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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/85

10:00 a.m., June 1, 1990

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
G. K. Arora	L. E. N. Fernando
F. Cassell	C. Enoch
C. S. Clark	
Dai Q.	
T. C. Dawson	B. S. Newman, Temporary
	J. Prader
	L. B. Monyake
E. A. Evans	S.-W. Kwon
	R. J. Lombardo
	M. A. Fernández Ordóñez
	N. Kyriazidis
M. Finaish	M. B. Chatah, Temporary
	I. H. Thorláksson
	O. Kabbaj
	B. Goos
J. E. Ismael	T. Sirivedhin
	J. R. N. Almeida, Temporary
	J.-F. Cirelli
	B. Sarr, Temporary
	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	S. Yoshikuni

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present
European Department: S. K. Jones. Exchange and Trade Relations Department: T. Leddy, Deputy Director. External Relations Department: G. P. Newman. Legal Department: F. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; T. M. C. Asser, L. J. Ordoobadi. Research Department: P. Isard. Secretary's Department: A. Tahari. Treasurer's Department: G. Laske, Treasurer; D. Williams, Deputy Treasurer; M. N. Bhuiyan, J. E. Blalock, W. L. Coats, Jr., A. R. Gluski, D. Gupta, Y. Ozeki. T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: Z. Iqbal, P. O. Montórfano. Assistants to Executive Directors: T. S. Allouba, B. A. Christiansen, B. R. Fuleihan, S. Gurumurthi, M. A. Hammoudi, A. Hashim, Hon C.-W., O. A. Himani, L. Hubloue, K. Ichikawa, M. E. F. Jones, C. Y. Legg, R. Marino, J. A. K. Munthali, G. Serre, Wang J., J. C. Westerweel.

1. OPERATIONAL BUDGETS - PRINCIPLES FOR CALCULATING AMOUNTS OF CURRENCIES, AND LEGAL ASPECTS OF SELECTION OF CURRENCIES UNDER ARTICLE V, SECTION 3(d)

The Executive Directors considered staff papers on the principles for calculating amounts of currencies under the Fund's operational budgets (EBS/89/201, 10/17/89; and EBS/90/66, 3/30/90) and on legal aspects of the selection of currencies under Article V, Section 3(d) (EBS/90/87, 5/7/90).

The Deputy Treasurer made the following statement:

A number of Executive Directors have asked the staff of the Treasurer's Department for information regarding the changes made in the allocation of currencies under the Operational (Currency) Budget since the 1962 statement was approved by the Executive Board. In view of the relatively large number of changes made in allocating currencies, a chronology of the main changes is presented below. The chronology is based on the changes decided by the Executive Board in connection with individual operational or currency budgets. Up to the coming into effect of the Second Amendment of the Articles, the quarterly currency budgets were drawn up in the light of the guidelines agreed in accordance with Executive Board Decision No. 1371-(62/36), adopted July 20, 1962. Since April 1978, the operational budgets have been based on Article V, Section 3(d), and implemented in accordance with guidelines adopted by the Executive Board in 1979 and in 1981; any subsequent modifications in the application of the guidelines were presented in the various operational budgets and approved by the Executive Board.

It should be stressed that the harmonizing of reserve tranche positions to members' gold and foreign exchange reserves has been followed since 1962 but its pace has needed to be moderated from time to time, especially on those occasions when the Fund's holdings of a particular currency were low and the Fund's overall liquidity position was under strain; this sometimes resulted in receipts being concentrated only on those currencies which the Fund held in relatively small amounts in relation to the quotas of the issuing countries. Indeed, the need to safeguard the Fund's liquidity position has on occasion overriden the application of the principle of harmonization, and on occasions when the Fund's liquidity was coming under strain, the use of ad hoc methods of allocating currencies has been proposed to the Executive Board for considerable periods of time. In general, the methods of allocating currencies under the operational budget that have been followed since 1962 have had, as an important objective, the safeguarding of the Fund's liquidity as well as attempting to harmonize members' reserve tranche positions to their holdings of gold and foreign exchange.

Beginning Date	Transfers	Receipts
July 1962	In proportion to members' gold and foreign exchange (GFE) reserves. 1/	Large repurchases mainly in proportion to members' reserve positions in the Fund (RTP). 2/
March 1967	In proportion to members' gold and foreign exchange (GFE) reserves. 1/	Repurchases allocated in proportion to RTP.
October 1968	Specific currencies were included in the currency budget either for purchase or repurchase to accelerate the harmonization of members' RTP/GFE ratios.	
August 1969	In proportion to members' GFE reserves (with certain ad hoc adjustments).	Repurchases allocated in proportion to RTP.
September 1976 (to May 1978)	Allocations based largely on Fund holdings of currencies.	Repurchases allocated in proportion to RTP.
June 1978	In proportion to members' GFE reserves (with certain ad hoc adjustments).	Repurchases allocated in proportion to RTP.

Beginning Date	Transfers	Receipts
September 1979	Transfers were directed to those members whose RTP/GFE ratios were below the average. 3/ 4/ 5/ 6/	Receipts were allocated to those members whose RTP/GFE ratios were above the average. 3/ 6/ 7/ On occasion, repurchases were restricted to the currencies of those members that were at relatively low levels compared to their quotas--in 1978-79, repurchases were made exclusively in deutsche mark and yen.
May 1981	In proportion to members' GFE reserves. 5/ 6/	In proportion to members' RTP. 3/ 6/ 7/ 8/
March 1986	In proportion to members' GFE reserves. 5/ 6/	One half of receipts were directed to those members whose RTP/GFE ratios were above the average. 3/ 6/ 7/ One half of receipts were allocated in proportion to members' RTP.
December 1986	One third of transfers were directed to those members whose RTP/GFE ratios were below the average. 4/ 5/ 6/	One third of receipts directed to those members whose RTP/GFE ratios were above the average. 3/ 6/ 7/
	Two thirds of transfers were allocated in proportion to members GFE reserves. 5/ 6/	Two thirds of receipts were allocated in proportion to members' RTP. 3/ 6/ 7/

Beginning Date	Transfers	Receipts
December 1988	One sixth of transfers are directed to those members whose RTP/GFE ratios are below the average. 4/ 5/ 6/	One sixth of receipts are directed to those members whose RTP/GFE ratios are above the average. 3/ 6/ 7/
	Five sixths of transfers are allocated in proportion to members' GFE reserves. 5/ 6/	Five sixths of receipts are allocated in proportion to members' RTP. 3/ 6/ 7/

1/ For the period to March 1967, small drawings were executed in the main reserve currency of the purchasing member. Large drawings were allocated in rough proportion to strong members' gold and foreign exchange reserves. Intermediate drawings were made from a pool of currencies, drawn in proportion to members' GFE reserves.

2/ Smaller repurchases were arranged through "turnstile" operations where the principle was to match repurchases with drawings in the same currency, thereby avoiding a change in a member's net creditor position.

3/ Members' positions in the Fund include certain loans (GAB).

4/ Provided such transfers would not reduce the Fund's holdings of currency below one half of the average for all members included in the budget.

5/ The Fund's holdings of a member's currency are not allowed to fall below 10 percent of quota (prior to 1979, the minimum was 5 percent of quota).

6/ Transfers and receipts of U.S. dollars are made on the basis of ad hoc proposals. (The ad hoc policy was implemented prior to 1979.)

7/ Receipts are not allocated to any member beyond a point where the Fund's holdings of currency would be greater than the norm for remuneration.

8/ In 1982-84, the Executive Board agreed to make ad hoc modifications to calculated transfers to reduce drawings in the currencies of members with small quotas and relatively large reserves.

Mr. Enoch made the following statement:

The operational budget is the basis of the financing arrangements by which the Fund obtains the currencies that it needs. The current procedures for determining which currencies should be included in the operational budget--and in what amounts--have served the institution well over the last decade.

Most fundamentally, these procedures have ensured that the Fund has generally been able to make available to purchasing members the currencies of countries with strong or improving balance of payments and reserve positions. They have also--by and large--allowed the Fund to meet the financial demands placed upon it without unduly weakening the external positions of its creditor members--a critical requirement for the smooth functioning of the Fund as a cooperative institution.

This has been achieved without placing a disproportionate burden on any particular Fund member. With the exception of the United States--for which ad hoc arrangements have generally been used--no country presently included in the operational budget has a reserve tranche position amounting to more than 5 1/2 percent of its total stock of gold and foreign exchange holdings. Moreover, the Fund's holdings of particular currencies have, especially recently, remained fairly evenly distributed in proportion to quota. At present the ratio of the Fund's currency holdings to a member's quota is below 50 percent of the current average in only four cases. And in two of these four cases this has arisen largely because of the members' previous failure to consent to the quota increases proposed for them.

In addition, it is important to note that under the current system the Fund's net use of particular currencies varies significantly from year to year as countries' experience changes in their balance of payments positions. At present, for example, the Fund's holdings of Spanish pesetas are quite low, at 30 percent of quota. In 1986, however, at 70 percent of quota, the Fund's peseta holdings were significantly higher than the average for creditor members as a whole. Conversely, the Fund's holdings of Saudi riyals have risen from 43 percent of quota to 86 percent of quota in the last four years.

The current arrangements have worked well in part because they have been applied with flexibility. So, while the underlying design has been to ensure that net transfers are made in the currencies of members with strong balance of payments and reserve positions, this general principle has been modified in practice by a number of procedures specifically designed to take into account the Fund's holdings of members' currencies in proportion to quotas.

Alongside ad hoc adjustments, the most important of these modifications has been the general method of allocating receipts. Since 1981, receipts have been allocated in proportion to members' reserve tranche positions. The current procedures have placed considerable weight on the desirability of maintaining an even distribution of Fund positions in proportion to quota. Indeed, the 1981 guidelines, establishing the present arrangements, clearly state that the Fund's holdings of a member's currency are not to be pushed substantially below the average level for members included in the operational budget.

Against this background, it seems that the current arrangements have succeeded in striking a balance between the importance of concentrating net transfers on those members best able to supply currency, and the desirability of spreading the burden of supplying resources to the Fund as evenly as practicable across the membership.

Nevertheless, on several previous occasions it has been suggested that this balance should be shifted, and that greater, if not exclusive, weight should be given to the objective of equalizing Fund currency holdings in proportion to quota.

As the staff papers indicate, there are a number of powerful arguments against this proposition. First, and most obviously, quotas are not--and are not intended to be--indicative of short-term developments in members' balance of payments and reserve positions. Therefore, they provide almost no information about a member's ability to finance a reserve position in the Fund. As the Board concluded in a somewhat different context, quotas reflect "needs" as well as "strength." Thus, variability in a member's balance of payments is a factor that is taken into account in calculating its quota. Moreover, quotas are changed only at relatively infrequent intervals. It would therefore seem perverse to allocate currency transfers on the basis of such an imperfect indicator of members' comparative ability to contribute to the financing of the Fund--especially as more reliable and timely indicators are readily available.

Second, and closely related, if the allocation of currency transfers were based on quotas, this would lead overall to less use of relatively strong currencies than under the current system and more use of relatively weak currencies. It would be difficult to argue that this was in the best interests of the institution as a whole, particularly at a time when there is some concern that the Fund's overall liquidity ratio may be on a downward trend.

Third, if net transfers were allocated without reference to the level of creditor members' reserves, this could result in some members' reserve tranche positions becoming undesirably large in relation to their total reserves. And this in turn could increase the risk that such members might have to draw on their Fund positions, with likely adverse implications for the Fund's liquidity.

Much of this ground was covered by the staff paper of last December (EBS/89/201) which suggested there should be no change in existing practices. These arguments are just as valid now as they were six months ago. Nevertheless, the question has again been raised of whether it might not be more appropriate to base the operational budget on the objective of harmonizing Fund positions in relation to quotas. In this context, two new arguments have been put forward: first, that the existing burden-sharing arrangements strengthen the case for a quota-based system for allocating net transfers; and second, that the current guidelines are legally inconsistent with the Articles. Let me offer a few comments on these two arguments.

First, as far as burden sharing is concerned, there is no doubt that these arrangements have significantly reduced the attractiveness of Fund positions to creditor members. In these circumstances, it is not surprising that some members are keen to find a way of reducing the Fund's use of their currencies.

On the other hand, the burden-sharing arrangements have been set up to meet what we all hope will be a temporary problem. When the problem of arrears is resolved, payments made under burden sharing will be refunded in full to contributing members. To change the whole basis on which the operational budget is designed in an attempt to correct for temporary inequities caused by the problem of Fund arrears would seem to be a very short-sighted, indeed a perverse, step. The procedures underlying the operational budget should be designed not to compensate for a temporary distortion, but to provide resources for the Fund in such proportions as to maximize the Fund's liquidity and best approximate members' relative ability to contribute resources at any point in time.

Moreover, even if Fund positions in relation to quota were harmonized across the membership, this would not ensure that burden-sharing contributions would be paid in proportion to quota. Full equality in this sense could only be achieved if members' remuneration norms were also harmonized. And this raises once again the thorny issue of members' relative contributions of interest-free resources to the Fund--a problem of equity no less deserving of consideration than the question of members' relative burden-sharing contributions.

With the lowest remuneration norm of all countries in the operational budget, the United Kingdom is contributing resources to the Fund of over SDR 60 million per annum. These are not in the form of an interest-free loan, which under the burden-sharing arrangements will be repaid, but are a permanent contribution. Any attempt to change the current system of burden sharing, or to do so through the back door by changing the structure of the operational budget, would need to be accompanied by a re-examination of the whole question of remuneration norms.

The second argument that needs to be addressed is the Legal Department's new finding that the current procedures for allocating net transfers under the operational budget are not consistent with Article V, Section 3(d). This is a rather extraordinary finding, implying as it does that the Board and the staff have been implementing the Fund's Articles incorrectly for more than a decade.

On closer inspection, however, the Legal Department's present ruling leaves a number of important questions unanswered. First, it is clear from page 6 of the paper that the key question--the appropriate interpretation of the word "balanced" in Article V, Section 3(d)--is answered essentially by assertion. The Legal Department asserts that the practice of the Fund is to express members' positions in terms of quotas, and, therefore, that "balanced positions in the Fund" may be understood as "balanced in terms of quotas."

But clearly this is not sufficient. Most obviously, it is manifestly not the case that in this particular area the practice of the Fund has been to express members' positions in terms of quotas. On the contrary, as the Legal Department notes in the very next paragraph of its paper, throughout the period since 1979 the practice has been to define balanced positions in terms of members' holdings of gold and foreign exchange reserves.

More generally, I would be grateful to hear from the Legal Department where else in the Articles the phrase "balanced positions in the Fund" appears and, in these cases, to hear whether indeed this has, in practice, been taken to mean "balanced in relation to quota."

As the Legal Department notes, the wording of Article V, Section 3(d) is in fact quite similar to that of Article XIX, Section 5(a)(i), which also refers to the concept of promoting over time a "balanced distribution" of SDR holdings. In the case of this provision, however, the meaning of "balance" is fully spelt out in Schedule F, which makes it clear that--in this context--"balance" is to be judged in relation to official holdings of gold and foreign exchange.

The Legal Department argues that it cannot be concluded that Schedule F has any relevance to the appropriate interpretation of Article V, Section 3(d). However, equally, on the arguments the Legal Department presents, it cannot be concluded that the definition of "balance" included in Schedule F does not carry over to Article V, Section 3(d). Indeed, two considerations point unambiguously in the opposite direction.

First, it is clear from earlier, and fuller, drafts of Article V that the wording of the two provisions was very similar indeed. For example, draft Article V, Section 3(d), in paper DAA/75/2, referred to a "balanced distribution of reserve positions in the Fund"--almost identical wording to the text of Article XIX, Section 5(a)(i). Second, and even more telling, in the Executive Board's report to the Governors on the proposed Second Amendment, the point is made quite explicitly that "the Fund will apply similar criteria in the preparation of both the [currency] budgets and the [designation] plans" (page 20).

In addition, the Legal Department invokes the Rule of Effectiveness to argue that "balanced positions" in Article V, Section 3(d) cannot be defined in terms of reserves, because this would introduce a redundancy into the text of the Article. However, this too is questionable. It is clear that the stock of a member's reserves, and the ratio of its Fund position to that stock, are two separate concepts. The first can be taken as an indicator of the member's ability to make a future contribution to the financing of Fund transactions; while the second reflects the relative size of the member's contributions in the past.

For these reasons, I find it very difficult to accept that for the last decade we have all been acting in a way that contradicts the Articles of Agreement. At the same time, I would not wish to argue that Fund currency holdings in relation to quota should be completely disregarded in allocating net transfers under the operational budget. Indeed, as I have already noted, the current arrangements already incorporate a balance between the two harmonization principles.

Mr. Fernández Ordóñez made the following statement:

The staff paper (EBS/90/66) that has been distributed is a sensible response to the statements that this chair has made since December 1988, and more precisely to the statement made on December 13, 1989. The staff paper concentrates on studying the consequences of trying to balance positions in the Fund all at once, and suggests, as an alternative, balancing Fund positions over a period of one or two years. The companion paper (EBS/90/87) examines some legal aspects of the selection of currencies, particularly the role of quotas in the process of the selection of currencies.

With the aim of having a fruitful discussion today, we should divide our discussion into two parts. The first should be on the general method of calculating each member's contribution to the operational budget; the second should be on giving guidelines to the staff for the preparation of the next operational budget. The best outcome of our meeting would be an agreement on a general method and on the timing of its implementation and, consequently, the application of that method to the next operational budget. But, in our view, it will be neither possible nor desirable to agree on a general method at just one meeting. We should choose a method that has the longest possible life span. This will be possible only if we have studied it carefully before approving it.

At the same time, we need to decide which method we are going to apply to the next operational budget. We must remember that the old method was not endorsed at the time of its review by the Board. We decided to use it for one quarter only. Thus, we are now obliged to tell the staff how to prepare the next operational budget. We should not rush into approving the new method, which will be based mainly on quotas. But, at the same time, some countries will continue to bear a disproportionate burden if the current method is left unchanged. Furthermore, these countries feel that the need to balance positions in the Fund is long overdue. How are we to reconcile these two contradictory objectives? In our view, the solution will be found by spending the necessary time in agreeing on a general method but, at the same time, introducing some changes in the current method of calculating the next operational budget.

I will now comment on the general method and its timing of implementation. As we have said, the staff paper concentrates on the timing for introducing a method based on balancing positions and on the desirability of introducing certain qualifications to a method based mainly on quotas.

In order to have a productive discussion today, we will center our intervention on the questions posed by the staff, but, before doing so, it would perhaps be useful to recall the reasons that led us to center our discussion today mainly on the timing of the new method. In fact, the method should be called the "new" method because the method based on quotas was used before the current method was approved. We must remember why we are changing from a method based on the level of foreign assets held by central banks to a method based on quotas.

First, there is the question of legality. Article V, Section 3(d) says that the selection of currencies will take into account the promotion of balanced positions in the Fund. The legal paper is clear enough. Quotas are the relevant criterion for determining balanced positions in the Fund. The legal paper also reminds us that other elements (balance of payments, reserve positions, and developments in the exchange markets) should be taken into account in selecting the currencies for the operational budget. These elements and others--the list is not exclusive--can be used to select the currencies to be used in the operational budget. There is no problem with that. We all agree that we should continue selecting currencies based on judgment of the strength of the balance of payments of member countries. It is indisputable that all countries with liquidity, whether they are small, medium, or large, must provide resources to countries that need liquidity.

The second reason we are focusing our discussion today mainly on the question of timing for achieving balanced positions in the Fund is that reserves are not a good proxy for liquidity. Foreign reserves held in central banks were a good proxy for a member's liquidity when the current system was designed, but this is no longer the case. Nowadays, reserves are a misleading indicator of the magnitude of strength of the balance of payments position of each member country. The staff, logically, accepts this view on page 2, because this is the staff's view, as expressed in documents such as "International Liquidity and the Role of the SDR," "The SDR and the International Monetary System," and "Further Considerations on International Liquidity and Systemic Role of the SDR and the Question of SDR Allocation."

In the paper distributed for our discussion, the staff does not suggest the possibility of looking for another indicator of liquidity. We should be grateful for that. In this case, not only the papers produced by the staff, but also the very long Board discussions on the subject, are enough to persuade us to forget this attempt.

We should also recall the influence that the decision on burden sharing had on the operational budget. As we have said many times, this decision negatively affects creditors' perceptions of reserve positions in the Fund. Until that decision was adopted, changes in positions in the Fund were seen as innocuous in the composition of foreign reserves. Now, and especially with the approval of the extended burden sharing, each time a central bank increases its reserve tranche position in the Fund it loses 20 percent of its interest. The burden-sharing decision thus reinforces the need to be strict in applying the Articles of Agreement and to proceed immediately to balance members' positions in the Fund.

But does this mean that we should look for a change in the operational budget that will distribute the burden of arrears exactly in proportion to quotas? In our view, no. It is true that even if positions in the Fund are balanced, the burden of arrears would not be distributed exactly in proportion to quotas. As long as this burden is calculated on the remunerated part of quotas, countries with a higher nonremunerated part would pay a smaller amount--in proportion to their quota--of the burden of arrears than the others. But the system will be fair enough to avoid undesirable behavior in member countries. We do not need to hold an interminable debate on equity. It is better to implement a method of selection of currencies--the balancing of positions--based on the Articles and in conformance with the characteristics of today's international financial system, than to try to be exact in distributing the burden of arrears. Besides elegance, I see many advantages to a solution that, being fairer in distributing the burden of arrears, does not mention them. Most likely, these are the reasons why the staff has proposed that we concentrate today on Section IV of EBS/90/66 as points for discussion.

I would also suggest that, as we conduct our discussions, we keep six basic points in mind. The first is the fundamental monetary character of the Fund. The decision of the Board on burden sharing has affected the perception of member countries of their reserve positions in the Fund. But the character of the institution has not changed. It cannot be otherwise. The Board cannot change the fundamental monetary character of this institution. Consequently, the Articles continue to confer on each member an unconditional right to use its reserve tranche, and the Fund cannot prevent that use. To be precise, there is one exception: when a member has been declared ineligible to use the Fund's general resources. Unfortunately, in these cases, the reserve tranche was used a long time ago.

The second is the monetary character of central banks. Most central banks are not statutorily allowed to make gifts. Only a fair distribution of the burden, in accordance with the Articles, would permit them to maintain a reserve tranche position in excess of the nonremunerated share without having legal troubles.

Third, we should remember that the purpose of the operational budget is to facilitate and make smooth the operations of the institution. In proposing any method, we should bear in mind that it should facilitate the execution of the Fund's operations. If we approve a method--like the current one--that creates serious difficulties for some member countries, the execution of the operational budget could be impaired.

Fourth, when discussing the timing of the introduction of the new method, the staff paper presents only the "costs" for some countries of changing from one situation to another, but it does not present the costs for other countries of maintaining the current situation. Let me give an example: Norway. If you look at the ninth column in Table 3, Norway is providing about SDR 300 million in excess of what it would contribute if the positions in the Fund were balanced. This figure, in proportion to its GDP, would be the same as if the United States were to contribute SDR 15 billion in excess. That is, it would be as if the United States were currently contributing SDR 21 billion to the operational budget. This would be more than 100 percent of the U.S. quota.

Fifth, another criterion should be to reduce the time the staff devotes to preparing the operational budget. We should find a simple method that does not create too much paperwork. The system based on quotas is really very simple, but we can simplify the whole process even more by making equally simple the process of selecting countries to participate in the operational budget. It is not necessary to study the strength of the external sector of all those 30 countries that participate in the operational budget each quarter. We must assume that all countries that were part of the last operational budget will continue in the next operational budget. Then the staff could concentrate only on a very small group of countries, and, first, on those countries that are going to become part of the operational budget. The staff would propose entering some countries on the basis of its judgment of the external position of these countries. Second, as to those countries that might leave the operational budget, they usually would have expressed previously to the Fund their intention to reduce their reserve tranche position. The staff might give the Board its assessment on this intention.

Consequently, the work would be concentrated only on a small number of countries. Experience shows that the bulk of countries has remained part of the operational budget for a long time. But, owing to the recent changes in the international financial system, the stability of that group will increase in the future. Consequently, we do not need to devote a single line in the staff papers to measuring the external strength of those countries that are normally part of the budget.

Sixth, the method should not create difficulties for members (it must have fair distribution, smooth changes, etc.), but another criterion should be that the method should not create difficulties for the Fund. We need to have this in mind--and be generous--when approving any kind of limits on the use of reserves of members, because the Fund must also have assurances that it can manage their operations without coming continuously to the Board for exceptions.

With these remarks in mind, let me now turn to comment on the points proposed for discussion beginning on page 12. In our view, the first paragraph is not a point for discussion. In that paragraph, the staff says that the current system of harmonizing the contributions to the operational budget with the level of members' foreign reserves has been successful because now the contributions are more proportionate to foreign reserves. We recognized this in our first intervention, in December 1988, but, in our view, it is close to a tautology: the current method, which tries to relate Fund positions to the foreign reserves of members, has achieved a distribution of the Fund's positions that is proportioned to the foreign reserves of members.

I will now comment on the points raised in paragraph 2. First, the staff says that it will not be possible to balance positions in the Fund within the period of one operational budget. We recognize that the transfers and receipts of the members will be substantial, but we cannot accept that it is impossible. Nevertheless, on the question of timing, we are sure that we will agree on a reasonable period of introduction.

Regarding point (ii), again we agree that the transfers and receipts will concentrate on a relatively small number of members, but we do not see any problem when we take into account the total liquidity of those countries. Even if we consider the transfers only in relation to the level of foreign reserves--and do not forget that this is only a very small part of their liquidity--we can see in Table 3 (where net transfers have been distributed in four operational budgets) that the highest figure is 3.1 percent for one country in the first quarter. This is the highest figure of all 124 net transfers in the table (31 countries during four quarters). Besides this country, which is the only country that could face changes of more than 3 percent of its foreign reserves in two quarters, only four countries will need to make adjustments of more than 2 percent of their foreign reserves--and we insist that foreign reserves are only a part of the liquidity, and that the percentage of total liquidity will certainly be smaller than that figure--in two quarters. This will happen in the event that we accept the simulation in Table 3, where the changes have been concentrated in the first three quarters. We could design an equal increase for four quarters; the average changes for each quarter would then be only 2 percent in the case of one country. In the case of the member that would transfer the maximum absolute amounts, the transfer would represent only 0.8 percent of its foreign reserves in each of four quarters. Obviously, this period of one year--four quarters--would smooth the changes, but would maintain the unbalanced positions in the Fund during an excessively long period.

At this stage, let me sum up the reasons to balance the positions in the Fund all at once. First, it is perfectly possible and it involves only a question of programming some purchases and repurchases. Second, this change will be made for just one quarter. In the future, the changes in the positions will be very smooth and will follow the increases and decreases in Fund credit. Third, the cost for countries that should increase their reserve position is not comparable to the cost for countries that have to maintain excessive reserve positions. In the one case, it is only a question of changing the composition of foreign reserves, while in the other involves a real budgetary cost. The cost of changing the composition of reserves is difficult to measure, but the cost of having used this method during the last 18 months can be precisely calculated. Fourth, this is a zero sum game. The slower the rhythm of increasing the percentage of quota of those countries that are below the average, the higher the cost for countries that are above the average. The longer the delay, the longer the period in which some countries will continue subsidizing other countries. Fifth, this question was raised one and a half years ago. By balancing now in just one quarter, the total time elapsed in balancing the positions will have been one year and three quarters. Sixth, to strengthen the financial position of the Fund, we need to approve the extended burden sharing as soon as possible. Obviously, this extension cannot be implemented before the positions have been balanced, because the reduction in the remuneration has become substantial. A delay in balancing positions would inevitably delay the construction of one of the pillars of the arrears strategy.

I agree with what the staff says in point (iv), but what is important is to determine what is a "large impact" on a member's gold and foreign exchange reserves. In Paragraph 3, it seems as though the staff doubts that the method of balancing positions in the Fund could mean an increased reliance on members with "perhaps somewhat weaker overall external positions." This doubt would be justified only if there were a direct link between the amount of foreign reserves and the strength of the external position. It would be more justified to say that "the current method is perhaps based on some members with weaker overall external positions."

Notwithstanding all the above, and looking for a compromise, we are willing to accept the idea suggested in point (iv) of introducing a "cap" relating the positions in the Fund to foreign reserves, although we do not see the rationale for that. Let us accept, for instance, a cap of 20 percent, and try to balance the positions, with the exception that the reserve position could never exceed 20 percent of total members' gold and foreign exchange reserves. This limit should not be applied to members in whose currencies the greater part of international reserves is invested. Once we have balanced the positions in the Fund (see the last columns in Table 3), all countries will be comfortably far from that figure; the United States will have the highest figure with 13.8 percent. However, it would be reasonable to establish a 20 percent cap in case the Fund credit and the level of gold and foreign exchange reserves differ from predictions. In doing that, most member countries would have assurances that their position in the Fund would not exceed 20 percent of their foreign reserves. All additional resources needed by the Fund would be supplied by the rest of the members whose reserve position is lower than 20 percent of their gold and foreign exchange. With this cap, the situation of the Fund's liquidity will be comfortable because 20 percent of official reserves of members participating in the operational budget is currently about SDR 80 billion.

Once we have decided that some countries are strong enough to be part of the operational budget, the amount each country will contribute will be calculated in proportion to the quota. Because there is no simple indicator of the relative strength of those countries, trying to qualify this relative strength would require an enormous amount of work. Let me give an example: if the current rate of use of quota is 30 percent, with the current quotas Germany would contribute SDR 1,621 million to the operational budget and Italy, SDR 872 million. Certainly, nobody will dispute that the strength of the external sector in Germany is comparatively higher than that of Italy. This would suggest that we should use an indicator that reduces the percentage of quota used in the case of Italy and increase the percentage of Germany. But how much? It is preferable not to look for a method that would increase the contribution of Germany and decrease the contribution of Italy because it would be difficult to agree in which proportion the position of Germany is stronger than the position of Italy. The legal paper suggests that it is perfectly legal to use other criteria. There is no question about this. It must be clear that we will support any proposal that uses the other criteria mentioned in Article V in comparing members' contributions. But we have refrained from making any specific proposals because we think that, on the small chance that we will reach an agreement, the cost in terms of staff and Board time would be enormous.

Notwithstanding this, we should take into account the weakness or strength of the external sector of each country in the operational budget. We should take into account that concept, but we should do it at the time of selecting countries for the operational budget.

Finally, even though reserves do not have any relation to the relative strength of each country's external sector--especially in the group of countries that have creditworthiness--we could continue to use reserves to avoid creating difficulties for individual countries.

Reserves would continue to be used in three ways. First, countries joining the operational budget would not increase their reserve tranche positions in an amount exceeding 5 percent of their total reserves. In fact, these countries are better protected under the rule of balancing positions in the Fund. With the current method, the developing countries that enter in the operational budget contribute more than the average in a short period of time (see the case of Korea, and project the case of Thailand). Nevertheless, this limit would give additional confidence to countries that are coming from a situation in which reserves are the main source of liquidity to a new situation based mainly on credit and foreign assets held by other economic agents. Second, no country will increase its reserve tranche by more than 5 percent of its reserves in each quarter. Third, reserves could also be taken into account in calculating the total "cap" of 20 percent that we have suggested.

I will not comment on the method to be applied in the next operational budget. As I said at the beginning of this statement, some countries are bearing a disproportionate burden with the current method. This problem will be solved by applying the new general method. But if we do not agree today on the details of a general method, we can alleviate that burden in the next operational budget.

As is shown in the last column of Table 2 on page 5 of EBS/90/66, the average of used quota is about 30 percent. Some countries are close to that figure, but other countries are very far from it. In our view, the guidelines for the next operational budget should be simple to implement but, at the same time, should alleviate the burden of those countries. Our suggestion is to apply the old method and, at the same time, introduce a cap on the use of members' quota. The size of the cap is a matter of judgment. It could be, for instance, a cap of 50 percent. This would mean that the average being 30 percent, and no country would contribute more than 50 percent of its quota in the next operational budget. Certainly, even with this cap, some countries would continue contributing two thirds in excess of the average. This would not be a situation of balanced positions. But, at least in my view, it would be enough to have a positive answer from those countries in the required consultation on the use of their currencies and to have an orderly implementation of the next operational budget.

Nevertheless, what is important is that these guidelines not interfere with the process of deciding on a general method. It should be clear that these guidelines would be applied exclusively to the next operational budget, and that the system applied in that budget (the old system slightly corrected) would not be used as a precedent for the decision on the general method.

Mr. Hogeweg made the following statement:

For various reasons, today's discussion on the methods of allocating currencies in the Fund's operational budgets is of great concern to us. Among these it stands out that, on a subject that is vital for the financial position of the Fund and which determines the ability of the Fund to give financial support to its members, there seem to be two conflicting opinions from departments. At the same time, arguments about Fund liquidity and about the equity of burden sharing--which, of course, are very distinct issues--are used side by side. In these circumstances, there is a real risk that the interests of the Fund as an institution are lost sight of. In my view, it is precisely the interests of the institution which should prevail.

The system of allocation of currencies in the operational budget has not been constant over the years. Yet it has consistently been based on the principle that the stronger countries provide the resources to finance the weaker members, and the pattern has been that over time harmonization of positions in the Fund in terms of gross holdings of gold and foreign exchange was aimed at. This system has served the Fund well for many years. The logic of using the foreign exchange of central banks which have foreign exchange seems irrefutable. Certainly, the world has changed and official reserves may well be less good as indicators of strength than before. However this does not change the basic logic of the system, which relies on the foreign exchange holdings of central banks. The system promotes some harmonization of the composition of reserves and as such has some stabilizing effect.

I do not follow the view of the Legal Department that our practice has been inconsistent with our Articles of Agreement, because of the perceived redundancy of the three considerations in Article V, Section 3(d), if harmonization is interpreted in terms of reserves while reserves already figure in the first consideration. This is a form of legal hairsplitting which cannot convince me that the present Legal Department really knows better than its predecessors, who for over 30 years have never jumped to the conclusion that harmonization must be pursued in terms of quotas on legal grounds.

However that may be, I believe that we should discuss the matter from an economic perspective. It is quite legitimate to ask ourselves whether, in the current monetary system, with the increasing importance of capital markets, the present system of allocation in the operational budget continues to be optimal for the Fund. That is, does it optimally provide the Fund with the liquidity it needs? On the basis of the material offered to the Board, I have the impression that it does. Relating it to quotas would necessarily imply that countries in the operational budget with low reserves relative to quotas would be confronted with a rising share of their reserve tranche position in total reserves. This may adversely affect their willingness to finance the Fund and increase the chance of drawing on reserve tranche positions. Of course, this effect would be stronger the more the net use of Fund resources rises, as is currently projected. If, indeed, a quota-based operational budget would adversely affect Fund liquidity, I firmly believe that the institution cannot afford it.

It is important to recognize that the present system of the operational budget predates the Second Amendment, i.e., it was created at a time when creditors to the Fund had no guaranteed level of remuneration. In that light, it is interesting to observe how much attitudes have changed. It is clearly a concern about burden sharing, which still guarantees creditors a remuneration of 80 percent of the SDR rate, which leads to calls for a quota-based system. Concerns about equity of burden sharing, both between debtors and creditors and within those groups, are of course completely justified. In the discussions on burden sharing in the context of the strengthened arrears strategy, it has been widely recognized that quotas represent the basic Fund measure of a member's rights and obligations and as such would constitute an equitable base for burden sharing. However, it has also become very clear that our Articles do not provide a vehicle to implement quota-based burden sharing, and that the only way for the Fund to create additional net income in order to safeguard its financial position is via the rate of charge and remuneration. At the same time, the fact that, on the occasion of the Second Amendment, a minimum level of remuneration has been guaranteed and unremunerated balances have been frozen, leaves the Fund fundamentally vulnerable to adverse developments consequent on a risky loan portfolio.

I believe that it would be a serious mistake if we would, in order to solve a problem which relates to burden sharing (which is in principle a temporary affair) change the way we allocate the currencies used in our operations--which lies at the permanent heart of this institution--in a way that would adversely affect our liquidity. The two issues should be considered on their own merits. The operational budget is not the correct instrument to provide more equitable burden sharing. Its primary function is to provide the Fund with the liquidity it needs to fulfill its obligations to members.

Mr. Al-Jasser made the following statement:

At the outset, I would like to express my belief that it is a sign of health and dynamism when an institution takes a pause to evaluate long-held views and procedures. In that way, it can reaffirm its commitment to some, revise others, and reject unsuitable procedures. Therefore, I would like to take this opportunity to state that, after thorough evaluation, I find myself in complete agreement with the Treasurer's Department paper (EBS/89/201) on the principles for calculating amounts of currencies under the Fund's operational budgets. According to the current procedures, a member's currency is included in the operational budget if its combined balance of payments and gross reserve position is considered "sufficiently strong." The amounts of each currency to be included in the budget are determined by balancing members' positions in the Fund with their gross reserve position. It is abundantly clear to me that these procedures have served the Fund well for many years, and I see no reason to change them.

The rationale behind this balancing approach, whereby a member's contribution to the financing of the Fund's operations is determined in terms of the resources that it can make available for this purpose, is not only sound and valid, but also pragmatic and efficient. The most crucial feature of this procedure, and to my mind the most attractive one, is its inherent flexibility, which allows the Fund, and the membership at large, to benefit from, and adjust to, the changing circumstances of individual members. I may add that the Fund can ill afford to do away with such a feature.

The Fund is a cooperative institution that provides a mechanism under which members with strong external positions make available foreign exchange to members with weak external positions, i.e., a mechanism for converting an external position of a strong member to an external position of a weaker member. Hence, the external position of members is not only the primary determinant of which currencies are to be used in the operational budget, but also the primary source of funds for the transfers in the budget. Thus, it makes perfect sense for the Fund to adopt a method that emphasizes the use of currencies of members with large or rising reserves. This satisfies the need of debtors for usable currencies, while simultaneously protecting the liquidity of the Fund without jeopardizing the liquidity of its creditor members.

Given that the current system has adequately met the requirements of this institution, it is only reasonable to question why we would want to change our current policies. Mr. Fernández Ordóñez has put forward an intellectually stimulating idea that would lead the Fund to determine the amounts of currencies to be included in the operational budget in proportion to quotas. He puts forward two arguments in support of this idea: first, the widespread liberalization of capital markets has substantially reduced the relevance of gross reserves as a measure of members' liquidity. He adds that since he cannot find an alternative indicator of liquidity, we should adopt a quota-based system. Second, he suggests that there are no legal grounds on which to balance positions in the Fund with respect to the gross reserves of members.

I find the first argument logically weak, since it attempts to replace what to my mind is a good indicator of liquidity--although reasonable people can disagree on this--with an undoubtedly inferior indicator of liquidity. Clearly, variations in a member's gross reserves reflect the changing short-term trends in its liquidity position, while it is obvious to everyone that quotas change infrequently and seldom reflect the current relative strength of a member's external position. Therefore, the adoption of a quota-based system, as emphasized by Mr. Dawson on December 13, 1989, might weaken the Fund's liquidity position and lead to operations that might be inconsistent with balance of payments financing needs.

Indeed, the adoption of such a system could well give rise to a paradoxical result, whereby a member that has recently experienced a balance of payments deficit and a reduction in its gross reserves would be included in the operational budget, not in proportion to its ability, but in proportion to its quota. As was well explained in the staff paper on the principles, this could heavily tax that member's gross reserve position leading it to withdraw from the operational budget and possibly to draw on the Fund's resources. This leads to a reduction in the number of members included in the budget, as well as to increased reliance on a few members that may not possess the necessary reserve levels. Hence, the celebrated flexibility of the system will be given up, and the Fund's liquidity position, as well as its cooperative nature, could very well be impaired.

Moreover, if the reserve position of a member is not a good indicator for calculating its currency contribution, then its adequacy to determine the currencies that enter into the budget is open to question. In other words, if a quota-based system is adopted, then the whole approach for the selection of currencies to be included in the operational budget would have to be changed. Clearly, if reserves are considered a poor indicator of liquidity, then all members that have a neutral or creditor position in the Fund would have to be included in the budget in proportion to their quotas. Somehow I do not feel that such an approach is practical.

Had it not been for Mr. Fernández Ordóñez's second argument, I would have now been able to rest my case and consider his idea as a mere intellectual exercise, albeit an interesting one. However, the Legal Department has presented us with a paper (EBS/90/87) which identifies three elements that are relevant not only to the identification of currencies to be used, but also to the calculation of the amounts of the respective currencies to be used. The paper distinguishes between two economic tests that are couched as strict requirements, namely, the balance of payments and reserve position of members and developments in the exchange markets, and a third subsidiary element that is the goal or guiding principle of promoting over time balanced positions in the Fund.

Up to this point, I am in complete agreement with the Legal Department's interpretation. However, I differ with it on its sudden reinterpretation of the meaning of balanced positions in the Fund. The basis for this reinterpretation seems to lie with the claim that there is no specified standard against which "balance" should be measured and, therefore, it may be understood to mean balance in terms of quotas. The paper then makes the sudden jump from this possible explanation to the definite conclusion that quotas are the relevant criterion for the determination of balanced positions in the Fund.

Needless to say, I am surprised by this conclusion, particularly as the commentary explaining the Second Amendment suggests an alternative against which balanced positions should be measured. Indeed, it is stated that Article V, Section 3(d) "will provide an express legal basis for currency budgets comparable to the designation plans for special drawing rights under Article XIX, Section 5," and that "the Fund will apply similar criteria in the preparation of both the budgets and the plans." Not surprisingly, Schedule F relating to Article XIX, Section 5 stipulates that the Fund should "promote over time equality in the ratios of the participants' holdings of special drawing rights in excess of their net cumulative allocations to their official holdings of gold and foreign exchange."

Now I feel comfortable in resting my case and reaffirming the view that quotas are not the relevant criterion in determining the amounts of currencies used in the operational budget. As to the tables provided by the Treasurer's Department at the request of Mr. Fernández Ordóñez, there is no need to comment on them, since they are merely simulations of his suggestion. Moreover, the results of these simulations run counter not only to the traditional wisdom of the Fund, but even to the Legal Department's reinterpretation, since that reinterpretation designates balancing in terms of quotas as only a secondary long-term guiding objective.

It is clear that the existing system has served the Fund and the membership at large well during the past two and a half decades. I see no convincing reason to change a system that has been working well merely because of temporary or transient circumstances. The institutional memory of the Fund provides us with ample evidence that the existing system is appropriate and should not be subjected to substantial changes to meet short-term concerns. Any budgeting system derives its legitimacy from its continuity, predictability, and consistency. The operational budgeting system of the Fund meets these criteria and, therefore, should be maintained. However, if concerns other than meeting the requirements of the operational budget are what has prompted this discussion, then I urge that we do not tamper with our system for that reason. These concerns should be addressed separately and on their own merits. Nevertheless, the existing system is flexible enough to accommodate the special concerns of individual members, and we should not do away with this flexibility.

The General Counsel remarked that a few Executive Directors seemed to have misinterpreted the staff paper on the legal aspects of currency selection under Article V, Section 3(d). It had been suggested by one speaker that the present practices were inconsistent with the requirements of the

Articles. The staff, had not come to that conclusion. The staff in analyzing the provisions of the Articles that dealt with the two sides of the operational budget, i.e., the transfer side and the receipts side, had noted that the criteria--three in all--governing both sides were the same. Those criteria, as stated in the Articles, could be supplemented by principles approved by the Executive Board. Of the three criteria that were to be taken into account, the first two seemed to be noncontroversial: the balance of payments and reserve position of members, and developments in the exchange markets were the most important elements, and the staff had said that they should be given primary consideration. The controversy thus far was centered on the third element--the desirability of promoting over time balanced positions in the Fund. As had been noted several times in the past, there were two possible interpretations of the application of that criterion. The staff's conclusion was that balance of positions should be understood in terms of quotas. In any event, however, that criterion had to be combined with the first two, as had been the practice under the existing guidelines. Therefore, in his view, the only question that was in dispute was the extent to which quotas were relevant. Could quotas be given greater importance, or could their role be reduced? The staff did not think that a role for quotas could be eliminated altogether, but the staff had not concluded that quotas should override the other two criteria.

Mr. Al-Jasser noted that the discussion concerned the underlying principles of the operational budgeting system of the Fund in the context of the Fund's cooperative nature. That system had been flexible enough to meet the liquidity needs of the Fund as well as the changing circumstances of the membership at large. In his opening statement he had not commented on the paper by the Treasurer's Department (EBS/90/66), which, as he understood it, was a set of simulations based on Mr. Fernández Ordóñez's suggestions rather than a staff proposal or position. However, in his opening statement Mr. Fernández Ordóñez had asserted that the staff did indeed agree with his suggestions and interpretation. It would be helpful at the outset of the discussion to have the staff comment on that matter.

The Deputy Treasurer responded that, as Mr. Al-Jasser had remarked, EBS/90/66 had been prepared in response to Mr. Fernández Ordóñez's request to show how a system based on quotas could work. That paper did not contain staff proposals. The final section of the paper mentioned some of the issues that the staff had encountered in making the simulations contained in the paper.

Mr. Enoch remarked that in his opening statement he, like Mr. Al-Jasser, had stressed the need to safeguard the Fund's liquidity. That emphasis was in line with the staff statement that it had been a long-standing policy to give safeguarding the Fund's liquidity the highest priority. In his opening statement Mr. Fernández Ordóñez recognized the need to safeguard the Fund's liquidity, but Mr. Fernández Ordóñez had also made much of the argument that reserves were not a good proxy for the liquidity of individual members. He himself agreed that they were not ideal, but they were certainly a better indicator than quotas, which reflected needs as well as strengths, and which changed only slowly and at long intervals. The operational budget was considered every six months, as it had to be determined in the light of sometimes rapidly changing economic circumstances. It surely made no sense to base assessments under the operational budget primarily upon a factor--quotas--that changed only every five years. Mr. Fernández Ordóñez had suggested that rising reserve positions in relation to quota, taken together with burden sharing, would make members reluctant to hold such positions, and that that reluctance would undermine the Fund's liquidity. But a member was surely far more likely to become reluctant to remain in the operational budgets at all if its contribution to the budgets became out of line with the size of its overall reserves. Table 6 of EBS/90/66 suggested that currencies could move out of and into such an operational budget with alarming rapidity.

He also had some problems with Mr. Fernández Ordóñez's argument that the present method of determining the operational budget should be changed for reasons of equity, Mr. Enoch continued. The equity concerns derived largely from the burden-sharing arrangements. But those arrangements had just been approved in their new form by the Interim Committee, and they reflected a carefully crafted compromise. Moreover, contributions through participation in the operational budget were by no means the only or, in many cases the principal, means by which members contributed to financing the Fund or the arrears strategy. Unremunerated reserve tranche positions and contributions to the enhanced structural adjustment facility were two other important means. Hence, assessing a member's contribution to the Fund by looking at just one of the means of contribution gave a partial and, in many cases, a very distorted, picture of the member's overall contribution. For cases in which inequities did persist, the Interim Committee had just endorsed Mr. Arora's proposal that such members should contribute toward the financing needs of members in arrears following the implementation of a Fund-monitored program.

In addition, he had questioned the new interpretation of Article V offered by the Legal Department, Mr. Enoch went on. Notwithstanding the General Counsel's comments at the beginning of the present meeting, it was clear that the Legal Department paper had presented a new interpretation. In particular, the fifth conclusion of the paper stated that "quotas are *the relevant criterion for the determination of balanced positions in the* Fund, both on the transfer and the receipt sides of the operational budget." Underlying his concern about the new interpretation was the knowledge that the existing guidelines, which had been followed since the Second Amendment, had been established by the Executive Board, no doubt with advice from the Legal Department, shortly after the same Board had proposed the new Article V, Section 3(d) to the Governors. It would be very odd if the Board were to have formulated guidelines that contradicted the intention of the new Article. That was the conclusion one must draw if the new Legal Department interpretation was accepted, and that conclusion was counter to the accepted means of analyzing the Articles, namely, that to understand an Article, one must determine the intentions of the original drafters.

It had been implied by Mr. Fernández Ordóñez that the Board had already broadly endorsed his proposal to change the basis for the operational budget, and that the only remaining task was to sort out the modalities, Mr. Enoch commented. The technical paper produced by the Treasurer's Department was indeed a description of the modalities of such a change. The Board's previous expression of willingness to see further work on the proposed changes was far from the same as an indication of the Board's willingness actually to implement the changes. In his view, it would be much more constructive to seek to meet Mr. Fernández Ordóñez's concerns within the framework of the existing guidelines, which were based on the traditional interpretation of the Articles. One could envisage, for example, incorporating within the guidelines a limit on the extent to which Fund holdings of particular currencies would be allowed to fall below the average for all creditor countries. Such a compromise should go a considerable way toward satisfying Mr. Fernández Ordóñez's concerns, but to do any more, and certainly to change the whole basis of the Fund's operational budget system, would be to confuse the temporary interests of a small number of creditors with the long-term interests of the institution as a whole.

Mr. Fernández Ordóñez said that, in reaction to Mr. Enoch's statement, he wished to comment first on the relationship between the present discussion and the decision on burden sharing. His chair clearly had not been actively supportive of burden sharing. Even if the Board were able to find an acceptable formula for the burden sharing, or even if all the arrears to the Fund were eliminated, there would still be a problem with respect to ordinary resources, the operational budgets, and the need to achieve more balanced positions in the Fund. Members' balance of payments and reserve positions must be taken into account, but the present practices with respect to the operational budget ignored the need for more balanced positions in the Fund and the budget's relation to quotas.

A good solution to the problem of selecting currencies for the operational budget should help to alleviate the problem of the imbalance in members' positions in the Fund, Mr. Fernández Ordóñez continued. He agreed with Mr. Enoch that it would not be useful to open a debate on equity, but the Board should try to find the best method for providing resources to the Fund.

As to Mr. Enoch's second argument, a quota-based solution to the selection of currencies would provide greater protection for the Fund's liquidity than the current method, Mr. Fernández-Ordóñez continued. If one were to accept the argument that reserves were a good indicator of liquidity, then a currency selection based on quotas would result in using less reserves from members with a low level of reserves in proportion to their quota. There would then be more room in which to use the resources of countries that had a higher level of reserves. In addition, the Fund would be in a position to act quickly to use members' resources to face a difficult situation. Hence, a system based on quotas would protect the Fund's liquidity. The Fund's liquidity suffered when members were not willing to finance the Fund and wished to reduce their reserve tranche position. That happened when members' positions in the Fund were not balanced and when the Fund tried to rely on countries with a weak balance of payments.

Mr. Al-Jasser remarked that he was pleased that Mr. Fernández Ordóñez apparently felt that the implementation of the operational budgeting system was a long-term issue that should not be encumbered with short-term concerns. He himself also agreed that it was important to pay close attention to the liquidity situation of individual members; if their liquidity was strained, then the liquidity of the Fund could be adversely affected. It was difficult to find an acceptable definition of "liquidity." In that connection, reserves might not be the most helpful factor to have in mind. But reserves were clearly better than quotas, which were obviously a poor indicator that tended to change infrequently and did not change with the evolution of circumstances of countries over the quota review period.

Mr. Fernández Ordóñez considered that the argument that quotas were not a good basis for currency selection was weak. After all, even though quotas did not change often, the Fund based all its policy and operational decisions on them. Quotas were clearly of crucial importance to the Fund.

Mr. Hogeweg commented that, in discussing the issue of the selection of currencies for operational budgets, it was best to consider which solutions were best for the Fund's liquidity, rather than try to resolve issues concerning equitable burden sharing among individual member countries.

Mr. Yoshikuni made the following statement:

> I welcome this opportunity to evaluate the guidelines for calculation of currencies under the operational budget, in response to the fundamental question raised by Mr. Fernández Ordóñez. Unfortunately, the staff papers before us seem to suggest somewhat contradictory conclusions. Of course, as the General Counsel just said, the issue at stake is not so much whether we should base the budget on quotas, but to what extent we should do so. Still, while the legal paper concludes that quotas are the relevant criterion for harmonization, the operational paper seems to suggest that, in practice, there might be some difficulties with this approach and certain limits may be required. Concerns about the direct use of quotas as the basis of harmonization are more explicitly stated in the previous paper, EBS/89/201, entitled "Principles for Calculating Amounts of Currencies under the Fund's Operational Budget." It is therefore unclear to us what management's exact position is.

In any event, we have to address two issues today: one is the liquidity of the Fund; the other is the issue of equity among the members included in the budget. The budget needs to reconcile these two objectives if it is to operate in the most efficient way.

On this point, let me make a few observations. First, the operational budget is the most fundamental instrument for the Fund's financing arrangements, and its smooth operation must be assured in all circumstances. In this respect, safeguarding the Fund's liquidity position is the most important consideration. However, this does not imply that there is no alternative to the current system. We need to carefully assess the impact of the new proposals on the Fund's liquidity position. To this end, the staff may wish to prepare a paper with quantitative analysis of this point, taking into consideration, at the same time, Mr. Fernández Ordóñez's observation about the proxy of a country's liquidity. The paper should also address the impact of the new proposals under the new quotas.

Second, from the viewpoint of assuring smooth operation, we need to reduce disincentives for the members to participate in the budget. Mr. Enoch suggests that there is a risk that an excessively large reserve tranche position vis-à-vis total reserves may result in a drawing by the member. However, at the same time, there is a reasonable risk that an unduly large reserve tranche position in relation to quota, which would impose a larger burden on a member, might result in a drawing on the Fund's position. Thus, the budget should avoid particular difficulties for any individual country by maintaining flexibility in currency determination.

Third, closely linked to the above, we should consider the implications of the new system on burden sharing. I agree with other Directors that the arrears problem and burden sharing are of a temporary nature. We should be aware, however, that there is indisputably an irregular distribution of burden sharing, with respect to quotas, which cannot be justified by the difference of the norm. Some countries with relatively modest external reserves may be uncomfortable with such an excessive burden. We should also consider whether, or to what extent, we will address this problem, and how to solve it. The staff may wish to prepare a paper to facilitate our discussion on this question. Such a paper should include data on the new method's impact on SCA-1 and SCA-2. We should recall, in this connection, that the Board has discussed the extension of burden sharing assuming the continuation of the current method of calculation. The estimates based on the new quota distribution will be very helpful. Finally, the introduction of a quota-based budget will necessitate changes in the projection of possible voluntary contributions, such as Mr. Arora's proposal. Staff elaboration on this would be appreciated. All in all, we need more time and more relevant materials to seek a satisfactory solution to this matter. As my authorities are keenly aware of the importance of this issue, they would like to know the sequence of possible changes to the budget in a comprehensive manner. We therefore wish to reserve our position on any proposals and conclusions until the relevant materials for consideration become available. Meanwhile, we think that it is appropriate to extend the current method of calculation into the budget for this quarter, in light of the sharply split views in the Board.

Mr. Cirelli made the following statement:

To my mind, the discussion we are holding is a very important one; behind its technical title, the financial ability of the Fund to provide support is at stake. That is perhaps the reason why we are presented with such controversial conclusions. This means at least that the subject we are discussing does not involve only technical questions, which would be easy to solve, but also principles, which are not always easy to define.

Before getting to the heart of the matter, let me make three remarks. I share the views expressed by other Directors that the method employed for a long time now has served the Fund well. It is not in itself a bad method--after all, there have been few complaints since 1962--and I would like to avoid fruitless confrontations over the method of calculation, with, for example, the method used up to now being considered ineffective while the one proposed is regarded as being ideal. It is clear, however, that in establishing a method of calculation we have to take into account many elements, such as how to better ensure the liquidity of the Fund, as well as the fairness implied by the cooperative nature of the Fund. This is what the Articles require us to do. But, at the same time, the present method that we have used for a long time could not be presented as an unchangeable block. History shows that it has been adapted to circumstances since 1962. So I will not challenge the method on legal grounds. Like others, I cannot imagine that we have applied illegal rules. Besides--if I am not mistaken, the General Counsel has confirmed it today--that is not exactly what the General Counsel is arguing, and I did not read in the well-written legal analysis that the actual method was illegal. On this point, the conclusions that appear on page 16 are more than clear; as is stated on page 2, the three elements used by the Articles are not exclusive. This proves, however, that we can exercise some flexibility.

Let us recognize, indeed, that the present method, while having the merits of experience, also poses questions. Let me express some of them. What role do a central bank's reserves have to play in judging the strength of a country? That notion is being challenged by Mr. Fernández Ordóñez, with several interesting arguments. I think that before taking a definitive stance, we at least need the help of our Research Department by giving us its opinion, and I would be pleased to see a paper on the role of reserves on which to base our assessment.

If reserves are a good standard, why is the SDR not included in reserves? What is the rationale behind this exclusion, especially as the Articles provide that we must try to make the SDR the principal reserve asset in the international monetary system? Could the staff give us some economic explanations for this exclusion?

Apart from these questions, let us recognize that the present system is certainly not entirely coherent. First, a major currency is not part of the rules and is treated on an ad hoc basis. Second, from time to time the Executive Board has agreed to make ad hoc modifications, as was done for small countries. Third, we have adopted two different policies regarding transfers and receipts, and I do not grasp the reasoning for such a difference. Does the staff agree with the explanation by Mr. Enoch on this matter?

Keeping these elements in mind, I wish to make several comments. The present method is more than flexible. It does not have an indisputable basis, both from an economic point of view and in terms of the way it has been implemented up to now. It is not possible, however, to reach a final and permanent agreement today on an alternative method for two reasons. First, we do not know whether the criterion of balanced positions is still pertinent. Clearly, further studies are needed in order to assess the reserve harmonization ratio. Second, we have not been provided an in-depth study of a new method. Hence, as concerns have been expressed about changing our system, such as the rigidities of the quota-based system for judging the financial strength of one country, it is clear that rather than debating methods, we should attempt to see how to evolve from where we stand now.

In order to achieve this evolution, I recognize that there are two issues that deserve consideration: how to better protect the liquidity of the Fund; and how to avoid impairing this liquidity at a time when it is expected to decline. As to this first question, we must avoid creating movements that will adversely affect countries' willingness to finance Fund operations. This calls for (1) more indisputable principles of harmonization in an economic sense, and (2) a smooth transition to avoid abrupt modifications. As for the second question and the short term, the search for equity is fully justified, and I would be prepared to address this issue in such a way that major distortions would be removed quickly for the next operational budget.

Mr. Ismael said that in selecting and determining the amount of currencies for the operational budget, the present approach in its various variations had over the years served the needs of the Fund and its members well. It had accommodated the special circumstances of members with relatively weak reserves and/or less than solid balance of payments positions.

The paper illuminating the legal aspects of the selection of currencies under the Articles had, in the application of the harmonization principle, cast doubt on the procedures adopted in the past, under which the Fund had not tried explicitly to seek balanced positions of members in the Fund in relation to their quotas, Mr. Ismael went on. The finding of the paper did not decisively rule in favor of the use of quotas as one of the factors or as the sole criterion for the determination of the amount of currencies in the budget. Nevertheless, it presented a strong case for continued clarification and interpretation of the relevant Article. In that connection, he did not agree with the argument that the continuing use has conferred legitimacy on the present system. Therefore, the staff should carefully look into all aspects of that issue before the Board tried to resolve it.

In the event that a change or modification of the harmonization principle was necessary, he tended to share the staff's view that an immediate conversion might pose difficulties for some members as well as put in doubt the ready availability of resources for the Fund, Mr. Ismael said. In light of the scenario under which Fund credit was likely to expand in the near future, he was more inclined to accept the staff's suggestion that the new system should only be phased in over a period of two years. It was useful to note two key phrases in the harmonization principle--namely, "desirability" and "promoting over time"--which clearly indicated that the achievement of balanced positions in the Fund was a goal and which implied that the principle should be applied in a flexible manner. In that connection, he wished to emphasize that special consideration should be given to members newly included in the budget, so as not to cause undue difficulties for them in supplying resources to the Fund. Finally, as to the immediate concern of issuing guidelines to the staff for the preparation of the next operational budget, he supported the interim measure suggested by Mr. Fernández Ordóñez, namely, a cap, perhaps 50 percent of quota, or a certain percentage above the average, placed on members' positions in the Fund.

Mr. Goos remarked that Germany was one of the members that was disproportionately affected by burden sharing. In that connection, he appreciated Mr. Fernández Ordóñez's wish to change the current procedure for the transfer of currencies under the operational budget toward a more quota-based approach. Even disregarding the objective of fairer burden sharing, as had been argued convincingly by Mr. Hogeweg and others, there were a number of considerations in support of placing greater emphasis on quotas in harmonizing reserve tranche positions. In that context, he had considerable sympathy for the view that, in general, rights and obligations of the Fund should be based on quotas. Nonetheless, he agreed with those who stressed that the current procedures governing the currency budget had served the Fund and its membership well. He shared the concern expressed in particular by Mr. Hogeweg, Mr. Enoch, and Mr. Al-Jasser that a quota-based harmonization rule on the transfer side would reduce the flexibility of the currency budget and might cause members with relatively weak balance of payments and reserve positions to opt out of the budget.

The uncertainties with respect to the smooth functioning of the currency budget and the complementary loss in Fund liquidity were powerful reasons for approaching any proposal to change the existing selection criteria with utmost caution and reservation, Mr. Goos continued. Moreover, for the reasons presented by Mr. Enoch and others, the legal paper did not provide compelling arguments for changing the current procedures which, after all, reflected an almost 30-year-old practice of the Fund. As a participant in the discussions of the Second Amendment of the Articles, he recalled that the adoption of the relevant language of Article V was never really meant to change the currency selection practice.

Therefore, he had a strong preference for maintaining the existing currency selection criteria and he appealed to Mr. Fernández Ordóñez to reconsider his request to change those criteria, Mr. Goos stated. Such a reconsideration should be facilitated by recognition of the fact that the remuneration coefficient had been raised to 100 percent only in recent years. Hence, the established harmonization practice had always given rise to an uneven distribution of costs if judged against members' quotas. But as was rightly stressed by others, those costs were of a permanent nature, whereas the costs arising from burden sharing were at least expected to be only transitory. That difference was clearly a crucial one, and it should be kept in mind.

If Mr. Fernández Ordóñez insisted, he himself would be prepared to consider a compromise solution based on the already existing flexibility of the current procedures, but such a compromise solution must not adversely affect the Fund's liquidity, Mr. Goos commented. At the same time, after having listened to some of the previous speakers, he hoped that the search for such a compromise solution would not lead to the production of a number of additional staff papers, thereby increasing the staff's already large work load.

Mr. Kyriazidis made the following statement:

Mr. Fernández Ordóñez has raised some issues with important implications, perhaps going beyond the composition of the currency budget. He has, in fact, implicitly raised the question of equity in the distribution of the burden of financing the Fund's operations among creditor countries. In a cooperative institution like the Fund, it is indeed important to ensure, to the extent possible, that no member feels that it is forced to bear an unfair share of the burden and has to take action to remedy the situation, with possible adverse effects on the Fund's liquidity and its ability to carry out its operations smoothly. Member countries are committed to financing the Fund's operations by placing their currency--which in effect, in most cases, is equivalent to placing part of their foreign exchange reserves--at the disposal of the Fund, within the limits of the quota or special drawing rights. This general commitment is subjected under Article V, Section 3(d) to what I would call the ability to pay, defined by balance of payments strength and reserve position, but also by the desirability of maintaining over time balanced positions in the Fund. These conditions appear to me to imply a recognition that the drawing of currencies carries some costs for the member country whose currency is drawn, and it is desirable that these costs should be distributed in an equitable manner through the harmonization of positions in the Fund.

The point to be debated today concerns the appropriate criteria only for harmonization, subject always to ability to pay. Mr. Fernández Ordóñez believes that the only criterion should be the ratio of reserve tranche positions to quotas, and this view receives considerable support from the interpretation that the Legal Department gives to the meaning of Article V, Section 3(d). The fundamental point in this discussion is the current cost, otherwise the drawings of currencies by the Fund would constitute a neutral exchange of reserve assets and the desideratum of maintaining balanced positions of the Fund would be of very little practical interest.

The matter of costs borne by a member country when its reserve tranche position in the Fund rises has not been discussed in any great detail in the past. It was only indirectly raised when the burden-sharing agreement was first introduced when the United States felt, with good reason I believe, that it was being unduly penalized because of its high reserve tranche position in relation to its quota, and it was then accepted that an attempt to remedy the situation would be made through the operational budget. Mr. Fernández Ordóñez posed the problem on a more general plane, again, but chiefly in relation to the burden-sharing arrangement. However, I believe that costs are involved independently of the burden-sharing arrangement, because monetary authorities do have the possibility of investing their reserves in high-quality assets with a higher yield than the rate of remuneration.

The burden-sharing arrangement of course as now applied, and the projected extended form of it have raised the cost of any increase in reserve tranche positions considerably. The fact that the situation is temporary does not change much the substance of the problem, since even the refund will, in the final analysis, not be a complete refund and will entail a loss in terms of opportunity costs.

Quite apart from the burden-sharing question, there is an implicit recognition that there is a cost in reducing reserve tranche positions in the Fund in the arguments presented by Mr. Al-Jasser, Mr. Enoch, and Mr. Hogeweg. Indeed, the argument is made in favor of the use of strengthened criteria for harmonization; otherwise countries might find themselves with an undesirably high proportion of their reserves in reserve tranche positions in relation to other reserve assets. However, a member's reserve position in the Fund has features that do not place it on an equal footing with other reserve assets. There is a cost, and not necessarily in the narrow sense. In fact, there seems to be a liquidity aspect to these reserve positions. When a country accepts that its currency is to be drawn, it also agrees to maintain or tolerate that position within the Fund--in other words, the country agrees not to count the reserve tranche position as part of its first line of reserves for the simple reason that if it behaved otherwise, the member would not be very cooperative and might cause liquidity problems in the Fund. It must be prepared to maintain a reserve tranche position over a longer period, and not use it as an ordinary reserve asset that can be liquidated on first call. This is part and parcel of good relations between the member and the Fund.

Present policies have appeared to place too much emphasis on the ability to pay as defined in Article V, and relatively little emphasis on the desirability of maintaining balanced positions in the Fund as interpreted by the Legal Department. The result has been, as indicated by the data provided by the staff, a wide disparity in the reserve tranche positions as a ratio of quotas, with some countries having a surprisingly high ratio--I have in mind the major creditor members--and others having unexpectedly low ones, even though they cannot be counted among the members that are relatively weak financially or otherwise.

Thus, in view of the costs involved, the ability-to-pay principle would appear to have led to the equivalent of levying a progressive tax based on foreign exchange reserve holdings and balance of payments strength. Mr. Fernández Ordóñez has contested the equity of such an arrangement. In view of the above, I would agree that some modification of the present policy is justified, but I cannot go as far as Mr. Fernández Ordóñez proposes, i.e., for an immediate adjustment of the ratios of reserve tranche positions to quotas to the average for creditor countries as a whole. My position on the whole is very close to that of the Legal Department. I do believe that the ability to pay is an essential safeguard for all member countries and the Fund for obvious reasons. And its application should not be limited only to the selection of the currencies to be drawn. But harmonization with reference to quotas should perhaps be pursued more actively than it has been thus far so as to ensure the most equitable possible distribution of costs.

Accordingly, I would be willing to go along with transitional arrangements aimed at a gradual harmonization of reserve tranche positions in relation to quotas over a reasonable period. I would be wary, however, of setting as a goal the equalization of positions, for two reasons. First, balance does not necessarily imply equity. Second, given the importance of adhering to the criteria of ability to pay and equity, as well as for practical reasons, if we did adopt equality of positions as a quasi-absolute rule, we might even commit the sin that Plato has ascribed to democracies, namely, parceling a limited degree of equality to equals and unequals alike.

Mr. Dawson made the following statement:

The operational budget represents the most concrete expression of the Fund's role as a monetary institution. The selection of currencies in the budget reflects the fundamental principle that each member, regardless of size, in a position to extend financing has an obligation to assist members experiencing temporary balance of payments difficulties. The current procedures have worked relatively well over the years. However, changes in the international monetary system, including the role of the dollar, and the emergence of the arrears problem and burden-sharing arrangements have altered to a certain degree the assumptions underlying present procedures.

The procedures for allocating transfers in the currency budget on the basis of gold and foreign exchange reserves were established in the context of an international monetary system characterized by par values, convertibility obligations, and limited international capital markets. In such a system, gold and foreign exchange reserves provided a reasonable approximation of a country's capacity to extend financing, particularly as Fund operations in general involve an exchange of a member's currency for reserve assets. Moreover, the central role of the dollar as the principal reserve asset did provide the United States with special obligations.

However, as the Executive Board's discussion of international liquidity demonstrated, gold and foreign exchange reserves are no longer a fully satisfactory proxy for a country's financing capacity. The development of international capital markets and regional financing arrangements have enabled creditworthy countries, particularly those countries that would be included in the Fund's operational budget, virtually unlimited access to financing. The adoption of more flexible exchange rates and the diminished role of gold in official transactions have fundamentally altered the role of official reserves to that of a last line of defense rather than the primary means of financing. In recognition of these developments, the amended Articles of Agreement provide that a broader concept of financing capacity should be used in determining which currencies to include in the operational budget by referring explicitly to balance of payments positions and exchange market developments in reaching a judgment.

In these circumstances, it seems to me that the current method for allocating currencies in the operational budget solely on the basis of gold and foreign exchange reserves does not provide a fully satisfactory approach in terms of ability to provide financing. While most members continue to meet their obligations by converting their currencies into reserve assets, the amount of gold and foreign exchange holdings is not a significant constraint. At present, for example, the gold and foreign exchange reserves of creditor countries is on average more than 25 times their Fund reserve positions, and their total financing capacity is a large multiple of even that amount. Moreover, the largest creditor countries also have the option of allowing their currencies to be used directly or of achieving conversion through market transactions.

The present ad hoc treatment of the dollar in the operational budget also raises some fundamental questions. The rationale for this treatment is that the gold and foreign exchange reserves of the United States do not provide a meaningful guide to the ability of the United States to provide financing because of the reserve currency role of the dollar. Therefore, the amount of dollars included in the budget is based on the Fund's dollar holdings as a share of the total Fund holdings of usable currencies--now about 25 percent. At present, about 20 percent of gross U.S. gold and foreign exchange reserves are in the form of Fund reserve positions, about five times the average level of other countries in the operational budget.

We would certainly agree that U.S. gold and foreign exchange reserves do not provide a meaningful guide to our financing capacity, just as they are not a meaningful guide for other creditor countries included in the budget. Although dollars drawn from the Fund are normally not converted into other reserve assets, it seems to me that the considerations relating to the amount of financing the United States should provide the Fund does not differ fundamentally from those confronting other countries, for several reasons. First, the United States must borrow in capital markets to finance any dollars transferred to the Fund under the operational budget and thus incurs the same interest costs as other creditor countries which exchange their currencies for reserve assets. Second, the increase in foreign dollar holdings will have the same potential monetary or exchange rate effects as for other countries included in the budget. Third, the ability of the United States to borrow in its own currency, and thus avoid potential exchange rate gains or losses, reflects the size and openness of the U.S. economy and financial markets rather than the legal obligations of the par value/convertibility arrangements under the Bretton Woods system. These factors are reflected in the U.S. quota in the Fund and thus the amount of financing the United States is committed to provide to assist other members. Third, the so-called exorbitant privilege of being able to borrow in dollars also carries with it certain offsetting costs in terms of reduced exchange rate and monetary flexibility. Since other countries have been extremely reluctant to allow their currencies to serve as reserve assets, these costs must exceed the potential benefits.

In these circumstances, we question whether the present ad hoc treatment of the dollar in the operational budget continues to serve the same purpose as in earlier years. While we recognize the important role that the dollar plays in the Fund, we believe that consideration should be given to allocating dollars in the operational budget on the same basis as other creditor countries. I would note, by the way, that after any transitional period, the amount of dollars used in the currency budget would rise under a quota-based arrangement, as the U.S. share of quotas of creditor countries is about 30 percent, whereas the dollar is presently 25 percent of transfers in the budget.

It seems to me that the issue confronting the Executive Board derives not from a lack of ability of countries to provide greater financing to the Fund, but rather from a willingness to do so either because of concern about the liquidity of Fund reserve positions or the interest cost involved in holding a portion of official reserves in the form of reserve tranche positions. With regard to the liquidity of Fund reserve positions, the right to mobilize these reserve assets is guaranteed under the Articles of

Agreement and is an essential feature of the monetary character of the Fund. While some countries may be reluctant to use their Fund reserve positions for political reasons, this is a self-imposed constraint, which should not be ratified through procedures governing the operational budget. Allowing such a prejudice to govern the selection of currencies in the operational budget will weaken the liquidity of the Fund, not strengthen it, and could seriously jeopardize the monetary character of the Fund. The United States has used its Fund reserve position in the past and would have no hesitation to do so in the future should the need arise. We hope that other creditor countries would also be prepared to do so and would avoid making reserve positions an illiquid asset much like gold. It would be unfortunate indeed if, at a time when each of us are increasing our subscriptions to the Fund, the concept of Fund transactions as an exchange of monetary assets were to be called into question.

The adequacy of gross reserves as a measure of financing capacity and the appropriate role of the dollar in the Fund are issues that have been with us for some time and which have been considered frequently in various contexts, including the periodic reviews of the operational budget. It is unlikely that these alone would have required a change in the present approach were it not for the arrears situation and the problems created by the present method for distributing the costs of burden sharing. The basic assumption that reserve positions in the Fund are close substitutes for other reserve assets is no longer valid at a time when remuneration paid to creditors is roughly 20 percent below the interest rates on other reserve assets. My authorities are prepared to accept these costs as part of the effort to strengthen the Fund's financial position and to deal with the growing problem of arrears. However, the cooperative nature of the Fund requires that these costs be distributed more equitably.

As you know, we reluctantly accepted the present mechanism for burden sharing when no other direct means for obtaining the necessary resources proved feasible. The agreement on extended burden sharing sought to ameliorate some of the problems associated with the present system by reallocating the cost between debtors and creditors in a manner that roughly approximates overall quota shares between the two groups. At that time, we suggested that possible modifications in the currency budget could help to provide a more balanced distribution of the costs of burden sharing among creditors. In effect, the approach described in the staff paper represents a broadening and extension of the "mitigation" arrangements introduced several years ago.

We believe that the simulations described in the staff paper could provide a useful, albeit imperfect, means of achieving a more equitable distribution of the costs among creditors. It does not address the problem of countries which are neither creditors nor debtors. Moreover, the distribution of the costs among debtors will still be based on the amount of outstanding loans to each country. However, we see no reason why a second-best solution should not be adopted if it represents an improvement over current arrangements. There was broad recognition during the arrears negotiations that a quota-based approach to burden sharing was the most equitable system. The staff's legal paper indicates that it would also be the most consistent with the spirit and letter of the Articles of Agreement. Proposals based on the staff simulations would at least move us in the right direction.

As Mr. Al-Jasser has reminded me, I expressed concern last December that changes in the procedures for allocating currencies in the operational budget could adversely affect the Fund's liquidity and ability to provide financing. We still have these concerns, although we are also mindful of the fact that the Fund's financial position is currently quite strong and would be seen to be even stronger were the proposals advanced by our British colleagues at the recent review of the Fund's liquidity adopted. Similarly, the number of currencies in the budget is at record highs, and potential transitional problems associated with new countries being added to the budget are likely to be minimized. Thus, now would appear to be an opportune time to modify current procedures to reflect more fully changes in the international monetary system and to deal with the problems created by the burden-sharing arrangement.

In this connection, we are attracted by the idea that a portion of the allocation be based on gold and foreign exchange reserves and the remainder on the basis of quotas. This approach would recognize legitimate concerns regarding both the Fund's liquidity and the impact of the burden-sharing arrangements. We are concerned, however, that the alternative methods of using caps on the amount of currencies to be allocated in the budget are inherently discriminatory and would result in an unproductive debate over the level of the cap. Furthermore, a purely quota-based distribution could adversely affect the Fund's liquidity in the period leading up to the implementation of the quota increase.

Finally, we recognize that any new approach poses risks and could have unintended consequences. Therefore, we would also propose that any new procedures be given a trial run to the end of 1991, at which time the Executive Board could review the issue. This would enable us to consider the Fund's liquidity in light of the quota increase and to have a better fix on the magnitude and cost of burden sharing.

Mr. Evans made the following statement:

The staff papers do not provide all the answers, but they do reveal a good deal of the long history behind the issues and thus caution us against stepping too quickly into a seemingly brave new world.

The papers, not surprisingly, have left differing impressions on different readers. For my part, they have highlighted three basic issues. First, this is clearly not a new issue. For the best part of three decades, the concept of a "rational and equitable" distribution has been with us but has been left undefined--other than, and then poorly, by practice. And that because our predecessors, in their wisdom, recognized that concepts such as rationality and equity cannot be defined for all time. Thus, they declined to formalize such objectives under the Second Amendment, notwithstanding that they were prepared to formalize similar, but less complex issues, in relation to the SDR, in Schedule F. I believe that we would be wise to retain the flexibility they have bequeathed us, notwithstanding Mr. Fernández Ordóñez's understandable desire that the method we decide should have "the longest possible life span."

Second, it is clear that a large reserve tranche position in the Fund is not a highly prized asset. Perhaps it never was, but it has become even less highly prized with the advent of burden sharing and, now, the prospect of extended burden sharing. And while we will all be working to ensure that those latter elements are not forever with us, realism dictates that they will be for the foreseeable future. Hence, our design of a system for selecting currencies for the moment--and recognizing our retention of flexibility to change that design in the future--must be based on the premise that we are attempting to allocate among creditors their share of a lowly valued asset. This immediately suggests, for a cooperative institution, that such an allocation scheme cannot be sustainably based--and I emphasize based--on anything other than obligations, i.e., quotas.

Third, it has been accepted for a long time that international reserves are not an adequate unique measure of liquidity. I would, however, stop a little short of Mr. Fernández Ordóñez' demolition of the concept. Clearly, we still regard the concept very highly in respect of debtors countries; Fund programs are premised on providing adjusting countries with international reserves to buffer their adjustment programs. Similarly, we measure success of adjustment programs by the attainment of external viability, including the acquisition of "adequate" reserves. But, going beyond that, it has become obvious that the optimal level of reserves for any individual country involves a wide range of issues, and that international reserves, per se, are no indication of a country's ability to provide liquidity to the Fund or to anyone else. Moreover, it is my observation that the level of reserves in relation to GDP is quite probably negatively correlated to a country's medium-term external viability: countries with a strong external position and long-established financial markets have less need of reserves than do countries with satisfactory but still fragile external positions. I found Mr. Dawson's illuminating comments on this issue most telling, as I did his comments generally. Hence, I believe that we should not be too tardy in downplaying the role of reserves in our operational budget.

Against that background, I will comment on the main issues before us. I can accept, with only one minor reservation, the conclusions of the Legal Department's paper, including the proposition that "quotas are the relevant criterion for the determination of balanced positions in the Fund...." I can also readily accept the fourth conclusion, to the effect that all three elements are relevant to both identification of currencies and amounts to be used.

I also note the discussion of a single, as against a two-stage, process. I am sure that it would not be beyond the wit of the staff to develop a relatively simple formula that would determine both identification and amount of currencies against the three basic criteria and encompassing adjustment paths where those three determinants were considered to be interrelated; the Research Department regularly tackles more complex mathematical requirements than this.

In practice, however, I believe that we should keep the questions of identification and amount separate: (i) the issue of identification is largely a judgmental process, and should remain so; and (ii) the issue of amount should be determined, overwhelmingly, by the harmonization principle, based on quotas, with the "over time" condition satisfied by taking account of the possible reserve problems of individual countries.

I have, however, one question. The Legal Department, in its paper (EBS/90/87), has dissected Article V, Section 3(d) clause by clause. However, the staff has omitted reference to the clause "in consultation with members." I would appreciate, therefore, a clarification of this clause, as it applies to either identification or amount, recalling that the process we are now considering is one which can be interpreted as either imposing burdens on members or, alternatively, requiring them to recognize their obligations. Either way, there is scope for members to resist. Hence, does the clause "in consultation with members" restrain the

Fund's ability to implement guidelines which may require members to accept reserve tranche positions when they may be reluctant to do so?

This issue is, I believe, at the heart of the concerns expressed by Mr. Al-Jasser, Mr. Enoch, and Mr. Hogeweg in their well-argued defense of the current arrangements. They stress the importance of having a system that gives prime attention to ensuring the liquidity of the Fund. In the same vein, they are concerned that a system based on quotas could see some countries achieve too high a reserve tranche position and become more likely to draw upon that tranche, thus weakening the liquidity of the Fund.

These are legitimate and important concerns. But it is not obvious to me that they are concerns that would attach only to a quota-based system; or, indeed, that such concerns would be heightened by the use of such a system. Those concerns exist under the current system. Indeed, it is the concern of where the current system might lead--in terms of countries resorting to the use of their reserve tranches to relieve themselves of some of the burden imposed by that system--which is behind the calls for change. It is said that the current system has served the Fund well, and perhaps this is so, but the issue is whether it will continue to do so, given the mounting level of concern to which I have just referred. If the only issue to be addressed were that of Fund liquidity, then the current system is not optimum, as Mr. Hogeweg has suggested. A system based solely on that criterion would have a much smaller number of countries in the operational budget than we now have. The fact is that the current system is not based on the sole criteria of the Fund's liquidity; rather, as I indicated earlier, factors such as rationality and equity have been with us from the inception of the operational budget. What has happened in the meantime, and particularly in recent years, is that those factors have--regrettably, perhaps--assumed greater weight. And not only in their own right but also in terms of the implications for Fund liquidity if they are not given the weight that current circumstances suggest. Should those factors change in the years ahead, as we all hope, then will be the time to revert to the weights of the past.

I believe that we should be careful, in addressing the question of Fund liquidity, not to confuse means with ends. I have heard no one today suggest that maintaining Fund liquidity should not be a prime consideration. The differences appear to be more on how that is best done. One might note a parallel here with the situation of about a decade ago, when many considered that pursuing the elimination of inflation would run counter to growth objectives. It has taken the past decade to remove that confusion, and I hope that it will not take us as long to resolve the issue before us today, because some of us are confusing objectives with the means of achieving them.

For those reasons, I would favor moving to a harmonization principle based on quotas, with adjustment constraints which take account of reserve positions, along the general lines proposed by Mr. Fernández Ordóñez. I would stress, however, that in comparing such a system with the current one we are not talking about the difference between black and white. Rather we are talking two different shades of grey: one composed from a reserve base with quota overtones; and the other composed from a quota base with reserve overtones. In the long run, the two might yield similar results. There is, nevertheless, some importance attached to getting the basics right--in terms of the Articles and of our prevailing concerns--and that is why the current situation merits a change. Whichever way we go, however, it should be clear that no system will work satisfactorily unless there is a very broad consensus behind it. There is not such a consensus behind the present system.

Mr. Thorláksson made the following statement:

I fully share the view expressed by several Directors that today's discussion has resulted primarily from dissatisfaction with the present burden sharing mechanism owing to the fact that the operational budget is possibly the only means by which the Fund could establish a legal framework for a quota-based, and thus more equal, burden sharing.

However, as stated by Mr. Dawson and other Directors, the fundamental problems underlying the burden-sharing mechanism cannot be solved by changing the system by which currencies are allocated under the operational budget, since this will only affect the distribution of the burden caused by the overdue financial obligations between the creditor countries. Moreover, because the arrears to the Fund are, we hope, a temporary phenomenon, one might even wonder if changing the whole basis of the operational budget in order to attain a more equal burden sharing among participating countries is the most reasonable approach.

At the same time, one has to recognize that the present system, which is based on a measurement against gold and foreign reserve holdings, at times results in a more extensive use of some currencies than can be justified if other factors are taken into account, thus placing an undue burden on the respective countries; for instance, differences in policies regarding the appropriate level of foreign reserves have an impact on the extent to which their currencies are used in the operational budget, regardless of the fact that external positions could be judged to be equally strong.

In addition, as has been elaborated on extensively by Mr. Fernández Ordóñez, and closely related to the aforementioned, the liquidity situation of a country cannot be unambiguously derived from the level of foreign reserves. Consequently, the current method of calculating the amounts of currencies in the operational budget does not necessarily imply a balanced distribution among the currencies of the participating countries. It appears, however, from EBS/89/201, that the staff disagrees with this view, and staff comments would be appreciated.

My authorities would be willing to consider some changes in the present system. However, before taking any decisions, the issues involved need careful consideration and thorough examination. This will probably also necessitate continuation of the present principles for the next operational budget and designation plan.

In our view, the continued work should be concentrated on finding a method that combines the present one with a measurement against quotas. This might imply certain limits on countries' reserve positions in the Fund relative to their quotas as a result of their participation in the operational budget. In this connection, it would be interesting if the staff could elaborate on the limits needed to avoid too large an adjustment in the use of certain currencies.

We, however, consider it essential that the system be flexible enough to accommodate the need for Fund resources. This also means that there should be provision for limits for particular countries to be temporarily exceeded, if necessary, to avoid hampering the Fund's liquidity position.

We also hold the view that the eventual implementation of a new system should take place over a longer timespan--say, two years. Furthermore, flexibility should specifically apply to countries whose currencies have recently been, or, in the meantime, will be included in the operational budget.

Mr. Clark made the following statement:

Let me begin by first expressing my appreciation to those Executive Directors who took the time to circulate statements concerning the issue we are dealing with this morning. It is obviously a complex issue, and for those of us who are relatively unfamiliar with the workings of the Fund, these statements helped by providing understanding. Given the comprehensiveness of these four statements and the background material provided by the staff papers, there is very little that I can add other than to indicate areas of agreement or disagreement.

First, in general, we can appreciate the arguments put forward by Mr. Fernández Ordóñez for examining, with a view to possibly changing, the current system of balancing positions in the Fund in relation to gold and foreign exchange reserves. The case for moving to a quota-based harmonization system seems at first glance to be quite persuasive from a legal point of view, based on the argumentation in the staff paper. In this regard, however, and not being a lawyer like Mr. Enoch and Mr. Hogeweg, I cannot help but wonder what the legal basis was for the harmonization methodology that has been used since 1962. As Mr. Enoch concludes, this new interpretation would suggest that the Board and staff have been implementing the Fund's Articles incorrectly for more than a decade.

Second, Mr. Fernández Ordóñez's argument about gold and foreign exchange reserves being an inadequate proxy for total liquidity available to creditworthy members, under conditions of widespread liberalization of capital movements and a system of floating exchange rates, is also well taken. But here again I have some difficulty. Why is it that the reserve position of a member is relevant in deciding whether a currency should be in the budget, but not relevant in calculating the amount of the currency to be used?

This takes me to what seems to be the real issue. With positions in the Fund currently serving as the yardstick for the distribution among creditors of the burden of financing protracted arrears to the Fund, it is now argued that it is more important to ensure that the balancing of such positions is done in the most equitable manner possible. In other words, equity considerations should dominate liquidity considerations in determining the amounts of currencies in the operational budget. But on this issue, we find Mr. Enoch and Mr. Hogeweg's arguments extremely strong. We agree, or at least we certainly hope, that the burden-sharing arrangements we have set up would be temporary, and that we should not try to correct one perceived problem by creating another.

Notwithstanding Mr. Fernández Ordóñez's strong argumentation, we are not convinced that the main arguments advanced in the past against the use of quotas as the basis for the allocation of currencies under the Fund's operational budget are no longer valid or relevant. In particular, the question remains whether actual quotas, reviewed only infrequently, reflect adequately the relative strength of members' external financial positions and their capacity to finance a reserve position in the Fund. More important, we worry that the use of currencies allocated on the basis of quotas might create difficulties for those members whose position in the Fund could become disproportionately high in relation to their total reserves.

To illustrate the point, consider Canada's position in 1985-86, when the Canadian dollar was under considerable downward speculative pressure leading to large-scale intervention and increased foreign borrowing. Had the allocation of currencies for the Fund's operational budget been based on quotas, then, as shown in Table 6, Canada's position in the Fund would have risen to 81 percent of its gold and foreign exchange reserves, compared with 23 percent under the current harmonization system. In these circumstances, Canada might have been forced to step up its foreign borrowing in order to meet its obligations to the operational budget. Alternatively, we may have had to seek permission to withdraw the Canadian dollar from the operational budget, with negative implications for the Fund's liquidity position. Moreover, we may have had to liquidate our reserve tranche position in the Fund, weakening still further the Fund's liquidity.

In conclusion, we believe that the arguments favor maintaining the current system for calculating the amounts of currencies under the Fund's operational budget. Nevertheless, should the Executive Board deem it appropriate to change its procedures and adopt a quota-based harmonization mechanism, then we would argue that limits would have to be placed on the extent of the Fund's call on a member's reserves, to avoid problems both for members and for the Fund's liquidity. Such a limit would give countries, such as Canada, a measure of comfort in knowing that they would not have to face circumstances similar to those that I described earlier.

In the event that we cannot come to an agreement today, we must nevertheless decide on what harmonization method should be applied in the next operational budget. It seems to us that until we can come to a consensus on the harmonization system, maintaining the current methodology would be the easiest and most practical solution. It is at least consistent with one interpretation of "balancing positions."

Mr. Prader made the following statement:

Today's issue is a very divisive one, as can be immediately seen from the figures on the impact of alternative calculation methods on various countries. Our constituency has not yet managed to arrive at a common point of view, which is perhaps an indication that today's discussion in the Board will be only a first exchange of views. The consensus-building process will be very much determined by the outcome of further careful studies on the effects of the working of a new general method and also of quantitative results concerning the compromise approaches suggested by the staff and Mr. Dawson.

My Belgian authorities have not yet formed a final view on how the legitimate concerns of some members with a relatively high reserve position in the Fund might be most properly accommodated. They look forward to today's discussion to guide their further consideration of this issue. One aspect of the problem which should in their view be taken into account, whatever solution is finally accepted, is the need to protect the monetary character of the Fund's operations and of its members' contributions to those operations. They consider it imperative to avoid the pitfall of taking only budgetary considerations into account when discussing the functioning of the operational budget and by doing so weakening the basic features of the guidelines of the operational budget.

In this context, my Belgian authorities recall that at the origin of the arrears problem is the concern that it may endanger the monetary character of the Fund. This important characteristic of the Fund does also have consequences for the operational budget mechanism, which can therefore not be purely quota based. Any mechanistic rule based on this principle would, in their view, be in opposition to the monetary character of the functioning of the Fund for two reasons. First, quotas take into account the relative economic importance of Fund members and, as stated by the staff, do not reflect short-term developments of members' balance of payments, intervention policies on exchange markets, and reserve positions; therefore, the basic aim of balancing members' Fund positions in relation to their reserves should be continued in order to ensure that sufficient reserves will be easily available at all times to finance the Fund's operations. Second, even if the Fund's liquidity would not be hampered as much as in the past by a quota-based balancing of members' Fund positions, it remains of capital importance for the members themselves, and especially for their central banks, that their reserve tranche position would remain as liquid as their other foreign exchange assets. Under a quota-based distribution of the operational budget, members' reserve tranche positions in the Fund would become more rigid than under the present system, thereby hampering the liquidity of central bank claims on the Fund.

In conclusion, my Belgian authorities therefore feel at the present stage that concerns about excessive contributions to the burden sharing should first be examined on the basis of the present system, which is predominantly based on a reserve-based distribution of the operational budget. Therefore, we look forward to further studies on the best possible way to reconcile the equity considerations raised by the burden sharing with the preservation of the liquidity of reserve claims on the Fund.

As far as the position of my Austrian authorities is concerned, it is not difficult to guess that their view is similar to that of Mr. Fernández Ordóñez.

I should perhaps stress one or two points. As a result of burden sharing and its extension for the financing of the rights approach, the allocation mechanism for the selection of currencies has lost its purely technical character. For as long as the rate of remuneration was equal or close to the rate of return in the foreign exchange markets, the distribution of monetary reserves between reserves invested in the foreign exchange markets and those held with the Fund was not relevant. If, however, as a consequence of burden sharing, central banks have to accept on their Fund-related business an interest income which is significantly below the respective market rates, then the formerly purely technical allocation mechanism of the operational budget becomes at the same time a scheme for distributing interest income losses. Due to this loss of technical innocence of the operational budget, perceptions about the monetary character of the Fund are bound to be affected. If this is the case, then the immediate question will be which criteria can be used to achieve a fair distribution of this burden.

Quotas are the essential criterion for a member's rights and obligations in the Fund, a principle which should apply consequently for the financing share of members in this cooperative institution as well. Why should the Fund, in dividing up members' shares in the financing of drawings on the Fund, proceed only on the basis of gold and foreign exchange reserves, in particular if those reserves are taken into account in the calculation of quotas only in the Bretton Woods formula, and only at a relatively modest portion? In fact, as Mr. Dawson stated today, a quota-determined allocation mechanism can be considered as a broad-based mitigation scheme for the selection of currencies.

One reason for supporting a change to a quota-based allocation system is the dissatisfaction with the present way of harmonizing members' participation in the operational budget. For instance, for Austria, the normal expectation would have been that the peak years of participation would have been offset by years showing below average ratios of participation. Instead, what has happened is that since 1983 harmonization has resulted only in a lowering of participation, which is still above the average of other Fund members.

In proposing quotas as the new criterion for the allocation of currencies, my authorities would be prepared to accept the following qualifications to such a new scheme. First, any reform should start from the assumption that the financing of the Fund has to be assured, or secured. In this context, the merit of the Treasurer's paper is to have shown that it is feasible to reform the operational budget and to base the allocation of transfers and receipts on members' Fund positions in relation to quotas. In any case, the reform of the operational budget could include provisions for the possibility of temporary liquidity strains, which would allow, even within a quota-based operational budget, for a greater participation by members with higher foreign exchange reserves holdings. Second, my authorities are prepared to accept that any reform of the operational budget in the direction of quota determination for the distribution of financing shares does not have to be implemented immediately but could be approached in the form of a gradual harmonization of Fund positions to quotas and allow for a transitional period as suggested by the staff. As a first sign of compromise, Mr. Fernández Ordóñez's request for a cap on the use of members' quotas could be adopted for the next operational budget. Third, even though my authorities believe that a quota-based operational budget would only change the distribution of financing, they would be willing to discuss the possibility of introducing reasonable upper limits, a so-called cap, for members' shares of Fund-related assets in overall reserves in case some countries would resist too high a share of Fund reserve positions in relation to foreign exchange reserve holdings. Fourth, in order to reach a consensus between the divergent positions in the Fund and to put future discussions on a constructive basis, it would be useful to have more elaborate information on the staff's alternative approaches mentioned on page 16.

As regards other compromise proposals, such as the one made by Mr. Dawson today, before taking a final position on them we would like to have, first, some estimate of what would be the quantitative outcome in terms of members' implicit burden-sharing contribution. Also, for Fund members with high gold and foreign exchange reserves, the uncertainties with respect to the functioning of the operational budget after the 18-month trial run are a cause for concern. One specific uncertainty is that at that review the proponents of a revised operational budget might not have such a forceful and eloquent ally as Mr. Fernández Ordóñez to defend their case.

Mr. Enoch said that Mr. Prader's Austrian authorities and some speakers seemed to have contrasted the present system with what they viewed as the flexibility that would be available under Mr. Fernández Ordóñez's proposals, and they had suggested that what they perceived to be the particular rigidities of the present system could be met by taking Mr. Fernández Ordóñez's proposals with certain caps or constraints. However, it was clear that the present system was very flexible. It was applied with a number of particular adjustments. Some of the problems identified by some of the previous speakers actually had already been perceived under the present system and were essentially taken care of under that system. At some stage, the staff could usefully comment on the extent to which some of the effects of the present system had already been mitigated. If the Board decided to ask the staff to assess the implicit cost of burden sharing, as Mr. Prader had suggested, it should also look at the total costs of contributions by individual members to the Fund and to financing the arrears strategy; in other words, the assessment should not be a partial one.

Mr. Prader considered that it would be appropriate to have estimates of total costs. The contributions to the Fund should not be based solely on the operational budget. In addition, his dissatisfaction with respect to the flexibility under the present system was based largely on the experience since 1983. If flexibility meant that some members' reserve positions were always above the average, then a different kind of flexibility seemed to be called for.

Mr. Enoch commented that his request to assess overall costs was of secondary importance. His first preference was that equity considerations not be given primary importance.

Mr. Arora made the following statement:

This is a very interesting and important discussion, because it raises some of the basic issues concerning the cooperative and monetary character of the Fund. This debate is interesting both for what it reveals and what it conceals. I wish to look at what it reveals first.

It reveals that the issue of the operational budget was not important in a practical sense until the arrears problem arose. Now arrears problems are very important for the Fund, and burden sharing has become the predominant one factor in determining how we conduct the normal operations of the Fund. Mr. Fernández Ordóñez said today that he is concerned mainly about how the burden-sharing problem was resolved; he has clearly focused on the burden-sharing problem as having given rise to the concerns that have been highlighted by Mr. Evans and others. I have no desire to minimize the burden-sharing problem, but the only question I would wish to put to Mr. Fernández Ordóñez and other Directors who share his views is whether this problem, which is perceived to be a very temporary one, should be the basis for a change in the entire system. Mr. Al-Jasser, too, has focused on that point. Perhaps we should not rush to change the system because of a temporary problem. We are most grateful to Mr. Fernández Ordóñez for raising this issue, which is of great concern to many Latin American countries, and for his support of a quota base for burden sharing. However, the Interim Committee has accepted the idea that a quota-based system would not be appropriate.

On the legal aspects, the General Counsel has stressed issues that have important implications today but were not as important in past years. However, all the speakers thus far have focused on the problem of the Fund's liquidity; they have usefully stressed that we should not take any steps that would in any way impair the Fund's liquidity. It is not clear to me whether or not Mr. Fernández Ordóñez's suggested quota-based system will impair the Fund's liquidity. At the same time, the point that Mr. Enoch made--that we do not judge a contribution to the Fund's liquidity only on the basis of a currency budget--is well taken. In the past there have been a number of ways in which to enhance the Fund's liquidity, such as contributions to the enhanced structural adjustment facility, which should be taken into account.

It is in this connection that the concealment I referred to is evident. There is of course no deliberate effort to conceal anything, but the nature of the debate thus far has been fairly restricted, and Mr. Dawson usefully drew attention to the vast and delicate changes that have occurred in the international monetary system and on efforts to cooperate to deal with the problems that have arisen in the system. Mr. Dawson had mentioned the problems caused by the ad hoc treatment of the U.S. dollar and the implications for the operations of the Fund. In my view, there is a tremendous amount of liquidity in the international system. To use Mr. Fernández Ordóñez's striking metaphor, our reserves, on which we are counting as proxies for liquidity, are like small fish swimming about in an enormous ocean of assets and liabilities. The problem is that the Fund has had very little influence over this enormous ocean of assets and liabilities since the explosive growth of capital markets, which began in the 1970s. Hence, there has been in the Fund and elsewhere concern about the fact that so much international liquidity is being channeled primarily through private hands. During the petrodollar crisis, it was believed that the commercial banks and capital markets could deal with the financial problems facing countries, and we are seeing now the results of the handling of that particular situation by the international capital markets. The Baker Plan and the Brady Plan were formulated in recognition of the fact that the commercial banks and capital markets alone had not been able to do the job. In the circumstances, the multilateral institutions have been expected to play a larger role. That was one of the reasons why many countries--including some G-7 countries--had favored a much larger increase in the Fund's liquidity than was actually finally proposed. In addition, developing countries, together with Japan, have pleaded for steps to increase the role of the SDR in the international liquidity system. At an Interim Committee meeting in 1988 the Governor for Japan stated that "immediate major changes have taken place in the international capital markets and in the international monetary system in the nearly 20 years since the SDR system was founded in 1969, and these changes make it impossible to continue to define international liquidity simply in terms of official foreign reserve holdings," the point that Mr. Fernández Ordóñez has made very forcefully--and to which, of course, no answer has been given. We know that, for practical reasons, we must continue to treat reserves in a certain way. Accordingly, we should have a full study on such questions as to how to define international liquidity and how we see the role of the SDR in the international monetary system.

This is the problem conceptually: there is liquidity in the system, but increasingly the multilateral system is unable to influence its disposition. The problem we are facing now is the very limited problem of how to deal with the burden-sharing situation, but the real problem is about international liquidity and how to make it accessible to the countries that need it. Initially, all member countries, led by the United States, acceded part of their sovereignty to the Fund in a very important area, namely, foreign exchange rate determination. The idea was that the system could best be handled by a multilateral institution, which would continually look at movements of capital and related factors. The hope was that decisions would be taken entirely on the merits of each case, but this has not happened. Now, we must focus our attention not on the very limited problem of how to organize the currency budget, but rather on how to help the Fund play a more important role in directing international liquidity.

Mr. Fernández Ordóñez said that he wished it to be clearly understood that he believed that equitable burden sharing was of crucial importance.

However, even if the burden-sharing issue were resolved, the Board would still have to face the need to achieve more balanced positions in the Fund. That need was stipulated in the Articles, which did not mention burden sharing.

Mr. Almeida commented that he agreed with the statement in the legal paper that the principles under Article V, Section 3(d) had given the Fund considerable flexibility in their application. The Fund had used that flexibility extensively. Since the first set of guidelines was approved in 1979, there had been a significant change in 1981 and another significant change in March 1986--while still keeping the basic 1981 guidelines. At present, the Fund used a further set of guidelines, a hybrid of the 1979 and 1981 guidelines. The statement by the staff showed that 11 specific criteria had been used between 1962 and 1988. The changes were a reflection of the difficulties that the Fund had encountered in selecting the currencies to be included in the operational budget and their amounts. In the end, the selection was a matter of judgment by the Executive Board, as it balanced all the various considerations involved.

He also agreed with the conclusion on page 8 of the legal paper that, under the 1981 guidelines, "balance takes a different meaning on the transfer side and the receipt side of the operational budget," Mr. Almeida continued. Even though both drawings and repurchases contributed to a narrowing of the ratios of reserve positions in the Fund to gold and foreign exchange reserve holdings, the contribution of each one was not necessarily the same, because of differences in the constraints on each side of the budget. That fact was shown in footnotes 5 and 7 of the staff's statement: the Fund's holdings of a member's currency were not allowed to fall below 10 percent of quota, and receipts were not allocated to any member beyond a point at which the Fund's holding of currency would be greater than the norm for remuneration.

However, he disagreed with the conclusion on page 11 of the legal paper that "the guidelines...have combined both approaches, i.e., the reserves and the quota, to give effect to the harmonization principle," Mr. Almeida said. In the 1979 guidelines, quotas were mentioned as a qualifying provision and nothing more; they were not even mentioned in the 1981 decision, thereby suggesting their limited and restricted utilization. The 1979 decision provided only that the equalization of the ratios should not be carried beyond a point "substantially below" the average level, expressed as a percentage of quota, of the members' gold and foreign exchange holdings. Quotas had always had secondary importance for the operational budget, and he saw no reason why that should have to change.

Mr. Lombardo said that he was impressed by the thrust of Mr. Fernández Ordóñez's opening statement. There was clearly an imbalance in the present system, and most of the arguments that Mr. Fernández Ordóñez had made were very strong. However, given the statements by Mr. Al-Jasser, Mr. Hogeweg, and Mr. Enoch, further analysis was needed not only by the staff, but also by the Executive Board, since the problem of currency selection had political implications. He agreed with Mr. Fernández Ordóñez's proposal to establish a cap on the levels of quota utilization. Although he was willing to consider other possibilities, the level of 50 percent proposed by Mr. Fernández Ordóñez seemed to be reasonable, and he was willing to go along with it.

Mr. Chatah considered that the issues at hand had both a legal and a policy dimension. As to the legal aspect, the staff paper clearly argued in support of quotas as the criterion for the determination of balanced positions in the Fund. Both Mr. Al-Jasser and Mr. Enoch had provided interesting rebuttals of that interpretation. Although it would not be desirable to leave the interpretation issue unresolved, he doubted whether that narrow legal question was a crucial one for the operational issue under discussion. As he understood it, the legal paper said that quotas were a relevant consideration in the selection of currencies together with the two other and more important considerations, namely, balance of payments and reserve strength, and exchange market developments. Thus, even if quotas were the relevant criterion for the harmonization principle, that was only one of the criteria for the selection of currencies. That fact implied, of course, that the current procedures for selecting currencies were perfectly legal, and that a change in those procedures should be justified not on legal grounds, but rather on policy grounds.

There were two policy issues involved, Mr. Chatah continued. One was whether or not the proposed change in the method of currency selection would facilitate Fund operations. The second was whether the current proposed changes to the system would make it more equitable. With respect to the first question, he had seen no convincing arguments that the proposed change would be advantageous from the standpoint of Fund operations. As to the equity question, although he had some sympathy for the arguments presented by Mr. Fernández Ordóñez, and one could think of situations in which the economic structure of a country might lead to large holdings of liquid assets relative to the quota, which might be quite small, it was not obvious that one could reach an objective conclusion that the alternative system being proposed would necessarily be more equitable, unless one were to start from the premise that equity should be measured on the basis of quotas alone.

For all those reasons, and as he did not have definite instructions on the proposed changes in current procedures, he was not in a position to support the changes proposed by Mr. Fernández Ordóñez, Mr. Chatah said. However, he would be prepared to consider proposals to increase the weight given to quotas in the system through caps or other limitations on reserve positions relative to quotas.

Mr. Sarr commented that, while he agreed that the discussion on the calculation of the amounts of currencies under the Fund's operational budget should ideally be kept separate from the issue of the burden-sharing mechanism, it had to be recognized that that mechanism added an important dimension to the present discussion, especially as it was of serious concern to some members. Therefore, the possibility, expressed by a number of speakers, of an ad hoc and flexible adjustment for countries with a high level of reserves relative to quota for the next operational budget seemed to be a sensible compromise, and he supported it.

Mr. Dai noted that Directors had very different views on the issues at hand. However, there was also a common view on the importance of safeguarding the Fund's liquidity position. In considering the system of calculating currencies for the operational budget, priority should at all times be given to the maintenance and enhancement of the Fund's liquidity position. Other considerations should be given only secondary importance. To that end, maintaining flexibility in the allocation and calculation process was essential. As different methods had a different impact on each individual member, the concerns of some members about burden sharing was understandable. His chair would keep an open mind on any proposals, provided that they incorporated the three basic principles to which he attached great importance. First, the Fund's liquidity position must be ensured and safeguarded. Second, the "ability to contribute" should be the basis of the allocation of currencies in the budget. As to which was the best indicator to measure "ability to contribute," it seemed that various arguments had their merits and, perhaps, all relevant factors needed to be taken into account. Further exploration of that matter would be helpful; an agreement could not be reached at the present meeting. Third, a certain amount of flexibility was necessary. Under general rules, due consideration should be given to the special and exceptional cases of individual member countries.

Mr. Kabbaj said that his chair had no strong views on the issues under discussion. There were pros and cons with respect to the present system as well as the system proposed by Mr. Fernández Ordóñez. On balance, he could go along with any consensus reached by the Executive Board that was likely to result in a blend of both systems. His chair attached importance to safeguarding the Fund's ability to continue playing the role it has always played in the international monetary system.

A number of Directors had referred to the introduction of burden sharing as a reason for their position on the issues under discussion, Mr. Kabbaj noted. He wondered to what extent the introduction of burden sharing had changed the remunerative nature of reserve positions in the Fund.

The General Counsel said that he wished to deal first with questions that had been raised during the debate following the opening statements by speakers. Mr. Evans had asked why, in dissecting the provisions governing the operational budget, the staff had not paid special attention to the clause in the Articles requiring consultation with members. The staff had not thought that that clause would create any difficulties of interpretation, because it had been made clear that the requirement of consultation with members in Article V, Section 3(d) did not confer any veto right on members with respect to the inclusion of their currencies in the operational budget. The term "consultation" had its normal meaning in the context of the provision on the use of currencies in the operational budget, although the procedure used for the consultation in the context of the operational budget was somewhat special, as the consultation took place through the Executive Directors, who, in that particular case, were supposed to act as representatives to express the views of members of their constituencies.

Several questions posed by speakers dealt with the extent to which the existing guidelines incorporated quotas in the harmonization principle, the General Counsel continued, in accordance with the conclusions reached in the legal paper. It was useful to note that the 1979 guidelines referred to the principle of harmonization in the context of the ratio to not only gold and foreign exchange, but also quotas, albeit in a secondary fashion. The relevant provision read: "Subject to (c) and (d) below, currencies shall be selected for use in purchases and repurchases, and in transfers of SDRs by the Fund under decisions adopted prior to the date of this decision, in such a way as to promote, over time, the equalization of the ratios of members' positions in the Fund, as defined under (a) above, to their gold and foreign exchange holdings. The application of the principle in (b) above will not be carried beyond the point where the Fund's holdings of a member's currency are substantially below the average level, expressed as a percentage of quota." The issue at hand was whether or not greater importance should be attached to quotas.

If, however, one took a position opposed to that of the Legal Department, the conclusion would be that quotas could be disregarded altogether in the harmonization process, the General Counsel went on. The staff had found no evidence in the practice of the Fund that quotas had in fact been disregarded; nor had any Director suggested during the discussion that quotas should be disregarded. Hence, the main question to answer was the importance of the role to be given to quotas, rather than the principle of including quotas in the application of the relevant provision of the Articles.

As to questions that had been posed by Directors in their opening statements, the staff would wish to answer them on a bilateral basis, the General Counsel said. There was no real dispute on the use of quotas. Most of the legal questions that had been raised had to do with the legal basis for using quotas as a criterion of the harmonization principle, but if it was agreed that quotas should be used in the application of Article V, Section 3(d), then whether that was mandatory or not was immaterial to the outcome of the discussion, and the Board could proceed with a discussion of the importance to be given to quotas.

Mr. Al-Jasser remarked that the legal paper had given the impression that the current system for selecting currencies, which was based on reserves, the balance of payments, and exchange rate developments, was not entirely appropriate, and that quotas constituted the relevant criterion only for harmonization. That matter was clearly a significant one.

Mr. Enoch said that he wondered whether the General Counsel meant that the staff's interpretation of the Articles and the guidelines was that the current system was consistent with the Articles, a system along the lines of Mr. Fernández Ordóñez's proposal would also be consistent, and, therefore, the Legal Department had little to say on the choice between the two.

The General Counsel responded that the staff had said that, because the existing policies did in fact pay regard to the role of quotas in the application of the harmonization principle, the staff had no doubts about the legality of the current system. The staff had explained that quotas were not the only criterion to be applied in the overall selection of currencies. Hence, depending on whether one was looking at the particular question of harmonization, or at the general question of selection of currencies, one might or might not agree with the Legal Department's paper. It would not be an appropriate understanding of the legal staff's position to look only at one aspect, namely, harmonization, without taking into account the other two factors that were part of the currency selection process. The legal staff was saying only that, in the context of the implementation thus far of the harmonization principle, quotas had been included and, therefore, the legal staff had no objection to the current system for selecting currencies. If Mr. Fernández Ordóñez were to argue that--for example--thenceforth reserves should be disregarded, then the legal staff would have an objection. However, Mr. Fernández Ordóñez was not making that recommendation. The proposal was to have a system combining reserves with quotas, but providing greater importance for quotas.

Mr. Newman commented that he took the General Counsel to mean that a system that combined reserves and quotas would be the most consistent possible solution, as it would meet all the various requirements of the relevant Articles.

Mr. Fernández Ordóñez remarked that the main conclusion of the legal paper apparently was that, according to the Articles, quotas must be one of the factors in any effort to achieve more balanced positions in the Fund. In any effort to use all the relevant criteria, use had to be made of the balance of payments, the reserve position, developments in exchange markets, and the balancing position, and the latter required the use of quotas.

The Deputy Treasurer recalled that several questions had been asked about the role of reserves in members' liquidity positions and about the impact of changes in the mechanisms of liquidity creation. It was true that members' gold and foreign exchange reserves were a part--albeit a very small part--of total international liquidity, however that term might be defined. The papers that had been produced in connection with the SDR allocation discussion showed that one could reasonably put forward a very wide definition of international liquidity, particularly by taking into account members' access to the private markets, which was essential for many, although not all, members' international liquidity. But that had always been the case. In 1962, and certainly in the latter part of the 1960s, there had been some question whether the counterparts of swap networks should be included in reserves and liquidity, and whether official bilateral arrangements were not a genuine part of a member's international liquidity. However, the Board had consistently taken gold and foreign exchange holdings as a reasonable proxy for liquidity. They had perhaps become a less reasonable proxy over time, but they were still part of a member's international liquidity that was immediately and unconditionally available for use by the member in foreign exchange markets or for balance of payments financing. It was because of that immediate and unconditional availability that the staff had continued to follow the long-established policy of using gold and foreign exchange as the basis for harmonizing reserve positions in the Fund--a policy which the staff felt had been fully consistent with the Articles, both before and after the Second Amendment. Therefore, in constructing the operational budgets the staff had considered how much of the stock of members' immediately available and unconditional total assets could be diversified into the Fund, having in mind the fact that all the assets in question were reserves; there was no question of altering the total amount of members' reserves, but rather their composition. It had always seemed quite reasonable to regard a Fund position as an integral part of members' reserves--as being immediately and unconditionally usable.

As to Mr. Kabbaj's question regarding the extent to which remuneration affected members' views on their asset holdings, up to 1971 the Fund had paid no remuneration at all on reserve tranche positions, the Deputy Treasurer remarked. Thereafter, up to the Second Amendment the rate of remuneration had been fairly small, only about 2 percent. After the Second Amendment, which established a link between the rate of remuneration and the SDR interest rate, the Fund had begun to slowly increase the remuneration coefficient as the SDR interest rate was raised. At present, the remuneration coefficient was at nearly the highest level ever, despite the burden sharing decision. The highest remuneration rate ever paid was 95 percent of the SDR rate, and the current remuneration coefficient, even after the present regular burden sharing adjustments--but not including the extended burden sharing adjustments--was slightly below 90 percent. It was not apparent that thus far the rate of remuneration had affected members' opinion of the usable and unconditional nature of their reserve tranche assets; therefore, the staff had not felt that the remuneration rate was a factor in considering the extent to which members could be asked to diversify part of their assets into Fund positions, which was thought to be a reasonable way to ask members to finance the Fund. As members' reserves rose, the Fund took a part of that rise, and as they fell, the members' exposure to the Fund was reduced. In that sense, the current system was, to a considerable extent, self-equilibrating.

Mr. Prader remarked that, in considering the historical evolution of remuneration, it was useful to recall the changed behavior of central banks since the rise in international interest rates in the 1970s. At present, the Fund had to deal with central banks that had become profit centers for which interest income had become very important. Consequently, central banks now looked at the rate of remuneration in a different way than they had in the 1960s and beginning of the 1970s.

Mr. Kyriazidis noted that thus far the whole discussion had centered around the fact that there must be some limitation to the reserve tranche positions, which meant that the majority of Directors and member countries did not consider reserve tranche positions to be of the same quality as other reserve assets at their disposal. That development should be further explored.

The Deputy Treasurer said that he had not meant to suggest that the level of remuneration had no effect on members. He had meant to say that thus far there was no evidence that the rate of remuneration had an effect on members' willingness to finance the Fund.

Mr. Fernández Ordóñez commented that the arrears problem had changed the central banks' perception of both remuneration and reserve positions in the Fund. Before the onset of the arrears problem, central banks had seen no risk in maintaining a reserve position in the Fund. At present, not only the rate of remuneration, but also the amount of resources available to the Fund, were relevant factors in the eyes of the central banks.

Mr. Enoch said that he did not agree with Mr. Fernández Ordóñez. In the past, member countries had been willing to forgo remuneration from the Fund; they had made straight contributions to the Fund. Under burden sharing, the contribution was much smaller, because the intention was that the burden sharing contributions would be repaid once countries eliminated their arrears to the Fund. Hence, countries were at present being asked to make a significantly smaller sacrifice than before.

Mr. Evans remarked that the Deputy Treasurer had usefully drawn a distinction between the situation in previous years and the present situation. He wondered whether there had been cases in which members had been reluctant to participate in the operational budget because of the prominence that the budgetary procedures gave to international reserves.

The Deputy Treasurer commented that Mr. Evans's question led him to comment on the next set of questions that had been raised, concerning the system of allocating currencies and the Fund's liquidity. It was generally accepted that the way in which currencies were selected was sound, taking into account the criteria set out in the Articles. The quarterly reviews of members' positions relative to each other had generally been accepted by the Fund. On occasion in the past, members had indicated, during informal consultation with the staff, that they were reluctant to be included in the next operational budget. There had usually been two sorts or reasons given for that reluctance. First, some members had argued that their reserves were borrowed reserves, and, therefore, the Fund should not seek to diversify those reserves. The staff had typically replied to that argument by pointing out that the staff took into account the overall balance in judging the strength of a member's balance of payments. Therefore, there had been very few cases in which members had insisted at the staff level on being taken out of an operational budget. There have been a few cases--but only a few--in which a member had argued that its reserve tranche position in relation to its total reserves was fairly high.

As to the matter of the Fund's liquidity and the system of allocation employed for the currency budget, the Deputy Treasurer continued, the current system for harmonizing on the basis of gold and foreign exchange reserves was self-equilibrating. There was some constraint on the extent to which members were asked to diversify into reserve tranche positions. The system of allocation could affect not the total aggregate of the Fund's liquidity, which was determined by the totality of members in the operational budgets, but rather how much of the currencies could be used at any one time. The staff had been very reluctant to push members with very low reserves into further diversification, even if those members issued the very currencies that the Fund needed most in terms of their usability. Hence, the extent to which the liquidity of the Fund was affected by the currency budgets depended very much on the system of allocation that was used. The more the system included constraints or limitations, the more the usability of the currencies available to the Fund on a day-to-day basis was adversely affected. That matter was of great concern to the staff in the day-to-day operation of the operational budget.

There had been occasions on which members had asked not to be included in the operational budgets, but that had occurred mainly because the relationship between the reserve tranche position and the total reserves of the members in question had been higher than they felt comfortable with, the Deputy Treasurer continued. That matter of comfort was extremely important when one shifted from one system to another, because the higher the proportion of reserve tranche positions to total reserves, the more members would feel reluctant to increase them as the Fund needed their currencies. In that sense, the Fund's liquidity position was affected by the distribution of members' positions in the Fund.

The introduction of a mixed system, based on gold and foreign exchange and quotas, had been suggested by Mr. Dawson, the Deputy Treasurer recalled. That approach was certainly possible arithmetically, but it left unclear how harmonization would be achieved. At present, harmonization was based on members' reserve positions in the Fund in relation to their gold and foreign exchange holdings. Mr. Fernández Ordóñez had suggested basing the harmonization on quotas. With a dual system, there was no clear principle of harmonization as such.

If Mr. Dawson meant that one form of harmonization should be heavily qualified by the other, that should be workable, the Deputy Treasurer continued. However, there would be some question of how many constraints should be applied in that connection, and it was the constraints that affected the day-to-day flexibility of the Fund. It was therefore particularly important to appreciate which method would lead to the greater number of constraints. In his view, the present system with its constraints would provide more flexibility than a system based on quotas with constraints on holdings or on the extent of reserve tranche positions or on how much of a change in a member's reserve tranche position would be included in the calculations. The choice was of course a matter for the Board's further consideration.

The possibility of including SDRs in reserves had been considered occasionally in the past, the Deputy Treasurer commented. There were basically two reasons why SDRs had not been included. The first reason was technical. Assessments of whether a member was sufficiently strong for inclusion was a requirement under the SDR Department and were therefore made in the context of the designation plan. However, under the designation plan, there was not only an assessment of strength but also an allocation of SDRs on the basis of a particular method the Fund had adopted in accordance with Schedule F. It would be odd to have a double use of SDRs, assessing the member's strength on the basis of perhaps its SDR holdings, and at the same time redistributing the SDRs among members. A second, more practical reason, was that SDRs were not included in reserves for the calculation of the amounts of currencies; when a member's currency was sold, with the exception of the United States and, to some extent, two of the other three reserve currency members, the purchasing member normally wished to have those currencies converted. It would be inappropriate if the reserves were rather high because of SDR holdings and the member were to insist on giving up SDRs rather than a fairly usable currency like the U.S. dollar, sterling, or French franc.

The General Counsel noted that there were two different provisions in the Articles on the assessment of strength, one for the SDR designation plan, and the other one for the currency budgets. The criteria for each were not identical. In any event, there were two assessments of strength, although in the relevant guidelines the two had been merged by the Executive Board. Hence, one of the questions at hand was whether the Executive Board wished to reconsider that practice. It would be open to the Executive Board to include SDRs in one assessment without including them in the other.

Mr. Newman said that, in contrast to the kind of mixed system that Mr. Dawson had described, the current system with specified caps would not deal with the issue of principle that had been raised. The system with caps would address only the particular problem of an individual country at a given point in time. The mixed system could lead to greater flexibility, while the system with caps would lead to more exceptions to inclusion in the currency budget, and, as members were excluded from the budget, it could be difficult to reallocate the currency selection among the remaining members in the budget to ensure that the Fund would have sufficient resources to finance the expected demand. Hence, the system based on caps would not eliminate the problem that had been discussed but would instead change the nature of that problem.

Mr. Enoch said that he did not agree with Mr. Dawson that a mixed system would be less arbitrary than a system with caps. A cap could be set with respect to the overall situation; it would leave one particular framework in place. Mr. Fernández Ordóñez had suggested a cap of 50 percent of the average of the ratio of reserves to quotas, a suggestion for which one could perceive some sort of rationale. While any cap clearly would be arbitrary, any hybrid of two systems would be equally arbitrary.

Mr. Fernández Ordóñez recalled that he had suggested a cap only for one quarter. In general, Mr. Dawson's proposal deserved careful consideration, because it would give more flexibility to the Fund than a method involving caps. In principle, a mixture could be better than using caps alone.

Mr. Al-Jasser considered that the suggestions made thus far had in effect been placing the cart before the horse. The subject of the discussion was the basis for harmonization. Thus far, harmonization had been based primarily on reserves. The proposal under discussion was to base the harmonization on quotas; that was the gist of the problem the Board was facing. Discussing optional variations of that alternative went beyond the main subject of the discussion and was therefore equivalent to putting the cart before the horse.

The Board should first address the issue of whether or not the existing system was sound and should be maintained, Mr. Al-Jasser continued. Then, if necessary, it could look at variations of the alternative that Mr. Fernández Ordóñez had proposed. At that stage, he would have several proposals to ask the staff to look into, because the main issue at hand touched on the very nature of the Fund and the way in which the operational budgeting system had been implemented for the past 28 years. If there was a very simple, temporary problem affecting certain members, then the flexibility that was clearly provided by the existing system should be able to accommodate those members' concerns. He would not wish to see the Board tinker with an existing system that was clearly workable.

He had hoped that the question of equity in burden sharing would be addressed on its own merits, without encumbering the discussion on the operational budget system, Mr. Al-Jasser said. A number of factors should be looked at if equity were to be dealt with as an issue in its own right. It would be inappropriate to take a snapshot of the contributions of one or two members at one point in time as the measure of equity; that approach would be counter to the cooperative nature of the Fund. The differences in contributions were legitimate and had served the Fund well in terms of safeguarding its liquidity. Equity should be measured over a longer period. The ability of members to contribute to the Fund's financing had been well utilized by the current operational budget system, and in implementing that system, the staff had been very sensitive to the concerns of all members. He had yet to hear a major complaint that had not been taken care of by the operational budget system. Therefore, while the present opportunity to pause and reconsider the operational budget system was a sign of the Fund's vigor and vitality, there was no clear need to change the system. After all, thus far, no one had said that the present system had failed to serve the Fund well. If a member was not being well accommodated by the system, management should take that into consideration and try to ameliorate any negative effects. In that connection, the legal points that Mr. Goos had made were well taken.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/84 (5/30/90) and EBM/90/85 (6/1/90).

2. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/136 (5/29/90) and EBAP/90/138 (5/30/90) is approved.

APPROVED: April 22, 1991

LEO VAN HOUTVEN
Secretary