was proposed, some thought was given to the idea that quotas should play a role, with some discussion of a constraint on the size of reserve positions with respect to quotas. Abstracting from such points, the United States feels it has a problem with the burden currently being placed on it. The staff has estimated that the United States is likely to forgo some SDR 28 million in interest payments during FY 1987.

Three options for mitigating the burden have been presented. Before indicating our preference, allow me to emphasize two or three points. First, it must be emphasized that any loss being experienced by the United States should be regarded as temporary. The real loss, or burden, due to overdue obligations, is the interest forgone on the unpaid remuneration payment in the period between the time it falls due and the time that it is actually paid.

Second, on the basis of the current guidelines for the use of currencies, there will likely be a substantial reduction in the share of the United States in total remunerated positions by mid-1988. To a certain extent, therefore, the problem we are facing today is self-correcting.

Third, as the staff points out, the use of U.S. dollars by the Fund has been broadly in line with the principles that guide such use and, bearing in mind that amount of net use of U.S. dollars since 1981 and the prospective changes in the U.S. position in the Fund, there would not seem to be a need for large-scale adjustment of the U.S. position through the operational budget.

As I have already noted, we do not object to an alteration in the rules for the use of currencies to meet the U.S. concern, although we agree with the staff that any alteration should be done only in relation to the cost of financing deferred income and not in relation to the increase in reserves.

Of the three options in the paper, the most intuitively attractive methods are those that attempt to bring the burden carried by the United States in line with the burden on the creditor carrying the next highest burden or with the appropriate quota share, recognizing that the use of quotas in this context is ad hoc. We therefore are relatively indifferent as between option 2 and option 3 set out in the staff paper, since they both appear to result in much the same effect on the net use of U.S. dollars. We might, if pressed, have a mild preference for option 2. In any case, given that the U.S. dollar on the transfer side has been mainly for operational payments, it probably is best to adjust the use of the U.S. currency on the receipts side.

I would like to conclude by noting that the high level of use of the U.S. dollar during the past four or five years is not accidental; it is the simple reflection of the global demand for the U.S. dollar as a reserve currency and as a means of transaction. In this broader context, it is clear that reserve currency countries derive considerable benefits, as well as experiencing some costs, from their special position.

Mrs. Ploix made the following statement:

I would like to underscore that the U.S. reserve tranche position has already decreased significantly over the past two years and is expected to decline further in the coming financial year. As a result, the relative positions of the United States and of other creditor countries have become more comparable, and the case for a mitigation seems to be less compelling.

However, as we agreed to examine ways of mitigating the share of the United States in burden sharing, we must now work out as practicable a solution as possible. Simplicity should be regarded as an essential criterion if the whole burden-sharing exercise is to remain manageable.

Since the staff had to devise a scheme within the framework of the operational budget, it could not but come up with a capitalization approach. I have no problems with this approach, but it is difficult for me to follow the staff reasoning in calculating the mitigation on an annualized basis. I do not see any strong reason for spreading out the amount of mitigation over four quarters. Instead of annualizing all the calculations, it would be much more straightforward, in my view, to keep to a quarterly basis.

After all, the final results will be the same, whatever method is used; moreover, as the rate of remuneration is now revised every quarter, it seems much more consistent to have the potential shortfall in remuneration reflected directly in the following quarterly operational budget. In the same vein, considering the fluctuations that can affect the revised rate of remuneration from one quarter to another, the extrapolation of a quarterly shortfall over the year can hardly be retained as a working assumption. Similarly, it is highly advisable that we end up with a method the results of which remain easily traceable, since the mitigation is a reversible process and will have to be unwound when the deferred income is paid back to the Fund. I therefore advocate a quarterly time frame instead of an annual one.

Nevertheless, given that the first adjustment to remuneration was calculated on a semiannual basis, and in order to facilitate a smooth inception of the new mechanism, I have no objection to the spreading out of the first amount of mitigation.

Of the three options described in the staff paper that could be used to determine the exact amount of mitigation, I have a strong preference for the third.

The first method appears too arbitrary in recommending a 50 per percent reduction in the calculated amounts. Why not a 33 percent or 25 percent reduction?

On the second option, I do not think that the point of reference, i.e., the next largest creditor, is relevant. In my view, the U.S. position should be viewed in the context of the Fund in order to remind us that, on some occasions, an outstanding position induces some special duties toward the institution.

Therefore, although it makes direct references to quotas, I support the third method, which is more broadly based. I wish to make sure, however, that quotas remain an ad hoc basis for calculating the amount of mitigation and that this reference to quotas does not mean use of quota shares to measure financial burden or to determine the allocation of currencies under the operational budget. I was glad to hear Mr. Dallara's confirmation of this point. I also want to be certain that there will be no technical difficulty raised when arrears are refunded and consequent modifications are made in the operational budget.

To conclude, I reiterate my support for this basic scheme as effected through the third option.

Mr. Lankester observed that he had been among those strongly supporting the final package of measures on burden sharing in the summer of 1986. As the staff noted, that package included the agreement that "techniques will be studied, and implemented as practical, of adjusting in the context of the operational budget the share of the United States in total remunerated positions with a view to mitigating the share of the United States in the amount of burden sharing to be assumed by the creditor countries." He freely admitted that he had had little idea at the time what that sentence might have meant in practice, but he had reservations about the equity for the United Kingdom of its shouldering more than a small part of the burden of mitigation. After all, the United Kingdom had the highest unremunerated reserve tranche relative to its quota of any of the large members of the Fund and, accordingly, bore a sizable share of the costs of the Fund.

There had been several key factors in the July 1986 agreement on burden sharing, Mr. Lankester continued. First, the United States had raised a specific problem, which others had agreed to attempt to tackle. Second, it had been agreed that the effort to tackle the problem would be made in the context of the operational budget, although as he had said earlier, he had not fully understood the implications of that agreement. Finally, the term "implemented as practical" had been an important qualifier. He believed that the Treasurer's Department would be the first to agree that none of the options put forward was particularly logical. Rather, each was an attempt to reconcile conflicting objectives in a way that did not open up a "Pandora's Box" of other special cases or suggest a precedent for considering the operational budget generally on the basis of quotas. His authorities had, while hoping to resolve the problem without undue delay or complication, found no elegant solutions among the options offered. The Treasurer's Department had made an admirable attempt, but it might have done better if it had shown how other creditors would be affected by each of the options. Such a presentation would have shown that under each of the options, the share of the United Kingdom in mitigating the U.S. share of the burden would be greater than the share for any other country: 18.5 percent for the United Kingdom against 12.5 percent for Saudi Arabia and Germany and 7 percent for Japan and France.

One implication of using the operational budget as a basis for the mitigation was that countries that had excessive credit positions in the Fund relative to their reserves and balance of payments positions would have to bear a large part of the burden of mitigation, Mr. Lankester remarked. The reason was that the operational budget provided for a faster reduction in the credit position of such countries, and mitigation involved a "countermanding" of that reduction. The result for the United Kingdom was that it would bear almost 1/5 of the cost of mitigation under any of the options offered. It seemed curious, if not unfair, that the United Kingdom should be bearing nearly three times the burden of mitigation of both France and Japan.

To be frank, Mr. Lankester said, the solutions proposed by the staff were not equitable, and there was no overriding force of logic that suggested that such inequities should be ignored. Nevertheless, the amounts involved were small when viewed in the overall context of the flows in the operational budget. Also, the issue of the mitigation of the U.S. share of the burden would be a most unwelcome problem to place before a new Chairman. In the hope of clearing the matter up at the present meeting, he was prepared to go along, with some discomfort, with option 3 in the staff paper, which was Mr. Dallara's preferred solution. His own preference would have been option 2. He hoped that his willingness to compromise would be seen as a useful contribution to the effort to tie up what he regarded as the last loose end of the original burden-sharing package.

Mr. Goos made the following statement:

> I agree with Mr. Dallara that the understanding reached by this Board on the mitigation of the U.S. share of the burden constitutes an integral part of the overall burden-sharing agreement. We, for our part, are prepared to honor that understanding. For the issue to be resolved at the present meeting is not so much a matter of how to justify the mitigation sought by the United States as to discover what formulas should be applied to measure the burden and to determine to what extent the burden should be mitigated. Nevertheless, before turning to these rather technical questions, I should not conceal that we hold some basic reservations about the notion of mitigation, particularly when it takes the form of selective relief. These reservations reflect the concern that we might create an undesirable precedent for similar requests by other members in other areas of Fund policy and that we could undermine the principle of equal treatment and, hence,

one of the cornerstones of Fund policy. My concern, I believe, carries all the more weight, considering that the financial costs involved for the United States are certainly less than substantial by all relevant standards. Moreover, while I acknowledge that the alternatives proposed in the staff paper would not substantially affect the principles that underlie the operational budget, I am concerned that undue tampering with those basic principles, by introducing rather irrelevant allocative criteria, could impair the functioning of the budget.

On the other hand, I should explicitly recognize the continued outstanding contribution of the United States to the operational budget, a contribution which is all the more commendable in view of the difficult external situation the United States has been facing for several years. Moreover, I have considerable sympathy for the U.S. request for mitigation, inasmuch as I share the view that reserve tranche positions and indebtedness to the Fund are not satisfactory criteria for burden sharing. I am, of course, aware of the strong dislike of our Legal Department for a quota-based allocation of the costs of deferred charges. But in view of the highly exceptional nature of those costs, I continue to feel that it would be more consistent with the cooperative character of our institution if the burden were borne by the membership at large and not by precisely those debtors that are punctual in their debt service payments to the Fund nor by those creditors that already shoulder a considerable part of the burden of financing the Fund.

On the specific mitigation formulas proposed in the staff paper, our first preference is for option 3, provided that this formula is applied uniformly to all creditors in order to mitigate and redistribute their burden as calculated on the basis of remunerated reserve tranche positions. This proposal may sound like a rather radical departure from option 3 as put forward by the staff. I should note, however, that it would fully meet Mr. Dallara's concerns. The reason why I could accept only such an extended and uniform version of option 3 is simple: if one relates, both for the United States and Germany, the burden calculated in accordance with the burden-sharing formula--i.e., on the basis of remunerated reserve tranche positions--to the burden calculated on the basis of creditor quota shares, the resulting ratio for Germany is higher than the ratio for the United States. In other words, if quotas are believed to represent an adequate yardstick for measuring the appropriateness of the burden, as implied in calculations of option 3, one has to conclude that the burden assigned to Germany under the burden-sharing formula is even more out of line than that for the United States. I think you will agree that in these circumstances a selective mitigation of the lower U.S. burden would be very difficult to justify to the external auditors in charge of assessing our transactions with the Fund.

If the Board is unable to go along with a revised version of option 3, I could accept as a second preference option 2. The formula underlying this option might be more arbitrary than that for option 3. Nevertheless, it would have the advantage of basing the calculations on the difference between the U.S. share and Germany's share and, hence, on an indicator that captures unambiguously the exceptionally high nominal burden borne by the United States. For the time being, I shall await the reactions of my colleagues and retain the option to re-enter the discussion later to elaborate further on my proposal in light of their comments.

Finally, let me emphasize two additional points which appear to be of importance. First, we assume that any kind of mitigation will be reversed by increasing the net use of the currencies in question once there were net payments to the Fund on previously deferred charges. Second, I take it that any mitigation procedure will be terminated with the termination of the burden-sharing agreement, i.e., at the end of fiscal year 1988.

Mr. Nimatallah asked how many members of the Fund were not participating in the burden-sharing scheme at present.

The Deputy Treasurer replied that some 26 countries were in a neutral position with respect to the scheme.

Mr. Nimatallah wondered whether there was any way to ensure that those 26 countries would share in the additional burden that would be created by the mitigation of the U.S. share. As Mr. Lankester had noted, the United States was not the only country carrying a burden larger, on a percentage basis, than its quota share among the creditors. He would like to find a way of spreading the additional burden among those that were at present not carrying any of the burden.

Mr. Donoso said that it was his impression that among debtor countries were some paying perhaps 2-3 times more under the current burden-sharing scheme than what they would pay if the cost of overdue payments were distributed according to quota shares in the membership as a whole. While the United States was perhaps paying more than its share among creditor countries would warrant, it was certainly paying less than it would have to pay if the burden were calculated on the basis of quota shares in the membership as a whole.

Mr. Zecchini expressed the hope that the issue of burden sharing would not be reopened. The debate on that issue had been a long and difficult one, and reopening it at the present meeting would pre-empt the review of the entire mechanism that was envisaged some two years hence. He hoped that the focus could remain the issue of the mitigation of the U.S. share of the burden.

Mr. Rye stated that he strongly supported Mr. Zecchini's views. If one approached the issue at hand on the basis of quota shares, all sorts of problems could arise. For example, his own country had a relatively small remunerated reserve tranche position but paid a net cost for the privilege.

Mr. Nimatallah said that he hoped his remarks had not been misconstrued. He was in favor of Mr. Dallara's request, but he was afraid that approving it would lead to similar requests by others. He had hoped to avoid a litany of requests by focusing on the heart of the problem. Mitigation, as he understood it, meant taking some of the burden from one member and transferring it to others, some of whom might already be overburdened. The question was whether such an approach was equitable and whether it could be reversed smoothly later if overdue charges were paid. In general, he was not opposing Mr. Dallara's request; he was only asking his colleagues to be aware of some of the problems and to adopt a rationale to the approach that was defensible. It would also be important for Directors to be clear about the precise figures under discussion. It was his impression, in that respect, that even countries like Singapore were carrying more than their fair share of the burden. It was against that background that he had asked his colleagues to look at the possibility of imposing, say, a small charge on those members not currently affected by the burden-sharing decision. That charge would help to offset the additional burden on some members that would be created by the mitigation of the U.S. share of the burden.

Mr. Dallara stated, first, that he would appreciate clarification of the number of countries not participating on either side of the burden-sharing arrangement at the present stage. Second, he was not certain Mr. Donoso was correct in stating that if the entire burden were to be distributed on the basis of quotas, the United States would be bearing more of the burden than it was currently bearing on the basis of its remunerated reserve tranche position among the creditors.

He was pleased to hear that Mr. Nimatallah was supportive of his request, Mr. Dallara continued. While acknowledging the legitimacy of some of the broader issues raised by Mr. Nimatallah, he would join Mr. Zecchini and others in noting that Mr. Nimatallah's proposal related to the entire burden-sharing arrangement and might better be discussed in the scheduled review of that arrangement. The issue before the Board at the present meeting concerned the implementation of a mitigation scheme that in principle had been endorsed by all creditors. While a number of other creditors might have legitimate concerns of equity, those creditors had accepted the proposition as part of the burden-sharing arrangements that the U.S. request for mitigation should be met if a practical means could be found for doing so. Suggestions to extend mitigation to other countries at the present stage would seem to be inconsistent with implicit and explicit aspects of the understandings that had been reached. The fact that only one creditor had expressed enough concern about the issue to ask for a mitigation of its share of the burden did not deny the validity of its concerns and should not hold up action to give effect to the agreement to mitigate the U.S. share of the burden.

Mr. Goos commented that while he did not contest that an understanding had been reached that the U.S. share of the burden should be mitigated, he had some difficulty with the notion that the Board had decided necessarily to implement a selective mitigation only for the United States. Against that background he had proposed an extended version of option 3, which would still meet Mr. Dallara's concerns but would at the same time meet some of his own.

Mr. Nimatallah noted that while the Board had accepted that the U.S. share of the burden would be mitigated, many Directors at the time had not been clear about how the burden would be shifted and on whom it would be placed. Now that the time for implementation of the agreement had come, it was clear that some countries, already overburdened, would be asked to bear an even greater share of the burden as part of the mitigation of the U.S. share. It was in that context that he had asked the Deputy Treasurer for a list of those countries bearing none of the burden under the burden-sharing arrangements, in the hope that a way could be found to spread among those countries some of the additional burden that would be created by the mitigation of the U.S. share.

The Chairman said that while he understood Mr. Nimatallah's concerns and appreciated the logic behind them, he felt compelled to remind Directors that a rather different logic had been at the root of the July agreements. At that time, Directors had accepted that those countries with a remunerated reserve tranche position would share in the burden by receiving less remuneration, while those paying charges would share in the burden by paying higher charges. There had been no suggestion of imposing any sort of fee on those members not paying charges or not receiving remuneration. Any attempt to impose such a fee at the present stage could reopen the entire burden-sharing issue.

Mr. Nimatallah commented that it was not his intention to reopen the matter at the present meeting. His hope was that his suggestion would be reviewed at a later stage.

The Chairman noted that the burden-sharing arrangement was by no means set in stone and that Mr. Nimatallah's approach could certainly be looked at in due course.

Mr. Lankester recalled that the July discussion on burden sharing had been laborious and, at times, heated. Some basic decisions had been taken, and the only remaining outstanding issue was the question of how the U.S. share of the burden might, if practical, be mitigated. He hoped that the basic decisions taken in July would be left untouched and that his colleagues would focus on the specific problem of how the U.S. share of the burden should be mitigated.

Mr. Sengupta agreed with Mr. Lankester that the Board should focus on the only outstanding issue relating to the burden-sharing decisions. Still, he could see some logic in Mr. Goos's point that whatever approach was adopted should be a rational and equitable one.

Mr. Posthumus made the following statement:

International burden-sharing operations tend to be extremely complicated, and the adjustment to the share of the United States in burden sharing threatens to make the one we have even more complicated. Still, the Board agreed that a certain adjustment of the U.S. share would take place, and I take that as a starting point.

The conclusion of the staff that in view of the prospective reduction in the size of the U.S. position in the Fund over the period to mid-1988, it is not necessary to effect a large scale mitigation arrangement for the United States is, I hope, acceptable. A second conclusion is that, as quotas were not accepted as a basis for the measurement of the financial burden, nor for determining the allocation of currencies under the operational budget, we should not use them to measure the adjustment of the U.S. burden now. Mr. Goos's first preference would, I think, increase the complications, so we should not take that road.

The question then is whether we can find another technique of more or less objectively adjusting the reserve tranche position of the United States.

The staff has given two illustrative calculations in Table 3. The table indicates that the cost for the United States of its share of financial overdue obligations in terms of a reduction of remuneration is SDR 28 million. If the reserve tranche position of the United States were mitigated by SDR 200 million in a year, then this would yield an income for the United States of 7 percent of SDR 200 million, or SDR 14 million, a mitigation of the cost by one half.

However, a decrease of the reserve tranche position of the United States would also mean that the remuneration for the United States would decrease. As the effective rate of remuneration for the United States is relatively low, this loss of remuneration will be less than the 7 percent which the United States can earn by investing its reserves in the market rather than in the reserve tranche position in the Fund. So, there will still be a gain, but it will be much smaller than Table 3 leads us to believe, for any of the three options.

Considering the limited amounts at stake, I wonder whether we should seek "objective" solutions to the problem. Appendix II indicates that ad hoc proposals guide the use of the U.S. dollar in the operational budgets. The desire to mitigate the U.S. share in

> burden sharing may be included in these ad hoc proposals, e.g., through the factor of the relative strength of the dollar in the exchange markets. This position happens to be weaker now, which is perhaps helpful for the United States already.

Mr. Zecchini observed that the nature of the subject before the Board was such that it did not require extensive discussion or bargaining. Directors were being asked to deal with the implementation of part of the agreement in principle already agreed in the July 1986 discussions on burden sharing. There was no question of applying the principles incorporated in the Articles of Agreement or of subjecting the proposal under review to economic analysis or technical justification. Indeed, there were no grounds for justifying the proposed changes in the budget procedures other than a political concession to the United States by a small group of creditor countries. In that respect, it was his understanding that given the particular role played by the U.S. currency in Fund transactions, the current method of burden sharing, which was based on remunerated reserve tranche positions, placed a burden on the U.S. budget at a time when all efforts must be directed toward reducing the U.S. budget deficit. As a political gesture of solidarity, he was ready to agree to a mitigation of the burden for the United States and to the staff's definition of the basis for mitigation, which confined mitigation to the loss of revenue resulting from the reduction in remuneration. In passing, he hoped that in adopting the proposed decision, those countries that would not be taking over the burden of mitigation would comply with the agreement that would be reached between the United States and those countries called upon to relieve part of the U.S. burden.

On the share of the burden to be mitigated, Mr. Zecchini said that he did not wish to enter into a technical discussion on the three optional approaches. Each of the techniques was arbitrary in nature as well as in result; hence, he could go along with the approach preferred by the U.S. authorities, although with three qualifications that should be introduced either as part of the decision or in a preamble.

First, Mr. Zecchini continued, it should be clear that by agreeing to the mitigation, the Board was not introducing any new principle that could be applied to other similar cases in future. The decision should in no way change the underlying principles on which the operational budgets were calculated. Second, the mitigation must be seen as a temporary measure aimed at dealing with a rapidly changing situation. According to the staff's estimates, the U.S. share in total remunerated reserve positions should decline from the current 38 percent to about 32 percent by April 1988, and the latter percentage could be considered an acceptable base for burden sharing. Therefore, to stress the exceptional and temporary nature of the measure, it was essential to fix a deadline for the expiration of the mitigation procedure. In his view, the procedure should under no circumstances be applied beyond 1988. It should also be understood that the procedure would include a mechanism for the reversal of previous mitigations when deferred income was repaid by the debtors.

Third, Mr. Zecchini remarked, it might seem unfair to put in place an open-ended mitigation process. It was not in his view appropriate to ask the creditors to shield the U.S. position for whatever amount of reduced remuneration might emerge during the two years of operation of the mitigation procedure. It would be advisable to establish some maximum amount of allowed mitigation. For illustrative purposes, the ceiling could be set at the highest level currently estimated on the basis of the three approaches outlined by the staff.

Mr. Yamazaki made the following statement:

As the staff paper rightly notes, it is important to bear in mind that the operational budget is not determined by financial incentives or disincentives resulting from gains or losses deriving from interest rates or exchange rates. The Fund's policy with respect to the operational budget, which is based on the balance of payments and reserve positions of members and developments in their exchange markets as well as the desirability of promoting over time balanced positions in the Fund, remains appropriate and should continue to be so. Principles behind ad hoc proposals that have been made with respect to the use of U.S. dollars in the operational budget have also been valid, and I see no need to change them.

At the same time, I understand, to some extent, the concern expressed by Mr. Dallara on the amount and the proportions of the burden that the United States will have to bear as a result of the burden-sharing scheme. I also recognize that taking a renewed look at this matter was a precondition for the United States to agree to the burden-sharing scheme. Under these circumstances, if it is accepted by the Board that mitigation of the burden is only a temporary measure and does not mean any modification of the principles which govern operational budgets, I can go along with a modest mitigation scheme. Of the three options outlined by the staff, I would prefer option 3, but, if the majority of the Board supports it, I could go along with option 2, as well.

Mr. Schneider made the following statement:

Despite the basic understanding on burden sharing reached at the end of July 1986, I have to admit that I was somewhat puzzled when we started discussing techniques for mitigating the amount of the U.S. participation in the burden sharing to be assumed by the creditor countries. I was left slightly at a loss to discern fundamental differences among creditor countries, based on the use of their currencies by the Fund, disregarding the fact that the United States, as the predominant reserve currency country, is more or less the only creditor country which can use its own national currency for Fund transactions. Moreover, I share the staff's view, expressed on page 5 of the paper, that the Fund's use of U.S. dollars over time has been in line with the general principles which are supposed to guide such use. I have also noted that this view has not been challenged by Mr. Dallara.

The only justification I could find in the paper for any mitigation arrangement in favor of the United States is the fact that the "norm" for the United States is 1.06 percent below the average "norm," and that this in turn means a lower effective rate of remuneration compared to creditor countries with a higher "norm." I must also admit that I did not find this line of reasoning overly convincing.

There are additional reasons for our rather moderate enthusiasm for the various mitigation schemes as outlined in the paper. First, the burden arising from deferred income has always been considered a temporary one, and there is no reason to suppose the amounts deferred this time will not be made up in the near future. If we accept any of the proposals, we run the risk that this could be interpreted as a sign that we no longer expect full repayment of the deferred amounts.

Second, whatever loss the United States incurs would already largely be mitigated by the normal working of the operational budget, because it is assumed that the U.S. reserve tranche position will contract sharply until April 1988.

Third, the cumbersome Fund procedures required to administer this relief arrangement could somewhat outweigh the prospective benefits for the United States.

However, since the majority of the Board seems to favor a mitigation arrangement that would in no way distort the principles underlying the operational budget, we might go along with a mitigation arrangement for the United States. Such an arrangement ought to be confined to the cost of financing deferred income, with the clear understanding not only that any mitigation decision would remain an exception, but also that the whole matter should be phased out before the end of FY 1988 at the time of the review of the burden-sharing decision.

On the method to be applied for calculating a possible mitigation, it seems to me that the second alternative is the least objectionable, because it at least relates the amount of mitigation to the size of the burden borne by other creditors. The first method fails for lack of any objective criterion for deciding by what percentage the burden should be lightened, while the third is not consistent with the general understanding that quotas do not reflect the relative strengths of members' external finances and thus their ability to finance their reserve positions in the Fund. But in the spirit of cooperation, and bearing in mind that the differences between methods 2 and 3 is rather minimal, I could also go along with option 3 if the majority of the Board favors it.

Mr. Nimatallah said that it was his understanding that remuneration for the United States under the burden-sharing decision would be reduced by some SDR 14 million but that if the reduction were related to the share of the United States among the creditor countries, the amount would be SDR 9.2 million. The difference--SDR 4.8 million--might be called the additional burden for six months. Capitalized over one year, the amount would be SDR 137 million. Assuming that was the amount by which the U.S. share of the burden would be mitigated, he would like to see the mitigation process spread over, say, eight quarters rather than the four proposed in order to soften the effect of the mitigation process on those who must bear the additional amount of burden brought about by the mitigation process.

The Deputy Treasurer responded that it was of course a matter for the Board to decide how long to spread the calculated amount. However, it seemed rather inconsistent to calculate the amount to be mitigated on an annual basis and then to spread it out over more than a year. Moreover, the adjustment would become a kind of "rolling" adjustment in each quarter as net new deferred income might be incurred and previously deferred income might be discharged. The calculations to take account of those differences would have to be drawn out beyond the two-year period, which would take the process well beyond the end of the period of adjustment under the burden-sharing decision, which was scheduled to be reviewed at the end of FY 1988. It should perhaps be noted that even the method proposed by the staff, under which the amount would be spread over four quarters, would take the scheme two quarters beyond the end of FY 1988.

Mr. Nimatallah remarked that he was still unclear about the extent to which the amounts in question were to be mitigated. His understanding of the term "mitigation" was more like "reduction" than "elimination," and it appeared that the staff was proposing elimination of the additional burden of SDR 4.8 million calculated on a six-month basis.

Mr. Dallara replied that there appeared to be some misunderstanding with respect to what his authorities were seeking. He was not asking for an elimination of the burden, which was equivalent to SDR 14 million for a six-month period; rather, he was seeking to have the SDR 14 million mitigated or reduced to SDR 9.2 million. On the period of the adjustment, he would have considerable difficulty with Mr. Nimatallah's proposal to accomplish the adjustments in the operational budget over a period of eight quarters rather than four. Indeed, the only reason for going beyond even one quarter was to avoid the potentially disruptive effects such action might have on the operational budget. Spreading the mitigation process over a period of four quarters meant that the burden would be carried by the United States longer than necessary and that the United States would lose the interest it might have earned on the additional income. While he could accept spreading the mitigation over four quarters for the reasons he had mentioned, he would have difficulty spreading it over any longer period.

Mr. Nimatallah reiterated that he was willing to go along with the U.S. request for both the amount and the period of the mitigation. He had only wanted to make clear to his colleagues that others suffered a similar burden and that any decision to mitigate the U.S. share was a political one and not based on any technical rationale. Before concluding, he asked the staff to circulate an additional table showing the distribution of the reduction of the amount of members' receipts in the operational budget on various assumptions for the amount of the mitigation.

Mr. Sengupta made the following statement:

I heard Mr. Reddy this morning clearly bring out the logic, or lack of logic, behind the issues being discussed today. I have little to add to his arguments except to highlight two points. First, the somewhat large remunerated reserve tranche position of the United States at present is a result of application of the sound principles that underlie the operational budget and, therefore, it is logical that the United States will have to bear an equiproportional share of the burden, which at this point in time is somewhat large in absolute terms. Second, if we are to apply a similar logic to the burden to be shared by the debtor countries, the countries that are large borrowers from the Fund today would have to bear a large portion of the burden due to deferred income on overdue obligations. And these are in fact poor countries that deserve some respite from their already heavy debt burdens. Because they are large borrowers at present, they are obliged to bear a large part of the burden under our decision.

Having said this, I recognize, as indicated by Mr. Dallara in his opening statement, that there was an understanding in our decision on burden sharing in July 1986 that attempts would be made to mitigate the share of the burden to be borne by the United States, and it is only fair that we implement that understanding. The staff has come up with three alternatives for reducing the remunerated reserve tranche position of the United States so as to mitigate its burden. Among the three alternatives, however, the third approach appears to have a greater rationale, since it is linked, though indirectly, to quotas and thus reflects to some extent the economic capacity of countries. However, since by implementing any of the alternatives, we will be departing from the principles of the operational budget, the extent of mitigation becomes a purely judgmental matter on how far other creditor countries are prepared to take up that burden. That is for the

Executive Directors representing those countries to decide, and I can support any consensus that can be developed on the issue in view of our July 1986 understanding.

Mr. Dallara remarked that it should be understood that the sound principles underlying the operational budget had been essentially ad hoc as far as the use of the U.S. dollar was concerned, and that was a point that might not have been fully appreciated by those countries not directly involved in the operational budget. As he understood it, for every country, other than the United States, whose currency was used in the operational budget, an effort was made to harmonize the relationship between the member's remunerated reserve tranche position and its gold and foreign exchange holdings. The gold and foreign exchange holdings of the United States were rather low in relative terms, and applying to the United States the approach taken to other countries would yield an exceptionally low use of the U.S. dollar in the operational budget, which would greatly complicate the implementation of the budget. Accordingly, and for quite some time, an ad hoc approach had been used for the United States that bore little if any relationship to the approach applied to other members. The result had been a heavy use of U.S. dollars in the operational budget, ranging from 1/4 to nearly 1/2 of the total of currencies used.

The Deputy Treasurer confirmed the points made by Mr. Dallara, adding only that, on the receipts side of the budget, amounts were allocated in proportion to members' reserve tranche positions. It was difficult to assess the significance of the gold and foreign exchange reserves of the United States in the allocation of currencies under the operational budget, in part because the method of valuation of gold followed by the Fund was based on the official price of SDR 35 per fine ounce. It was also true that for a reserve currency country like the United States, the extent to which its reserves directly affected its ability to convert its currency was a moot point, because there was in fact very little conversion of U.S. dollars when they were sold by the Fund, and whatever conversion was made was executed through the foreign exchange market.

Mr. Rye stated that he wished to associate himself with the remarks made earlier by Mr. Posthumus and Mr. Zecchini. The current Board discussion had been necessitated by the Board's desire to meet the commitment to the United States it had made following a long and difficult discussion in July 1986 on the burden-sharing arrangements. Any attempt to clothe the current exercise in objectivity could only lead to trouble, as comments by some earlier speakers had already demonstrated. He would prefer that the arbitrariness of the decision be as transparent as possible in order to limit possible future repercussions of any decision adopted at the present meeting. The most plainly arbitrary of the alternatives proposed by the staff was the first, although how far one should go in applying a simple proportion to arrive at the amount to be mitigated was open to question. In that respect, he would not necessarily wish to adopt option 1 with a 50 percent mitigation. Indeed, on that point, he had some sympathy with Mr. Nimatallah's concerns and found it difficult to see why the burden for the United States, after mitigation, should be less than that borne by Germany, which was precisely the outcome of option 3. Logically, he would have thought that the remaining burden for the United States should be somewhat greater than that for Germany. In other words, if pressed, his preference would be for a 25 percent mitigation under option 1 rather than a 50 percent mitigation. However, he recognized that his proposal was unlikely to be well received. Since the members of his constituency would not be greatly affected by whatever decision was adopted by the Board at the present meeting, he was prepared to join any consensus that might emerge.

Mr. Hospedales made the following statement:

> The staff paper (EBS/86/280) outlines three options, all aimed at mitigating the cost to the United States of its share in burden sharing. This initiative is in line with our understanding of the principle of burden sharing and the financing of overdue obligations.
>
> The staff paper has set out a technical rationale for the emergence of the particular problem facing the United States, and that rationale does not bear repetition; suffice it to say that a high past net use of U.S. currency--stemming from its reserve currency function and predominance as a trading currency--combined with its below average remuneration "norm," and the reluctance of the United States to enter into formal lending arrangements with the Fund, as others have done, have resulted in a nonremunerated reserve tranche position for the United States that is relatively large in terms of quota. Accordingly, the cost of financing the Fund is relatively high for the United States when compared with the cost to other members with relatively high "norms" and relatively small nonremunerated reserve tranche positions. The upshot of this is that the effective rate of remuneration for the United States is relatively low and would become even lower as a result of the costs associated with the temporary reduction in the amount of remuneration under the burden-sharing arrangement.
>
> The calculation of the loss of revenue resulting from the reduction in remuneration is consistent with the burden-sharing decisions on the temporary financing of deferred income. The staff is correct, it seems to us, to base mitigation on a calculation of the amount of resources--at the present five-year SDR interest rate--that would be needed to generate the equivalent of the loss of this revenue. Of course, full compensation would be inconsistent with the concept of burden sharing. Of the three options proposed by the staff on page 14, we could support option 3, which determines the extent of mitigation by the difference between the actual loss of remuneration to the United States and the loss of remuneration calculated on the basis of the share of the United States in the quotas of creditor countries. While

recognizing, like Mr. Dallara, that this approach may not be technically optimum or perfectly equitable for all those involved, it seems to us to be the least arbitrary of the three options. The question arises, however, in the context of a number of remarks, whether mitigation on the same basis could be made available to countries other than the United States. We also find acceptable the proposed procedures for implementing these mitigation arrangements, as defined on pages 18 and 19 of the staff paper.

Mr. Fugmann made the following statement:

In his helpful statement, Mr. Dallara refers to the Board's understanding on burden sharing. Allow me to quote--as is done in the staff paper--the relevant sentence of the Chairman's summing up of our meeting last July on the principles of burden sharing:

> "Techniques will be studied, and implemented as practical, of adjusting, in the context of the operational budget, the share of the United States in total remunerated positions with a view to mitigating the share of the United States in the amount of burden sharing to be assumed by the creditor countries."

This sentence is the basis for our discussion today, and my authorities have the following general remarks to make, which constitute less than a warm embrace, but not a repudiation, of the compromise of last July. They regret that the United States has insisted on an adjustment of its reserve tranche position in order, at least temporarily, to keep down its portion of burden sharing. The staff document shows that such special treatment at worst could jeopardize the application of the principles which guide the lending activities of the Fund. Moreover, we find it somewhat odd that the staff refers to the effective rate of remuneration for the United States as being relatively low, as this is a result of overall decisions relating to quota reviews approved by all member countries, including the United States. These decisions have, inter alia, resulted in a less than average rate of increase in the U.S. quota. In addition, such an intercreditor arrangement is not necessarily helpful in solving the arrears problem, as it can be interpreted as lack of confidence that deferred income will be paid to the Fund with the ensuing repayment of forgone remuneration to the creditor countries.

At the same time, my authorities are aware that the United States can make other demands in case the desired adjustment of the reserve tranche position is not implemented. For instance, there may be a risk of demands--with reference to balance of payments and exchange rate developments--of more far-reaching decreases in the sale of the U.S. dollar in the operational budget, which can create larger difficulties for other member countries and the Fund than the adjustment now being considered. We find it important, first, that such an adjustment, and possible later modifications of it on the basis of repayments to the Fund, should be effected through the operational budget; second, that the other general principles underlying the operational budget be maintained; third, that the adjustment should only relate to reduced remuneration as a result of deferred income as suggested by the staff. I understand from Mr. Dallara's statement that the U.S. authorities agree with these points. Finally, we find that the amount involved in the adjustment should be as low as possible, particularly in view of the projected sharp contraction of the U.S. share of total remunerated positions to mid-1988.

Mr. Donoso made the following statement:

The distribution of the burden on member countries arising from overdue payments is far from satisfactory. We are focusing today on alternative ways to correct the effect on one member country, which among the creditor members of this institution is one of those most affected by the burden sharing scheme. However, looking at the papers and at additional figures related to the subject, we have noted that the United States--once figures are presented in relative terms rather than in absolute terms--is not the country, among creditor countries, making the largest contribution to the burden sharing system to cope with the effects of overdue payments. There are smaller countries, which, in relative terms, are contributing more than the United States.

We wonder whether it is appropriate to center our discussion on ad hoc ways to accommodate one specific situation in a manner which would increase even more the burden of those other smaller creditors. We would have preferred a wider approach to apply some solutions that would have equalized the burden for each creditor member, after expressing it in proportion to their quotas.

Of course, adjusting the operational budget is not a mechanism which could be used if some kind of proportionality in the burden assumed by each creditor is an objective of the exercise. We would have liked to see alternative approaches to bring down the burden of the United States, but as a part of a mechanism able to provide a fairer contribution for each creditor member.

We can support the proposal that applies some mitigation and leaves the burden for the United States as if all creditor members were bearing the same burden in proportion to their quotas. This is option 3. We would hope, however, that this would be only a temporary measure to be replaced by some mechanism which actually would equalize the burden of each creditor as a percentage of its own quota. At this stage, we would like to reiterate very briefly our view that the excessive burden being assumed by debtor countries is more worrisome than the arbitrariness of the distribution of the burden of overdue payments among creditors.

In the present system, before modification, the United States is paying a percentage of the total cost of overdue payments that is lower than the percentage of total quotas represented by the United States. There are debtor countries that are bearing a percentage of the total cost of overdue payments that is twice or three times higher than the percentage of the cost they would be bearing if the burden were allocated among member countries in proportion to their quotas. We find this very unfair and even worrisome, given that nearly 50 percent of debtor countries are having difficulties meeting their obligations to the Fund and have been late in settling those obligations. We hope that at some point the cost of overdue payments will be distributed among all members in proportion to their quotas.

Mr. Abdallah remarked that a consensus seemed to be emerging in favor of option 3, which he could endorse.

Mr. Alhaimus made the following statement:

Basically, I share the conclusion of the paper that in light of net use of U.S. dollars since 1981 and the prospective changes in the U.S. position in the Fund, there would not seem to be a need for a large-scale adjustment of the U.S. position through the operational budget. Any mitigation that might prove necessary in light of the burden sharing consensus should, however, take into account the prospective sharp reduction in the size of the U.S. position in the Fund by mid-1988; it should not substantially alter or distort the principles underlying the operational budget; and it should, more importantly, be based on a clear concept of the burden and its measurement.

The mitigation approach proposed by the staff raises a number of complex issues and, as acknowledged by Mr. Dallara, "may not be technically optimum or perfectly equitable for all involved." The question that comes to mind, as Mr. Reddy and others have already noted, is whether the magnitude of the burden, especially in light of the size and role of the U.S. economy in the world, justifies the establishment of such a complex system on which so many questions remain.

The most difficult aspect of the approach is how to define the concept of burden and to measure it. This question has been resolved rather arbitrarily, by choosing the concept of loss of revenue arising from the temporary reduction in remuneration. The extent to which this loss is temporary and reversible should have led to a more careful consideration of the other concept, based on loss of interest income. The discussion so far has also added many questions and, as Mr. Zecchini observed, the mitigation procedures can only be seen in terms of the burden sharing compromise.

Finally, on mechanisms, I fully share the remarks by Mr. Goos and Mr. Nimatallah on the need for uniformity and equity. Indeed, it would be difficult for some creditor countries, including those in our constituency, to understand why a selective arrangement has been devised for one creditor while some other creditors are bearing an even higher relative share of the burden. On the basis of the principles underlying the third option, for instance, those other creditors are even more qualified for mitigation. Therefore, we expect that, should a mitigation mechanism be established, the concerns of small creditor countries would be taken into consideration in the actual drawing up of future operational budgets.

Mr. Yao considered that all major issues had been raised by previous speakers, and he could limit his remarks to supporting the consensus that seemed to be emerging in favor of the third option outlined by the staff.

Mr. Jiang stated that he too could go along with the apparent endorsement of option 3.

Mr. Nimatallah asked the staff to look into the possibility of devising a mechanism aimed at achieving greater equity in the bearing of the burden imposed upon the membership by the overdue obligations problem. Such a mechanism might even lead to lower rates of charge for the borrowing developing countries if some of the burden were spread to those Fund members not currently affected by the burden sharing agreement.

Mr. Goos reiterated that he was not satisfied with option 3, for which some measure of support had been given. All the approaches presented by the staff seemed more or less arbitrary in nature and in result. His point was that, even accepting the need for arbitrariness, Directors should at least search for a solution that was internally consistent, and it was on that point that he had some difficulty with option 3. The assumption behind that option was that the burden should be reduced in line with relative quota shares; however, if that criterion were applied, it would seem that Germany would be bearing an even greater share of the burden than the United States. Of course, it was apparent from the discussion that the Executive Board was not particularly concerned with internal consistency in the procedures for mitigation. Against that background, and since he was prepared to reach a consensus that, if possible, accommodated the wishes of the United States, he was prepared reluctantly to withdraw his reservations and go along with option 3.

The Chairman observed that Directors apparently agreed to resolve the matter of the mitigation of the U.S. share of the burden through the application of the procedure outlined in option 3 of the staff paper, it being understood that the arrangement was an ad hoc arrangement that had no bearing on the general principles underlying the operational budget and that it would be reviewed in the context of the review of the burden sharing decision at the end of FY 1988. He hoped that Mr. Dallara had clearly understood that the Board had agreed to the arrangement without enthusiasm but based on the desire of Directors to honor their commitment made to the United States during the July 1986 discussions on burden sharing. It should also be understood that the questions raised by Directors in the course of the discussion would have to be looked at in due course in the context of a discussion on the more general issue of mechanisms of distributing the burden.

The Deputy Treasurer, recalling Mr. Reddy's question on why the staff did not use more currencies in the operational budget on the same ad hoc principles applied to the United States, remarked that most other reserve currencies were converted into U.S. dollars in Fund transactions and thus played more the role of nonreserve currencies. Mrs. Ploix had asked why the calculations for mitigation could not be made on a quarterly rather than an annualized basis. She had also asked for assurance that there would be no technical difficulties relating to refunds when deferred net income was discharged. The staff had proposed effecting the mitigation over four quarters in order to smooth out any disruptions in the operational budget that might occur in a shorter period. Also, a quarterly calculation could raise difficulties relating to the need for a "rolling" adjustment that would be required because in each quarter there might be new net deferred income as well as some discharge of net income deferred in an earlier period. As had been explained in the paper, the staff would make a new calculation each quarter on the basis of what had occurred in the previous quarter, with net new deferred income, less any refunds, capitalized on the basis of a method approved by the Fund. The net figure would be produced in each operational budget for the information of the Executive Directors. That was an operationally smoother arrangement than calculating the full amount of participation on a quarterly basis.

It should perhaps be noted in response to a point raised by Mr. Posthumus, and supported in part by Mr. Zecchini, that the staff had not proposed some ad hoc amount for mitigation in each operational budget, the Deputy Treasurer continued. Rather, in its more arbitrary option, the staff had suggested a percentage of mitigation, along the lines shown in the first option. Without guidance from the Executive Board on how much to put in each operational budget, the matter could become debated each quarter whether the ad hoc amount was appropriate in light of the net deferred income and/or refunds in that quarter. Against that background, it was operationally helpful that the Board had provided firm guidance on the extent of mitigation.

It had been suggested by one speaker that consideration should be given to placing a ceiling on the amounts to be mitigated, in case the method agreed by the Board produced an amount that was so large as to be disruptive, the Deputy Treasurer commented. In fact, the staff had at an earlier stage considered placing a ceiling on the amount but had recognized that such action could create technical difficulties in its operations. Instead, if the amount turned out to be inappropriately large, the staff would raise the issue in the relevant operational budget and might ask the Board to look at the amount in that context.

Mr. Dallara remarked that he appreciated the willingness of the Executive Board--both debtors and creditors alike--to support the approach to mitigation that his authorities had preferred and to move promptly to implement it. It was clear from the discussion that many of the elements of the broader agreement reached in the July 1986 discussions continued to trouble some Directors, which made his authorities even more appreciative of the willingness of the Board to set aside reservations and honor the commitments made at the time of the burden sharing discussion.

The Executive Directors then concluded their discussion of techniques for adjusting the reserve tranche position of the United States through the operational budgets in order to mitigate the U.S. share in burden sharing.

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Dreizzen at the conclusion of his service as Alternate Executive Director.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/6 (1/12/87) and EBM/87/7 (1/13/87).

4. NIGERIA - STAND-BY ARRANGEMENT - POSTPONEMENT OF EFFECTIVE DATE

The Fund decides to extend until January 26, 1987 the period set forth in paragraph 3 of Executive Board Decision No. 8470-(86/196), adopted December 12, 1986. (EBS/86/246, Sup. 4, 1/12/87)

Decision No. 8500-(87/7), adopted
January 12, 1987

5. FLOATING EXCHANGE RATES, SURVEILLANCE, AND INDICATORS RELATING TO POLICY ACTIONS AND ECONOMIC PERFORMANCE - PUBLICATION

The Executive Board approves the publication in the Occasional Paper series of the staff papers on floating exchange rates, surveillance, and indicators relating to policy actions and economic performance as set forth in EBD/86/318, Supplement 2 (12/29/86).

Adopted January 12, 1987

APPROVED: August 11, 1987

LEO VAN HOUTVEN
Secretary