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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/189

10:00 a.m., December 1, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	S. M. Hassan, Temporary
	Song G., Temporary
	D. C. Templeman, Temporary
	E. L. Walker, Temporary
	H. G. Schneider
A. Donoso	
M. Finaish	T. Alhaimus
	M. Sugita
	B. Goos
J. E. Ismael	
	H. A. Arias
	J. R. N. Almeida, Temporary
	M. Foot
	H. Fugmann
	G. D. Hodgson, Temporary
Mawakani Samba	C. V. Santos
Y. A. Nimatallah	I. Al-Assaf
	J. de la Herrân, Temporary
	G. Pineau, Temporary
G. A. Posthumus	
	I. Sliper, Temporary
	R. Msadek, Temporary
A. K. Sengupta	A. S. Jayawardena
	S. Rebecchini, Temporary

L. Van Houtven, Secretary
J. K. Bungay, Assistant

Also Present

IBRD: H. H. Reichelt, Western Africa Regional Office. African Department: E. A. Calamitsis, T. P. McLoughlin, J.-C. Nascimento, S. M. Nsouli. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; M. Guitián, Deputy Director; S. J. Anjaria, G. G. Johnson, S. Kanesa-Thasan, P. Neuhaus. External Relations Department: G. P. Newman. Legal Department: R. H. Munzberg, J. M. Ogoola. Treasurer's Department: W. O. Habermeier, Consellor and Treasurer; T. Leddy, Deputy Treasurer; E. Decarli, D. Gupta, B. B. Zavoico. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, K. Murakami, J.-C. Obame, A. Vasudevan, K. Yao. Assistants to Executive Directors: O. S.-M. Bethel, V. Govindarajan, O. Isleifsson, S. King, K.-H. Kleine, T. Morita, V. Rousset, C. A. Salinas, G. Schurr, G. Seyler.

1. GUINEA-BISSAU - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Guinea-Bissau (SM/86/269, 11/4/86). They also had before them a report on recent economic developments in Guinea Bissau (SM/86/275, 11/11/86).

Mr. Mawakani made the following statement:

Despite the implementation of a number of adjustment measures, all available information indicates that the economic and financial situation of Guinea-Bissau has remained difficult in 1985/86. The overall economic activity has slowed down, the fiscal deficit has widened, and pressures on the external position have intensified. As reported by the staff, this critical situation should be viewed as the culmination of the effects not only of exogenous factors, but also of past internal policies.

The authorities are very concerned about the current and prospective economic and financial developments and are determined to take the necessary steps to address the multifaceted difficulties confronting the country. They are aware that one way of improving the development of economic activities is to reformulate the current pricing and marketing policies to allow market forces to play a greater role in the allocation of resources. Steps have been already taken to that effect. Since 1983 producer prices have been frequently adjusted in order to provide incentives to farmers. The system of price determination of all products but seven deemed essential has been completely liberalized, and the monopoly enjoyed by the two major public enterprises involved in importation and marketing has been abolished except for cereal imports. Furthermore, most of the sale outlets have been turned over to the private sector. However, in view of the inadequacy of the exchange rate adjustments implemented so far, these actions did not fully yield the expected beneficial effects. Therefore, the authorities intend to adopt a bolder approach. In that respect, at a party convention held in November 1986, a decision was taken that the Government should adopt far-reaching liberalization measures, coupled with a substantial exchange rate adjustment.

The rapid deterioration of the fiscal position is also a source of major concern to the authorities. To reduce the fiscal deficit and bring it under control, the authorities intend to take both revenue raising and expenditure reducing measures. On the revenue side, they have recognized the need to make the base more buoyant, and they are examining the feasibility of changing specific tax rates to ad valorem ones, including adjustments in the applicable rates. The authorities are further considering measures for improving tax collection procedures so as to bring in overdue taxes, as well as to enhance the level of receipts from fees and charges. Furthermore, as part of their overall efforts to improve revenue performance, they intend to institute stricter controls on the granting of exemptions for imports. On the expenditure side, they intend to reduce in the period ahead the size of the civil service with a view to containing the wage bill. It is also their intention to reduce other current expenditures.

In the external sector, the current account and the overall balance of payments have continued to be under pressure and have recorded substantial deficits, largely because of the weakness of export performance. In order to reduce the impact of the parallel market and improve export performance, the authorities share the staff view that the adoption of a more realistic exchange rate policy is of paramount importance, and they are evaluating all possibilities concerning exchange rate policy. Regarding the debt situation, the authorities are making every effort to obtain debt relief from creditors. It is their hope that creditors will sympathetically consider their request and grant favorable terms, as Portugal recently has done.

Mr. Almeida made the following statement:

The authorities made important progress in August 1986 in liberalizing domestic markets, removing impediments to the expansion of the role of the private sector, and allowing most prices to be market determined. The authorities are in the process of obtaining what has been impossible elsewhere--a reduction in the labor force of the public enterprises. They should be congratulated for that effort.

I am not sure that the speed of the reorganization of the public sector is going to be sufficient. The first stage of a comprehensive reform of the public sector will begin in 1987 through a study to be financed by the World Bank, but no further information about later steps has been given in SM/86/269 (11/4/86), and I suspect that it might take several years to obtain a clear picture of the sector. With an overall central government deficit equivalent to 80 percent of total expenditures, excluding grants, it is obvious that not much time is available for the authorities. I urge them to proceed at a faster pace to reform the public sector.

I agree with the staff that Guinea-Bissau's external position is not sustainable in the medium term as long as current policies are maintained and exports are projected to be constant in a five-year period, a hypothesis that seems unrealistic. As in other cases, it would be helpful to see alternative scenarios for the medium-term balance of payments, taking into account different sets of assumptions.

The staff suggests that an exchange rate adjustment is a key ingredient for the improvement of the external accounts. I do not think that this will be helpful so long as it is not accompanied by change in fiscal and pricing policies. In fact, as experience has shown in several other countries, a devaluation will only lead to inflation if it is not accompanied by tighter monetary and fiscal policies.

More urgent than anything else is an improvement of the country's statistical capability. Guinea-Bissau has been a Fund member for nine years, yet it still does not have a page in International Financial Statistics. Even key indicators, such as GDP, are not available. We should help the authorities by stepping up our technical assistance both in statistical and macroeconomic expertise.

Guinea-Bissau has major structural problems that would be better addressed in the context of a structural adjustment arrangement, rather than in the fashion suggested in the staff appraisal, namely, to take significant corrective actions without a clearly defined comprehensive adjustment program.

Mrs. Walker made the following statement:

The economic situation in Guinea-Bissau is critical, and the economic and financial policies that have been pursued by the authorities have contributed heavily to that situation. While the authorities have recognized the need for adjustment and have taken a number of important steps to improve the situation--particularly in pricing and marketing--the difficulties confronting the economy have continued to mount, and the required action is greater than has been taken thus far. In this regard, the authorities' present attitude--as expressed by Mr. Mawakani--that they intend to adopt a bolder approach is most welcome.

Such a bolder approach would have to begin with a substantial exchange rate adjustment, the pursuit of a flexible exchange rate policy thereafter, and a complete pass-through of the effects to domestic prices. The liberalization measures that have been taken thus far will have only a limited effect as long as the current exchange rate policy continues. The idea of a two-tiered market is a second-best approach, and if it is adopted, the depreciated market should be as wide as possible and unification should begin as soon as possible--certainly within the time frame of a program under the structural adjustment facility. I would be interested in any further information that the staff might have on the exchange rate.

Such an exchange rate depreciation will not be effective without tightened fiscal and monetary policies. Fiscal policies have been expansionary and have contributed substantially to the economic and financial problems of Guinea-Bissau. Expenditure must be controlled, and it would be important to include benchmarks guiding expenditure reduction in any program under the structural adjustment facility. A reduction in the civil service--both in numbers of employees and wage levels--is critical, and I welcome the authorities' resolve to tackle this difficult problem. There is also a need for cutting back capital expenditure and for making sure investment priorities are set and the resources are used efficiently. In this regard, we welcome the World Bank's review of investment priorities to ensure that the capital expenditure level is the maximum compatible with the country's absorptive capacity.

As for revenue measures, we would encourage the authorities to convert existing specific tax rates to ad valorem rates and to improve tax collection procedures.

Although few data are available, public sector enterprises appear to be experiencing financial difficulties. A study of these enterprises is necessary to determine their exact financial position and which enterprises could be transferred to the private sector or closed down. I welcome the authorities' intention to study this sector, and I urge them to call upon the World Bank for advice, in addition to financing, in this area. Reform of the public enterprise sector would be an important element in a program under the structural adjustment facility.

The major reform of the pricing and marketing system announced last August is a positive step, particularly since it allows for greater private sector participation in all aspects of domestic and foreign trade, except cereals. However, the effects of these measures are limited, because the principal imports are still subject to price control, and the exchange rate is overvalued. In order that those measures might have a more far-reaching effect, we urge the authorities to move quickly with exchange rate action and to increase prices sufficiently to cover production costs. Furthermore, while encouraging progress has been made in the liberalization in the external and domestic trade sectors, the incentive to export most products through official channels is still not there as long as the parallel exchange rate is so much higher than the official rate. Guinea-Bissau's external debt situation is difficult and is evidenced particularly by an accumulation of external arrears. Therefore, no new nonconcessional debt, excluding normal trade credits, should be contracted, and borrowing on concessional terms should be contracted only for priority needs. We urge the authorities to remain current in their obligations to the Fund and the Bank.

We would urge the authorities to request technical assistance in the statistical area, which needs improvement.

Guinea-Bissau's medium-term outlook is worrisome, and substantial adjustment measures must be taken in addition to those already started in 1986. We welcome the authorities' desire to adopt far-reaching liberalization measures, along with a substantial exchange rate adjustment, and encourage them to work with the Fund and the World Bank to develop a program that will address the serious economic and financial situation of the country.

Finally, I would be interested in hearing from the World Bank representative about what the Bank will be doing in Guinea-Bissau in the future.

The staff representative from the African Department said that the authorities had been contemplating the introduction of a second window for foreign exchange transactions. At the request of the authorities, a staff team had visited Guinea-Bissau in October and November 1986 to examine the technical issues relating to the establishment of such a window. Subsequent to those discussions, it was agreed that the establishment of a second window was not a realistic option, particularly in the light of the limited administrative capacity in the country. Accordingly, the authorities had determined that it would be preferable to approach the exchange rate through direct action, and they envisaged making a major adjustment in the exchange rate in early 1987, with a view to eliminating completely any remaining gap with the parallel market rate during the course of the year.

The staff representative from the World Bank remarked that the assistance of the World Bank in the past had been mostly in the field of infrastructure. The Bank had financed several road projects and had also supported offshore petroleum exploration activities, where there was some potential. In the past, the Bank had also provided general balance of payments support through a rehabilitation import credit and supplemental credit, which had been cofinanced partly through the Special Facility for Sub-Saharan Africa. For the future, in view of the severe structural adjustment needs of the country, Bank support should be in the direction of structural adjustment lending. In fact, a Bank mission was in Guinea-Bissau currently to appraise a structural adjustment loan. The Bank staff had been cooperating closely with Fund staff in those matters and fully shared the assessment of the recent Fund missions, namely, that Guinea-Bissau needed to take measures on the macroeconomic side, including the paramount need to come to grips with the exchange rate situation. The Bank planned to continue its assistance to Guinea-Bissau in infrastructural projects, particularly in transportation, and planned to continue providing technical assistance as well. Finally, the Bank hoped to continue cooperating with the Fund.

Mr. Mawakani indicated that the economic and financial prospects of Guinea-Bissau remained difficult. To address that situation, the authorities had begun to take corrective actions, especially in the pricing and marketing areas.

The authorities recognized that the magnitude of the exchange rate adjustments implemented thus far had been inadequate and that there was a need for the implementation of stronger measures, Mr. Mawakani continued. In that regard, the party had decided at its convention held a month earlier that the Government should adopt far-reaching liberalization measures, including a substantial exchange rate adjustment. The authorities were also formulating an adjustment program with the assistance of Fund and Bank staff. They intended to begin discussions in early 1987 on macroeconomic and structural policies.

The Chairman made the following summing up:

Executive Directors noted the rapid deterioration of the economic and financial situation of Guinea-Bissau that had been caused mainly by severe cost/price distortions and a growing overall fiscal deficit. Moreover, they expressed serious concern about the continuing accumulation of payments arrears.

While welcoming the recently enacted increases in consumer and producer prices, Directors observed that those adjustments had been insufficient to restore realistic cost/price relationships in the economy and to encourage the marketing of crops through official channels. The maintenance of an overvalued exchange rate had fostered growing parallel market activities, and reduced official exports, thereby placing further pressure on the already weak balance of payments.

In the circumstances, Directors encouraged the authorities to adopt promptly a comprehensive adjustment program designed to reduce the major structural and financial imbalances facing the economy. Directors stressed, in particular, the importance of fiscal reform and of the early adoption of appropriate pricing policies, including a flexible exchange rate policy, in order to reduce distortions and improve the balance of payments position. While supporting the recent liberalization efforts in the trade area and measures to enhance the role of the private sector in Guinea-Bissau, Directors urged the authorities to further liberalize the marketing system, especially for cereals.

Concerning fiscal policy, Directors noted that the unsustainably large overall budget deficit underscored the urgency of major corrective action. Directors were of the view that the control of the wage bill and of other current outlays was a key requirement and stressed that public investment should be trimmed and reviewed in collaboration with the World Bank. They also encouraged the authorities to work closely with the World Bank on the reform of agricultural policy and of public enterprises. On the revenue side, the introduction of ad valorem duties was urged, together with improvements in tax collection.

In view of the high external debt service burden of the country, Directors urged the authorities to avoid contracting external loans on nonconcessional terms. They also stressed the importance of eliminating external payments arrears as soon as possible.

Directors took note of the continuing weak statistical base of Guinea-Bissau and advised the authorities to take the necessary steps, with technical assistance from the Fund and other sources, to improve the coverage and timeliness of the data base.

It is expected that the next Article IV consultation with Guinea-Bissau will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Section 2, and in concluding the 1986 Article XIV consultation with Guinea-Bissau, in the light of the 1986 Article IV consultation with Guinea-Bissau conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/86/275, Guinea-Bissau maintains restrictions on payments and transfers for current international transactions, in accordance with Article XIV, Section 2. In addition, the restrictive features of a bilateral payments agreement with a Fund member are subject to Fund approval under Article VIII, Section 2(a). The Fund encourages Guinea-Bissau to reduce its reliance on exchange restrictions and to terminate the restrictive features of the bilateral payments agreement with a Fund member.

Decision No. 8458-(86/189), adopted
December 1, 1986

2. ENLARGED ACCESS POLICY - EXTENSION AND ACCESS LIMITS FOR 1987

The Executive Directors considered a staff paper and proposed decision, extending the enlarged access policy and the present access limits for 1987 (SM/86/277, 11/12/86).

Mr. Mawakani said that the proposed decision to continue the enlarged access policy and maintain the access limits at their present level was welcome. It was also an indication of the Fund's willingness to plan an active role in the provision of financial assistance to member countries. He hoped that those positive signals to the international financial community would trigger similar responses from major donors and commercial banks.

Mr. Nimatallah, Mr. Arias, and Mr. Song expressed their support for the proposed decision.

Mr. Hassan commented that he welcomed the proposed decision to formalize the implementation of the agreement reached by the Interim Committee in its last meeting regarding the extension of the policy on enlarged access and the retention of the present access limits for 1987.

While he understood that the annual and triennial limits should not be considered as targets, Mr. Hassan expressed the deep concerns of the countries represented by his chair regarding the restrictive implementation of the guidelines determining actual access for individual members within the current limits. Such restrictive implementation of access limits had resulted in a progressive decline in average access since 1983. The highly restrictive application of the decision to reduce access limits well below what had been intended in the decision had suppressed the amount of financing provided by the Fund, as a proportion of the total financing needs of members with arrangements, to less than 9 percent in 1986. Therefore, he urged that that situation be reversed in 1987 and that the guidelines governing actual access for individual countries be implemented with the objective of assisting members to attain viable external payments positions and to resume economic growth as soon as possible. In conclusion, he supported the proposed decision.

Mr. Ismael and Mr. Templeman expressed their support for the proposed decision.

Mr. Pineau said that he could endorse the proposed decision, even though the status quo was a second-best alternative in the present situation. As his chair had suggested at the past discussion on the matter (EBM/86/150 and EBM 86/151, 9/9/86), several factors would have warranted not only an extension of the enlarged access policy at the previous levels for 1987, but even an increase in the access limits. Those factors were the failure of the expected economic upswing to materialize; the poor market prospects for a number of key raw materials, which seemed to put any significant improvement in the external position of many developing countries out of reach in the near future; and finally, the fact that the Fund was in a position to assume the central role envisaged for it in the debt strategy, considering its satisfactory liquidity situation.

The September Interim Committee communiqué referred explicitly to those considerations but drew a more conservative conclusion, Mr. Pineau recalled. Although the mere continuation of the present access limits could fall short of many countries' future needs, his authorities had joined the majority; they considered that the continuation at least had the merit of safeguarding the Fund's potential for action. He thus supported the proposed decision.

Mr. Sengupta said that he supported the proposed decision. He also urged that note be taken of the point made by Mr. Hassan and hoped that Mr. Hassan and others could be reassured that there was no intention to interpret the guidelines on access restrictively.

Mr. Goos said that he supported the proposed decision. While he agreed with Mr. Sengupta's plea that the decision should not be applied restrictively, he thought that that had not been done in the past. In response to Mr. Hassan's statement, he noted that the share of Fund financing in overall financing could not be a guideline for the use of enlarged access policy.

Mr. Posthumus, Mr. Fugmann, Mr. Sugita, Mr. Schneider, Mr. Sliper, Mr. de la Herrán, and Mr. Rebecchini expressed their support for the proposed decision.

Mr. Finaish indicated his support for the decision, and stated that it was useful to take into account what Mr. Hassan had said about its application.

The Executive Board then took the following decision:

Enlarged Access Policy - Extension and Access Limits for 1987

The Fund, having reviewed the decisions on the policy on enlarged access and the limits on access to the Fund's resources under that Policy and under the special facilities of the Fund (No. 6783-(81/40), No. 7599-(84/3) as amended by Decision No. 8147-(85/177), No. 7600-(84/3) as amended by Decision No. 8147-(85/177) and No. 7602-(84/3)), decides that:

1. In paragraph a. of Decision No. 7599-(84/3) as amended, "1986" shall be replaced by "1987."

2. (a) In the third sentence of paragraph a. of Decision No. 7600-(84/3) as amended, "and 1987" shall be inserted after "1986."

(b) In paragraph b. of Decision No. 7600-(84/3) as amended, "1986" shall be replaced by "1987."

Decision No. 8459-(86/189), adopted
December 1, 1986

3. SAUDI ARABIAN MONETARY AGENCY - BORROWING AGREEMENTS

The Executive Directors considered a staff paper on a proposed extension of the commitment periods under the Fund's borrowing agreements with the Saudi Arabian Monetary Agency (EBS/86/250, 11/12/86).

Mr. Nimatallah said that he was happy to convey to the Board the consent of the Saudi Arabian Monetary Agency (SAMA) to extend the commitment periods for the undrawn balance of the SDR 8 billion--about SDR 500 million--under the 1981 Borrowing Agreement and the SDR 3 billion under the 1984 Supplementary Borrowing Agreement. That consent was one more step within Saudi Arabia's policy of continued cooperation with the Fund and its continued full support for the Fund's policy on enlarged access; without such support, the enlarged access policy would not be in place today. It was important to note that when deciding to lend to the Fund, Saudi Arabia had taken into consideration the welfare of the borrowing members. Specifically, when SAMA considered the extension of the commitment periods for those two large agreements, every effort had been made again to minimize the cost to the borrowing members. The Fund had made calls under those agreements only in line with its needs for borrowed resources to finance purchases. Without that flexibility, the Fund would have been forced to invest balances that were drawn before purchases were made, and the investment would have brought returns below the cost of borrowing. That loss would of course have been passed on to the borrowers. Instead, SAMA had chosen to forgo higher long-term rates on committed balances, and to keep them in near liquid form without a commitment fee until they were drawn down. SAMA did not charge the Fund any commitment fees as did, for example, the Bank for International Settlements (BIS). Of course, under normal bank lending practices, borrowers had to pay a commitment fee in such circumstances.

In that vein of cooperation, his authorities had agreed to extend the commitment period for six months for an amount up to SDR 500 million under the 1981 Borrowing Agreement, and for two years for SDR 3 billion under the 1984 Supplementary Borrowing Agreement, Mr. Nimatallah concluded. Unfortunately, in the light of the present unfavorable current account position of Saudi Arabia and the unclear liquidity needs of the Fund in the next several years, SAMA was not able currently to extend maturities beyond November 6, 1989 for the 1984 Supplementary Borrowing Agreement, or beyond May 6, 1994 for the 1981 Borrowing Agreement. He trusted that the Board appreciated the position of SAMA; as it was, SAMA would not have all of its resources returned to it for about eight years.

Mr. Arias commented that even though Saudi Arabia was facing its own financial difficulties, it had agreed to extend the final date for calls on undrawn amounts under the borrowing agreements with the Fund. His chair was grateful for the continuous support and cooperation that the Saudi Arabian authorities had provided to the Fund, and particularly to the member countries that had made use of the borrowed resources. He supported the proposed decision.

Mr. Finaish stated his support for the proposed decision, which was beneficial to the Fund. He wished to take the opportunity to thank Saudi Arabia for its contribution to Fund resources in recent years. The Saudi Arabian contribution had been unique, substantial, and most helpful to the Fund membership in difficult circumstances. The authorities deserved commendation for their continued cooperation with the Fund.

Mr. Posthumus voiced his support for the proposed decision, adding that he was very thankful to the Saudi Arabian authorities. The Board might wish to include in the decision an explicit expression of gratitude to Saudi Arabia for the proposed arrangements between the Fund and SAMA.

Mr. Sengupta said that he wished to associate himself with other colleagues who had expressed appreciation for the Saudi Arabian help, without which it would have been difficult for the Fund to implement an enlarged access policy. He was grateful to Saudi Arabia for allowing an extension of the commitment periods of the borrowing agreements with the Fund. Although it would have been useful if the maturity periods could have been extended as well, he appreciated Mr. Nimatallah's point, and hoped that if it was necessary in the future, the authorities might be able to reconsider the extension of maturity.

Two sentences in EBS/86/250 (11/12/86) gave rise to some questions, Mr. Sengupta went on. On page 2, the penultimate sentence read: "The potential shortening of the maturities of loans during the extended period under the 1981 Borrowing Agreement would be relatively minor." Was it just that the period of shortening of maturity was less than in the 1984 Agreement, or were there other implications about the deployment of that particular loan?

Some elaboration from the staff on the third sentence on page 3 would also be helpful, Mr. Sengupta noted. That sentence read: "If, in lieu of the extensions, the Fund were to call on the undrawn balances prior to May 6, 1987 and invest the proceeds temporarily until they are needed to finance purchases, the costs to members of using borrowed resources would likely be greater as borrowing costs typically exceed investment returns."

Mr. Goos said that he wished to associate himself with the expressions of appreciation by previous speakers. He supported the proposed decision.

Mr. Hodgson, in joining other speakers in supporting the proposed decision, remarked that ideally it might have been preferable to the Fund's membership to have symmetrical changes in the commitment period and maturity dates, but he could appreciate the points raised by Mr. Nimatallah as to why that was not currently possible.

Mr. Sugita commented that it was gratifying that SAMA was prepared to agree to extensions of the commitment periods for the two borrowing agreements with the Fund, which would strengthen the Fund's financial base and help meet its operational needs. For those contributions, he wished to express his chair's great appreciation to the Saudi Arabian authorities. He supported the proposed decision.

Mr. de la Herrán asked Mr. Nimatallah to convey the appreciation of his chair to the Saudi Arabian authorities for their efforts and support of Fund policies and financing. He supported the proposed decision.

Mr. Hassan, stating his support for the proposed decision, joined other Directors in thanking Saudi Arabia for its cooperation and for its willingness to extend the drawing period under the two arrangements, despite the difficult current account position that the country was facing.

Mr. Templeman noted the cooperative spirit of the Saudi Arabian authorities and welcomed the extension of the commitment period under the 1981 Borrowing Agreement with SAMA, which would provide a continuing supplement to the Fund's ordinary resources. He also appreciated the willingness of SAMA to extend the commitment period of the 1984 Supplementary Agreement. However, he had some concern about the mismatch of maturities that could result from the failure to extend the repayment period. For example, it was possible for a drawing to be made as late as May 1989, which would then have to be repaid in November 1989. He wondered whether it would be desirable for the Fund to draw under the agreement in such circumstances. Nevertheless, he had noted with interest a hint in Mr. Nimatallah's statement to the effect that, at a later date, SAMA might be willing to reconsider a further extension of the repayment period under the 1984 Agreement.

Mr. Schneider expressed his appreciation to Mr. Nimatallah and his authorities for having agreed to extend the commitment periods of the 1981 and 1984 Borrowing Agreements. Those extensions enabled the Fund to continue with the enlarged access policy during a difficult time.

Mr. Donoso, Mr. Ismael, Mr. Mawakani, Mr. Fugmann, Mr. Pineau, Mr. Sliper, Mr. Song, Mr. Msadek, and Mr. Rebecchini expressed their appreciation to the Saudi Arabian authorities, and stated their support for the proposed decision.

Mr. Foot joined other Directors in thanking the Saudi Arabian Monetary Agency for the continued facilities provided to the Fund. It was helpful to know that if the circumstances of SAMA should change, possibilities remained open for reviewing the decision on maturity dates. Mr. Nimatallah had made a point concerning the Fund's liquidity position, to which the Treasurer and the staff would of course call the Board's attention during the regular reviews.

The Treasurer, in response to a question about the impact of the potential shortening of maturities, explained that under the 1981 Borrowing Agreement, every loan had to be repaid in five installments from the fourth to the seventh year--on average, over about five years. It was expected that the Fund would draw the remaining balance--about SDR 500 million--within the six-month extension that had been granted. The situation was much different under the 1984 Supplementary Borrowing Agreement; as Mr. Templeman had pointed out, it was possible that the Fund might borrow under that agreement and then have the funds only for six months. Nonetheless, Mr. Nimatallah had made a point that times might change and that SAMA might be able later to reconsider the maturity dates. Moreover, the liquidity consideration would indeed be watched carefully in each semiannual Executive Board review. A staff paper (EBS/86/266, 11/25/86) on management of the Fund's liquidity in connection with its borrowing agreements with Japan and SAMA was scheduled for discussion on December 19. In that paper, the staff examined the liquidity implications and made certain proposals concerning the extension of the drawdown period with SAMA; it suggested that the Fund make somewhat earlier use of the resources from SAMA than otherwise would be the case under present arrangements. That would help minimize the mismatch.

The question had been asked why the cost to members of using borrowed resources would rise because borrowing costs typically exceeded returns earned on investments of undisbursed proceeds of borrowed funds, the Treasurer recalled. The Fund had the alternative to draw down all the amounts available and invest them, but short-term interest rates earned from investments were typically lower than medium-term interest rates paid by the Fund to SAMA. The investment would normally be for three months or less and the interest cost of borrowing was at rates for six months or two and a half years, at the option of SAMA. Because the period of interest on the investments would be shorter than that applied to amounts borrowed by the Fund, and given the normal upward slant of the yield curve, the Fund would be receiving less investment return than the interest it was paying to the lender. Of course, there were situations in which the short-term rates were higher than the longer-term rates, but such circumstances were highly unusual. Inasmuch as the Fund passed on the cost of borrowing to members drawing on the Fund's resources, any difference in the borrowing costs over the investment return would be at the expense of the borrowers under the policy on enlarged access.

Mr. Sengupta said that he had wondered whether the statement that borrowing costs typically exceeded investment returns had pertained only to SAMA loans or whether it was a general statement, and he was therefore glad for the elaboration provided by the Treasurer. A second, related point was the statement that most of the loans that were given to the Fund and through the Fund to the developing countries were concessional. It seemed odd that if the loans were really concessional, the borrowing costs typically exceeded the possible investment return even to an institution such as the Fund.

Mr. Nimatallah remarked that the general point to be remembered was that there was a mismatch of the drawing and utilization of resources. A change in the ratios of utilization of resources--ordinary or borrowed--might eliminate mismatches and preclude the need for drawing down amounts before they were actually needed. As for the rates earned on investments of borrowed resources, the relationship between the cost of borrowing and the investment returns depended on coincidence. Short-term rates were sometimes higher than, lower than, or equal to medium-term rates. The general discussion of those points might usefully be postponed until the Board's meeting on December 19.

The general issues aside, SAMA was doing its best to make a loan to the Fund that would minimize costs to the borrowers, Mr. Nimatallah concluded.

The Treasurer concurred with Mr. Nimatallah's observation that the point was a general one, adding that it might usefully be reformulated the other way around, namely, that investment returns typically were lower than borrowing costs.

The Chairman indicated that a better formulation of the general point on borrowing costs and investment returns might be that longer-term borrowing costs typically exceeded short-term investment returns, given the yield curve phenomenon.

The Treasurer then commented that there was a general predilection of Executive Directors to keep Fund investment low, not only because of the financial issue that had just been discussed but also because of a desire to reduce the mismatch of maturities implicit when borrowed funds were invested rather than disbursed. As for the Fund's investment policies, the Fund was not supposed to be an active participant in the market, and the Articles of Agreement and the Fund's policies restricted the Fund to making investments only with particular institutions. Moreover, Executive Directors had not approved maximization of investment returns by the Fund. They had approved certain practices, for example, investment to the disbursement date and investment in certain international organizations.

Mr. Nimatallah recalled that sometimes the amounts had to be drawn down and then kept awhile to be invested because the planned disbursement was delayed, as had been the case in Mexico. He did not believe that the Fund had an intentional policy of drawing down amounts and investing them, but sometimes, there appeared to be a firm, specific date for disbursement, which was then postponed. Of course, the lenders, such as SAMA and others, provided the money on the specified date and the Fund then needed to invest the amounts while waiting for the actual disbursement.

The Chairman made the following concluding remarks:

> I have been particularly involved in the development of these borrowing arrangements, beginning with the preliminary negotiations with the Saudi Arabian authorities in 1980. During all those years, I have greatly admired the statesmanlike attitude of the authorities. They were at that time beneficiaries of large balance of payments surpluses, and they quickly entered into very bold agreements--initially for SDR 8 billion, and increased later to SDR 11 billion--with a spirit of flexibility and cooperation vis-à-vis this institution that I have appreciated and admired enormously. There would have been no enlarged access policy, at least as we know it, without this association between Saudi Arabia and the Fund. Furthermore, Saudi Arabia did all this in 1980-81, before the debt crisis erupted. When, in August 1982, the major crisis broke out with the large Latin American countries, we were financially equipped to deal--albeit perhaps not perfectly--with the situation, and that readiness was possible because of the cooperation of the Saudi Arabian authorities; we should never forget that. This is a most remarkable example of a country that does

more than just participate in the organization--Saudi Arabia sees the organization as a crucial element of international financial stability and has acted accordingly to support it. I therefore want to thank the authorities from the bottom of my heart.

The Executive Board then considered the proposed decision.

The Chairman suggested that an addition to the decision that would reflect Mr. Posthumus's remarks would read, "and expresses its appreciation for the continued cooperation of the Saudi Arabian authorities with the Fund."

The Executive Board then approved the decision as amended:

The decision was:

The Executive Board authorizes the Managing Director to propose to the Saudi Arabian Monetary Agency (SAMA) amendments to the 1981 Borrowing Agreement and the 1984 Supplementary Agreement between SAMA and the Fund, substantially in the terms set forth in the Attachment to EBS/86/250, and expresses its appreciation for the continued cooperation of the Saudi Arabian authorities with the Fund.

Decision No. 8460-(86/189), adopted
December 1, 1986

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/188 (11/26/86) and EBM/86/189 (12/1/86).

4. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the consultations with the CONTRACTING PARTIES to the GATT on the Philippines, to be held in Geneva during the week of December 8, 1986, as set forth in EBD/86/309 (11/24/86).

Adopted November 26, 1986

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/48 and 86/49 are approved. (EBD/86/305, 11/20/86)

Adopted November 26, 1986

6. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by an Advisor to Executive Director as set forth in EBAP/86/296 (11/25/86) is approved.

APPROVED: July 7, 1987

LEO VAN HOUTVEN
Secretary