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04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/58

3:00 p.m., March 28, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	M. K. Bush
J. de Groote	H. G. Schneider
	T. Alhaimus
	M. Sugita
G. Grosche	
	Song G., Temporary
J. E. Ismael	
	J. R. N. Almeida, Temporary
	M. Foot
	H. Fugmann
	G. W. K. Pickering, Temporary
	J. A. K. Munthali, Temporary
	M. A. Weitz, Temporary
Y. A. Nimatallah	
P. Pérez	
H. Ploix	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	A. Vasudevan, Temporary
	L. Tornetta, Temporary

L. Van Houtven, Secretary
S. J. Fennell, Assistant

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Also Present

Exchange and Trade Relations Department: M. Nowak. External Relations Department: J. V. Ordenes. IMF Institute: O. B. Makalou. Legal Department: J. G. Evans, Jr., Deputy General Counsel; R. Munzberg. Research Department: N. M. Kaibni, H. H. Zee. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; S. I. Fawzi, R. A. Feldman, D. Gupta, Y. Ozeki, D. V. Pritchett, B. Von Numers, B. B. Zavoico. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: W.-R. Bengs, L. P. Ebrill. Assistants to Executive Directors: O. Isleifsson, Z. b. Ismail, S. King, K. Murakami, C. A. Salinas, B. Tamami, H. van der Burg, B. D. White.

1. LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors considered a staff paper on the review of the Fund's liquidity position and prospective developments in its financial position through 1987 (EBS/86/55, 3/5/86).

Mr. Pérez remarked that the Fund's liquidity position had improved since the previous review. The small deficit envisaged for 1986 had vanished, and the liquidity position appeared more solid than six months previously. The goal of the Fund was to maintain a highly liquid financial position in order to fulfill the mandates of the institution as laid out in the Articles of Agreement. In that regard, the Fund's current comfortable financial position and prospects were welcome.

His views were not so favorable on the manner in which that positive liquidity position had been achieved and the wrong signals that it could convey, Mr. Pérez indicated. Access policy and conditionality had been the two factors that had reduced the effective or real opportunity for members to make use of Fund resources. The improvements in the Fund's financial position did not reflect an improvement in the balance of payments position of members. While the external imbalances had improved somewhat, they remained considerable, and improvements in the external sector had been achieved through drastic import compression, which had impeded the expansion of international trade and members' economic growth.

Despite the uncertainties surrounding the staff's estimates, the medium-term outlook rarely changed significantly, Mr. Pérez noted. In fact, given estimated repurchases, the Fund's liquidity position would be reinforced. It was discouraging to note that although the Fund's liquidity position was solid, a decline in outstanding Fund credit was projected for 1986 and 1987, a time when many members' prospects for growth and external balance were bleak.

It would be a welcome development if the Fund were to experience a net positive inflow of resources from indebted member countries in future years owing to a significant improvement in the debt problem, Mr. Pérez remarked. However, the debt problem was far from being solved. He agreed with the staff that a number of uncertainties surrounded the forecast of the Fund's future liquidity position and that a sharp turnaround in the current situation could occur. For that reason, it was of paramount importance that the Ninth General Review of Quotas be initiated as soon as possible.

Mr. Grosche stated that he was glad to see from the staff paper that there was no immediate need for action to strengthen the Fund's liquidity position. However, it would be prudent to keep in mind that there were considerable uncertainties and potential weaknesses in the short and medium term. It was possible that the Fund's liquidity position would weaken substantially in the wake of unfavorable developments in the external positions of a number of member countries. Those developments could increase the demand for financial assistance from the Fund and could diminish the stock of ordinary resources available to the Fund in the currency budget. However, at present there was no need for action, as the stock of available resources should provide ample margin against unfavorable events in the short term. If the outlook for 1987 indicated substantial changes in the Fund's liquidity position, appropriate steps could be taken in fall 1986, or spring 1987.

Mr. Salehkhou remarked that the present review of the Fund's liquidity position and financing needs provided an opportune occasion to take a serious look at many of the Fund's policies. The liquidity situation reflected, on the one hand, the actual and potential ability of the Fund to assist its members and, on the other hand, the financial situation of the membership. Under normal circumstances, a favorable liquidity position for the Fund should indicate that the membership was experiencing little difficulty in managing its economic and financial affairs. However, even though the staff was for the fourth time since the Eighth General Quota Increase depicting a satisfactory liquidity position, he wondered if it could be concluded that the members' situation, particularly that of the developing countries, was satisfactory.

Unfortunately, as Directors had noted at the recent Board discussion on the world economic outlook and on the debt situation and strategy, the problems of the developing countries were far from resolved, Mr. Salehkhou remarked. The extent of the difficulties of the developing countries was reflected in the staff's projection of a doubling of their combined current account deficit from $35 billion in 1985 to $70 billion in 1986. As the Fund was expected to play a central role in tackling the persistent debt problem, he had expected that the staff paper would offer a range of options to address at least some of those problems. Unfortunately, the staff had followed the same approach as in previous years. It had concluded that the Fund's liquidity position was satisfactory and that no action was called for, bearing in mind the uncertainties in the medium-term outlook and the fact that a number of member countries that were not expected to draw on the Fund might find it necessary to make use of Fund resources. In considering that line of reasoning, there were two specific questions to address: was the liquidity position so tight as to warrant extreme caution year after year, and was the present situation the result of an improved world economy or of artificial constraints placed on Fund activities?

On the first question, if the Fund was estimated to commit only $6.8 billion in 1986 and 1987, was it necessary to have $28.5 billion in uncommitted ordinary resources, in addition to the $4 billion of borrowed resources and $18.5 billion in the enlarged General Arrangements to Borrow and the associated agreement with Saudi Arabia, Mr. Salehkhou inquired. In addition, it should be borne in mind that potential liabilities were adequately taken into account by the 25 percent adjustment factor, which amounted to $9 billion. Notwithstanding the highly conservative assumptions underlying those projections, the Fund had at its disposal a usable pool of resources of $51 billion, or $32.5 billion without the resources available under the General Arrangements to Borrow and the associated agreement with Saudi Arabia. As the projected commitments for 1986 and 1987 amounted to only $6.8 billion, it seemed that the uncertainties that justified such a large pool of resources were the kind that "fell out of the sky." In addition, the Fund would be initiating discussions on the Ninth General Review of Quotas at end-1986 so that the new quotas could become effective by end-1988. The Fund's present policy approach might wrongly lead to the conclusion that a quota increase was unnecessary.

On the second question, neither the financial position of developing countries nor their debt problems had improved, Mr. Salehkhou pointed out. The Fund continued to project net reflows of resources even though the combined external current account deficits of developing countries, including the oil exporting countries, were projected to double in 1986; commodity prices, including oil, were collapsing; real interest rates remained high; and debt service problems were becoming increasingly difficult to manage. He agreed with the need to enforce the revolving character of the Fund's resources. However, that principle should be applied with flexibility. Likewise, the rules for dealing with the prolonged users of Fund resources should be adapted to the particular circumstances of the world economy at any point in time. The debt problem was not of a cyclical nature: it was a crisis of an unprecedented nature. Rather than demonstrating appropriate flexibility, the Fund was reducing actual access well below the agreed limits and was making access to the special facilities particularly difficult. In addition, use of the extended Fund facility, which was the appropriate facility for dealing with the structural problems of developing countries, had for all practical purposes been ruled out.

The World Bank was also trying to limit its financial assistance to countries where its exposure was relatively high, Mr. Salehkhou noted. He wondered how the two institutions would convince private creditors to provide additional financing or to reschedule part of developing countries' debts while they themselves acted differently.

He was concerned that the Fund, for narrow financial reasons, was running the risk of losing its central role in tackling the debt problem, Mr. Salehkhou indicated. The debtor countries could not embark on the major structural reforms called for by the creditors without vigorous financial backing from the international community. The Fund still had the means, ability, and expertise to continue to play its central role.

The Ministers of the Group of Twenty-Four at their previous meeting in Buenos Aires had made a number of interesting suggestions, Mr. Salehkhou recalled. They had proposed that the Fund should seriously consider putting in place adequate resources to deal with medium-term balance of payments problems in developing countries and to revitalize the use of the extended Fund facility. The Fund, together with other multilateral institutions, should develop new mechanisms to help countries that were unable to repay their obligations on a fixed schedule because of adverse exogenous factors. The Group of Twenty-Four had asked the Fund to liberalize the rules governing the compensatory financing facility in order to enhance its automaticity, enlarge its coverage to the full extent of the shortfall, include terms of trade changes that were not clearly reversible, and accommodate severe and sudden adverse changes in the circumstances of several primary commodity exporters, including exporters of petroleum. The Fund should also seek ways of raising additional financing for that purpose. The Group of Twenty-Four had made many other qualitative suggestions that could enhance the role of the Fund and its utility to member countries.

The Fund was at a crossroad, and he suggested that the Executive Board review urgently the Fund's liquidity policies on the basis of a new staff paper, Mr. Salehkhou stated. On many occasions, he had emphasized that the cost of Fund resources was unduly high, particularly given the mix of ordinary and borrowed resources. It was abnormal that the lending rates of the World Bank were so close to those of the Fund, especially as the Fund was not remunerating creditor countries fully. If the Board could not revise the Fund's financial policies, then the staff should study urgently the possibility of lending from the Fund's ordinary resources alone. The Board should consider the possibility of substituting borrowed resources for ordinary resources in current arrangements, as only $6.8 billion of commitments were expected in 1986 and 1987. Such an approach would represent a contribution by the Fund toward reducing the debt service burden of its debtor members. However, he hoped that the Executive Board would not reach those extreme conclusions but would instead take up the issues raised by the Group of Twenty-Four at the forthcoming meeting of the Interim Committee.

Mr. Foot remarked that the staff paper demonstrated that the outlook for the Fund's liquidity position in the remainder of the current financial year was fairly comfortable. Despite the considerable uncertainties, the picture was likely to remain satisfactory in the medium term, given present Fund policies. It was not appropriate to discuss those policies at the present meeting. Nevertheless, Fund policies were open to change, and the projected liquidity position of the Fund partly reflected the prospects for a moderate decline in outstanding credit in 1987, owing mainly to an increase in repurchases. In view of the uncertainties involved in the medium-term projections, it would be useful if the staff could include some alternative scenarios that would help the Executive Board to establish the robustness of the staff's conclusions. It might also be salutory to compare past forecasts of the Fund's income position with actual outcomes. The Executive Board should continue to look ahead to the impact on the Fund of changing world circumstances, developments with respect to Fund activity, and progress on discussions between the Fund and Saudi Arabia on the substantial lending facility. Finally, the staff's conclusions in the report before the Board were appropriate.

Mr. Ismael indicated that as the Fund's liquidity position appeared to be relatively comfortable, no action by the Executive Board was necessary at present, particularly as the Fund's stock of usable resources remained relatively high. Demand for the Fund's resources in 1986 was in line with the staff's projections of commitments. There were considerable uncertainties regarding members' external financing requirements and the scale of Fund involvement in providing such financing in 1987. However, it was unlikely that an industrial country or a number of developing countries with large projected external financing requirements would make use of Fund resources. The uncommitted ordinary resources were adequate to meet projected demand under existing policies through the end of 1987. He agreed with the staff that in the absence of demand by industrial countries, the stock of uncommitted borrowed resources would be sufficient in the next financial year.

Mr. Nimatallah commented that it was encouraging to note from the staff paper that the Fund's liquidity position was comfortable. The Fund was well placed to respond flexibly to the expected financing needs of its members. More specifically, although the stock of uncommitted resources was expected to decline somewhat during 1986, the small net reduction in the Fund's credit outstanding by end-1986 would help to offset that decline. Therefore, he concurred with the staff's assessment that the Fund's liquidity position was likely to remain healthy for the remainder of the year and that there was no need to take action at present. However, should overdue obligations persist or increase, the Fund should start to look seriously into the question of provisioning to ensure that the Fund's financial integrity was not adversely affected.

On the demand side, the medium-term outlook was inevitably less clear, Mr. Nimatallah noted. Uncertainties existed regarding prospective demand for Fund resources. Although the current liquidity position was satisfactory and there was little reason to expect a sharp increase in demand for Fund resources, it would be prudent to monitor developments closely in order to be prepared for any adverse surprises. The ratios reviewed in the appendix were informative and reinforced his view that the Fund's liquidity position was sound. The steady decline in the quota ratio was welcome, and he was also encouraged by the projected increase in the liquidity ratio to about 74 percent by end-1987, returning to a more normal range. However, there had been a decline in the asset ratio, excluding gold, in 1985. It would be preferable if that ratio were consistently above 100 percent, and he hoped that the projected increase in that ratio would materialize in 1986 and 1987.

Mr. Rye stated that he agreed that the Fund's liquidity position remained comfortable, although considerably less so than six months previously. The projections for 1987 were surrounded by an unusual degree of uncertainty, which imparted a downward bias to the projection for disbursements and an upward bias to the projected level of liquidity. In that regard, it was worth emphasizing the staff's statement on page 7 of its paper that "many developing countries that are projected in the world economic outlook exercise to have large current account deficits and relatively high debt service requirements in 1987 are either not at present projected to make use of Fund resources in 1987 or are included in the projections for relatively small amounts. Moreover, the potential implication for demand for Fund credit arising from oil and other commodity price declines cannot yet be fully assessed...."

He assumed that those other speakers who had deplored the foreseen reduction in total Fund credit outstanding in 1986 and 1987 had not done so from any view that the Fund should be a net lender every year whatever the circumstances. Such a view was inconsistent with the institution's role as a revolving source of short-term credit. Periods of high lending, such as had been experienced in the recent past, must eventually be followed by periods when the Fund's total outstanding credit would decline. However, it could be argued that it was inappropriate for the Fund to be a net receiver of resources at the present time of economic difficulties, although that argument was not totally impregnable. It was not his purpose to canvass that argument at the present meeting but to suggest that it would lead to an examination of the ways in which the Fund's resource base might be enhanced. An early and substantial increase in Fund quotas was clearly the best option.

Mr. Orleans-Lindsay remarked that he was pleased to note that the Fund's liquidity position was satisfactory and might continue to remain so throughout the year, although the position was judged to be somewhat less strong than at the time of the previous review. He agreed with the staff's assessment of the current and prospective liquidity position of the Fund and the uncertainties regarding the medium-term outlook. No action was called for by the Executive Board at present. However, the elements of potential weakness and the uncertainties that had been identified should be carefully monitored, and steps for provisioning to ensure a continued satisfactory liquidity position should be considered.

Mr. Weitz noted that the current stock of the Fund's usable resources remained relatively high, and no significant variations were expected through end-1987. The Fund's comfortable liquidity position could be assessed in various ways, such as those presented in Table 1 of the paper and in Table 2 of its appendix. Uncommitted ordinary resources would remain above SDR 26 billion through end-1987, while uncommitted borrowed resources would remain on the positive side. It could be seen from Table 2 in EBS/86/55 that repurchases of both ordinary and borrowed resources were expected to exceed the amount of purchases under different facilities during the two-year period ending December 1987. In other words, the net credit expansion of the Fund would be negative for both years, a development that was regrettable in view of the persistence of major economic imbalances in a number of countries.

While he understood the explanations presented by the staff for the retrenchment of Fund assistance to members, he wondered whether the timing for such a retrenchment was appropriate, Mr. Weitz stated. The uncertainties regarding the projected availability of usable resources by the Fund and the potential changes in demand for such resources should be considered. He agreed with the staff's arguments regarding reserve tranche encashments, exclusion of some members from the list of those whose currencies could be used for Fund transfers, and the further deterioration of the external position of members using Fund resources. Most developments needed to be monitored and evaluated permanently because of the impact they might have on the Fund's liquidity position. However, it should also be kept in mind that the Fund had been cautious in assessing its liquidity position by setting aside SDR 9 million of potentially usable resources--one fourth of the total usable currencies available--to act as a cushion should developments turn out to be worse than projected. The legitimate concerns regarding a potential weakening in the Fund's liquidity position in the period ahead should be evaluated against the resources set aside by the Fund. Finally, it was clear from Table 2 in EBS/86/55 that the Fund's liquidity position should remain healthy, in terms of the relevant indicators normally used for assessing its position, particularly compared with historical levels.

Mr. Wijnholds remarked that he agreed that the Fund's liquidity position was satisfactory and that no action was required at present. The overdue obligations to the Fund did not in themselves pose a threat to the institution's liquidity but were indirectly of considerable significance in terms of the Fund's future funding capability. Debtor countries should not lose sight of that fact in light of the Ninth General Review of Quotas.

The liquidity position was projected to remain satisfactory in the medium term, but the staff was right in pointing out the uncertainty that the borrowing arrangements would continue after 1987 and the elements of potential weakness in the medium term, Mr. Wijnholds considered. It was possible that the net repayments to the Fund foreseen for 1986 and 1987 would contribute to payments difficulties in some cases and, hence, to renewed and as yet unforeseen recourse to the Fund by such countries. Furthermore, the recent decline in oil prices would, on balance, have a negative effect on the Fund's liquidity. While those factors were a matter of considerable conjecture, in matters of liquidity, the necessary prudence required the Executive Board to recognize that such developments could take place. The present situation in which all but a few industrial countries and a number of oil exporting countries and developing countries were included in the operational budget was somewhat unusual and unlikely to be sustainable. In sum, the medium-term outlook was not necessarily bright and continued close monitoring was called for.

Mr. Fugmann stated that as it was difficult to predict the demand for Fund credit, except perhaps in the very short term, Directors understandably had strong reservations regarding the Fund's liquidity position. However, the prevailing level of the Fund's usable resources, both ordinary and borrowed, were satisfactory through 1987. There was no expectation of an immediate need to strengthen the Fund's resources.

The favorable liquidity position projected for the coming year was due primarily to the large reflow of resources to the Fund, reflecting the revolving character of Fund financing and reduced demand for new Fund credit, Mr. Fugmann considered. It was to be expected that the Fund's financial contribution would change considerably and that, in certain periods, net reductions in Fund credit would take place, as was expected for 1987. However, forthcoming discussions on the Ninth General Review of Quotas, which should be advanced, as well as discussions on the enlarged access policy, should be based on longer-term considerations rather than on such incidental occurrences. In considering the Fund's medium-term and long-term resource needs, it should be noted that the favorable liquidity position could be considerably affected by increased demand for Fund credit and by the exclusion of some members from the list of members considered sufficiently strong to be included in the operational budget.

Mr. Tornetta observed that the Fund's liquidity position was relatively comfortable and that no action from the Executive Board appeared warranted at present. Total purchases for 1986 and 1987 on an annual basis were expected to be higher than in 1985 but considerably lower than in 1981-84. As large repurchases were projected for the next few years, the outstanding use of Fund resources was likely to decrease slightly, a factor that reflected the revolving nature of the Fund's resources. While he noted the various areas of uncertainty summarized by the staff, he agreed that the actual liquidity position constituted a sufficient buffer against unforeseen developments. Additional measures should be considered only if and when the need arose.

From the point of view of the Fund's overall liquidity position alone, the initiation of discussions on the Ninth General Review of Quotas appeared unnecessary, Mr. Tornetta noted. However, other factors also related to the need for a consideration of the Ninth General Review of Quotas, for example, the Fund's access policies and the desired blend between the use of the Fund's ordinary resources and of its borrowed sources. His authorities had an open mind on those matters but did not wish to enter into them on the present occasion.

Mr. Pickering observed that, based on current conservative projections, the Fund's liquidity position was comfortable and should remain so through end-1987. He therefore agreed with the staff that no action by the Executive Board was required at present. However, the staff should continue to monitor closely the uncertainties in the liquidity projections. In particular, the recent decreases in certain commodity prices, particularly oil, and the uncertainties associated with the external positions of some highly indebted developing countries needed to be followed closely, as they might lead to increased demand for the Fund's resources.

It had been clear for a number of years that the high levels of Fund assistance in the early 1980s, combined with the temporary nature of Fund financial assistance, would eventually lead to a period when the net flow of usable resources from the Fund to developing countries would be reversed as other sources of permanent external financing re-emerged, Mr. Pickering stated. Such a situation was projected to occur in 1987, but he urged the Fund staff and the Executive Board to remain sensitive to the types of problems that such a development might engender.

While the policy on enlarged access would expire at the end of 1986, he hoped and expected that it would be maintained through 1987 at levels of access that were appropriate both to maintain its usefulness and to ensure its temporary role, Mr. Pickering indicated. The staff's assumption that the 1986 access limits would continue in 1987 was appropriate and consistent with past practice. In addition, it should be underscored in the present context that the enlarged access policy was, for the first time, dependent on the Fund's credit lines with only one official creditor. He therefore welcomed the forthcoming discussions between the staff and the Saudi Arabian Monetary Authority (SAMA) on the disbursement pattern of undisbursed commitments under the borrowing arrangement with Saudi Arabia.

Mr. Sugita remarked that the staff's estimates of the Fund's liquidity position through end-1987 were broadly appropriate. Although the stocks of uncommitted ordinary and borrowed resources was considered sufficient to meet projected demand during that period, there were elements of potential weakness in the medium-term outlook, in particular, the future evolution of the debt problem and the recent decline in oil prices. In view of the large amount of work necessary to complete the Ninth General Review of Quotas, it was reasonable to initiate such a review in late 1986. The exact timing of such a review could be discussed on a more appropriate occasion, perhaps after the Interim Committee meeting.

Mr. Alhaimus observed that the staff calculations demonstrated that the Fund's liquidity position was satisfactory and that no action was needed. However, he agreed with other Directors that access policy and tighter conditionality might have contributed to the favorable liquidity position of the Fund. It was unfortunate that commitments under arrangements were expected to fall sharply in 1987 given the projected mounting difficulties of many developing countries owing to declining commodity prices, including oil, and the continuing debt problem.

Ms. Bush remarked that while there were a number of uncertainties surrounding the staff's projections, the Fund's current liquidity position was comfortable, with a current stock of uncommitted ordinary resources of SDR 28.5 billion. The liquidity position was expected to remain favorable through end-1987, when it would amount to SDR 26.4 billion. The effective liquidity position of the Fund was reduced somewhat by the need to maintain a substantial cushion of liquid holdings, as balance of payments and reserve positions of countries could change, thereby affecting the number of countries included in the list of members considered sufficiently strong to be included in the operational budget. Uncommitted borrowed resources would still be at a reasonable SDR 1.2 billion by end-1987. Therefore, the amounts available under the Fund's credit lines would be sufficient to finance the enlarged access policy through the end of that year. The staff paper demonstrated conclusively that there was no basis for any acceleration of the Ninth General Review of Quotas, as the Fund was well positioned with financial resources to meet the foreseeable needs of members.

Mrs. Ploix remarked that despite certain elements of potential weakness in the medium term, the Fund's overall liquidity position remained satisfactory. Ordinary resources seemed to be adequate, even given the margin of uncertainty, which should not be considered abnormal. Uncommitted, borrowed resources were at present derived entirely from agreements with SAMA, which allowed drawings until May 1987. She therefore welcomed the initiation of discussions on new credit lines with Saudi Arabia and looked forward to a report on that issue at the time of the next review of the Fund's liquidity position, when changes in the amount of borrowed resources could be determined more precisely. The issues could then be examined in a more general and operational framework, considering a modification of the mix of ordinary and borrowed resources, negotiation of borrowing agreements, review of commitments under the General Arrangements to Borrow, and prospects for quota increases.

More generally, the projections, although derived from mechanical calculations, might damage the Fund's image, Mrs. Ploix stated. They could give the impression that the projected net negative use of Fund resources of SDR 0.5 billion in 1986 and SDR 2.2 billion in 1987 was a positive development and that the guidelines on access policy were being interpreted very narrowly. Did the projections take into account the effect of the recent sharp decline in oil prices? She was also concerned that the projections might have serious consequences for the credibility and effectiveness of Fund intervention, particularly at a time when the Fund was encouraging multilateral institutions to increase their efforts to solve the international debt problem. It would perhaps have been more effective if the staff's presentation on the Fund's liquidity position had been more tentative, elaborating on the uncertainties and carefully focusing the report by providing, for example, an analysis by geographical category of the expected needs of members.

Mr. de Groote remarked that he agreed with the staff that no immediate action was required. The reduction in Fund outstanding credit in 1986-87 should be considered as a necessary counterpart to the high level of lending activities in 1980-85. Important economic imbalances would continue to require Fund intervention and support. It was precisely because of the risks that those imbalances might become larger, specifically because of the effects of declining oil prices on the position of several producers, that he welcomed the ongoing reconstitution of the Fund's resources available for lending. Given the uncertainties surrounding the medium-term outlook, the Fund should endeavor to maintain sufficient access to borrowed resources. Like other Directors, he welcomed the ongoing discussions with SAMA.

The continuation of the enlarged access policy could no longer be fully justified on the basis of Fund liquidity considerations, Mr. de Groote indicated. The Executive Board should keep an open mind and should adjust that policy if the circumstances of members so warranted. The conclusion that the Fund's liquidity position for 1986 and 1987 was satisfactory and that, therefore, no action was required by the Executive Board did not necessarily mean that the Fund was financially strong. The satisfactory liquidity position was facilitated mainly by a restrictive application of the enlarged access policy and a substantial reduction in access to the ordinary resources and the special facilities. Such a restrictive policy was, to some extent, induced by the perception that as many countries would continue to have serious balance of payments problems, there was a need to conserve the available limited resources for future years. That perception had naturally led to a tightening of conditionality, thereby burdening the deficit countries with severe adjustment and prolonging their period of adjustment. That development was inconsistent with the Fund's role as an institution that facilitated the adjustment process, as set out in Article VII of the Articles of Agreement.

The staff paper indicated that there would be a net decrease in outstanding Fund credit in 1986 and 1987, Mr. de Groote observed. The staff also stated that the outlook for 1987 was highly tentative, reflecting the substantial uncertainties surrounding the use of the Fund's resources and the possibility that the total of usable currencies might decline with the weakening of some creditor members' external financial positions. The staff indicated that if relatively large and unforeseen arrangements were concluded or if a large arrangement at present assigned a low probability actually materialized, the situation with respect to borrowed resources would be tighter in 1987 than had been suggested by the projections. The Executive Board had noted the seriousness of the balance of payments positions projected for a number of developing countries in the coming years in the report on the world economic outlook. There was little evidence to show that the world economic outlook projections would prove to be pessimistic. In fact, it could be argued that oil and commodity prices might decline even more sharply than had been estimated. Furthermore, the unwillingness of the financial markets to increase lending to the developing countries and the continued protectionist tendencies were matters of grave concern that had serious implications. The Executive Board should therefore consider how the Fund could improve its resource position and help members experiencing balance of payments difficulties. He supported a number of other Directors who had suggested that the work of the Ninth General Review of Quotas be advanced, given the need for additional resources for the Fund in the medium and long term so that it could fulfill its role in the international monetary system. The Fund's role in the new efforts to promote adjustment with growth should not be constrained by a lack of resources. The implementation of adjustment programs aimed at achieving growth would require a considerable injection of funds. He therefore strongly recommended that appropriate steps be taken for early discussions on the Ninth General Review of Quotas. Pending a quota increase, it might be necessary for the Fund to conclude additional borrowing arrangements. It would be useful if the staff could indicate ways in which the Fund's liquidity position could be strengthened in the medium term if a number of the uncertainties outlined in the staff paper materialized.

The Treasurer remarked that the Fund's liquidity position was satisfactory owing, in part, to the improved world economic situation and, in part, to the positive adjustment measures pursued by the deficit countries. However, it was also due to the ability of the deficit countries to cover their balance of payments gaps with resources from the private markets and official creditors. Some countries financed their deficits in a less positive way by incurring arrears rather than by adopting appropriate adjustment policies that could be supported by the Fund.

The medium-term outlook for the Fund's liquidity position was not altogether bright, the Treasurer agreed. The list of usable currencies was being reduced by the weakness in some members' positions. Since the paper had been issued, the currency of an industrial country had been excluded from the list of members considered sufficiently strong to be included in the operational budget for transfers of its currency. The Fund's strong financial position with respect to the ordinary resources should be seen against the total amount of outstanding borrowing of about SDR 15 billion. If the Fund did not have access to borrowed resources, its effective liquidity would be more than halved. Furthermore, if a major industrial country decided that its currency could not be used in the Fund's operational budget, the Fund's liquidity position would be reduced substantially. Moreover, if a country with a very large quota made full use of the Fund's resources, the institution's liquidity position would be considerably less positive. In other words, although it appeared that the Fund had a relatively large amount of usable resources, the effective liquidity of the Fund might at any time be considerably lower. The Fund should have a cushion of liquidity so that it could react rapidly to any unexpected and difficult circumstances.

The staff had taken into account in its projections the decline in commodity prices, particularly in oil prices, the Treasurer commented. The demand for Fund resources was projected to be affected, as was evidenced by the projected increase of 60 percent in compensatory financing purchases. On the supply side, some of the major creditors had been affected by the decline in oil prices. They had found it necessary to draw down their reserves or to allow the exchange rate to depreciate.

A number of Directors had noted that there was likely to be a net reduction in outstanding credit in 1987, but no speaker had observed that gross outflows were continuing at a substantial amount, the Treasurer pointed out. Gross purchases were estimated at SDR 5.2 billion for 1986 and at SDR 5.6 billion for 1987, compared with SDR 4 billion in 1985. The net reduction in outstanding credit was the result of large-scale repurchases rather than a withdrawal of Fund support for the adjustment efforts of debtor countries. Fund lending was based on the assumption that repurchases to the Fund would be made because the adjustment efforts of countries receiving Fund assistance had been successful. If there were no reversal of the outflow of resources, it could be questioned whether the Fund might, in fact, be a monetary institution or an institution providing long-term balance of payments financing.

With respect to Directors' suggestions regarding the presentation in the staff report, the Treasurer stated that the World Economic Outlook provided information on categories of developing countries by region and by financial and other miscellaneous criteria. However, the staff could include a breakdown of countries by different categories in its next review of the Fund's liquidity position, if Directors so wished. If the staff were to provide alternative scenarios based on different assumptions, as one Director had suggested, it would have to make difficult decisions, for example, regarding the credit policies of the Fund. The staff included a comparison of the previous year's projections of the Fund's liquidity position and its net income with the actual outcome, and offered complete explanations for any differences. It would perhaps be difficult in terms of workload to include comparisons for a number of previous years.

The Chairman made the following summing up:

Directors noted that the current liquidity position of the Fund was satisfactory and that no action was required at present. A number of Directors remarked that the level of repurchases projected would be high in the years 1986 and 1987, and they expressed concern about the net repayment of credit by members to the Fund in 1986 and 1987. I would suggest that this situation in itself is not abnormal. The large volume of repurchases is a consequence of the concentration of sizable Fund lending at the time of the international recession in 1982-84, the debt crisis, and of the maturity structure of Fund lending. I agree with a number of Directors that it would be contrary to the Fund's mandate to aim for a continuing expansion in net credit to members in the immediate period ahead, but I would point to the sizable volume of purchases projected over the next two years.

In any event, I think it inappropriate to focus exclusively on net global financial flows. There are considerable uncertainties in the international economy stemming largely from the commodity price declines and, in particular, from the large shortfalls in export earnings of oil producing countries. The Fund should be able to address these problems on a case-by-case basis--as they may be concentrated in a few countries--with enough flexibility to ensure that it can perform the functions for which it was established. There is the need to keep enough flexibility in the individual application of the Fund's policies on access to its resources, given the uncertainties in the world economy and the changing circumstances in individual countries, to avoid the emergence of very difficult situations that could have systemic implications for the debt strategy as a whole. The satisfactory liquidity position allows the Fund to be flexible in the treatment of individual cases. I will come back to this important point when we will examine access policy, but I would like members to reflect on the above remarks before they formulate their views on the matter.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/57 (3/28/86) and EBM/86/58 (3/28/86).

2. ARGENTINA - TECHNICAL ASSISTANCE

In response to a request from the Argentine authorities for technical assistance in evaluating the effects of the recent tax reform package and determining the direction of future tax reform, the Executive Board approves the proposal set forth in EBD/86/83 (3/25/86).

Adopted March 28, 1986

APPROVED: December 19, 1986

LEO VAN HOUTVEN
Secretary