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04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/205

3:00 p.m., December 19, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
Dai Q.	Jiang H.
C. H. Dallara	M. K. Bush
J. de Groote	
A. Donoso	
	M. B. Chatah, Temporary
H. Fujino	M. Sugita
G. Grosche	
	Khong K. N., Temporary
A. Kafka	H. A. Arias
T. P. Lankester	M. Foot
H. Lundstrom	H. Fugmann
	D. McCormack
Mawakani Samba	
Y. A. Nimatallah	I. Al-Assaf
G. Ortiz	L. Filardo
	S. de Forges
G. A. Posthumus	
	C.-Y. Lim
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
S. Zecchini	

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

Also Present

Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; G. Belanger, H. Hino. External Relations Department: D. M. Cheney. Legal Department: W. E. Holder, R. H. Munzberg. Treasurer's Department: W. O. Habermeier, Counsellor and Director; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; D. H. Browne, A. G. Chandavarkar, F. Gupta, R. B. Hicks, Y. Kawakami, B. E. Keuppens, B. Von Numers, G. Wittich, B. B. Zavoico. Advisors to Executive Directors: L. P. Ebrill, S. M. Hassan, K. Murakami, G. Pineau, I. Sliper. Assistants to Executive Directors: J. R. N. Almeida, K.-H. Kleine, T. Morita, A. H. Mustafa, C. Noriega, W. K. Parmena, S. Rebecchini, A. V. Romuâldez, D. Saha, C. A. Salinas, G. Schurr.

1. JAPAN - BORROWING AGREEMENT; AND MANAGEMENT OF FUND LIQUIDITY - USE OF ORDINARY AND BORROWED RESOURCES UNDER POLICY ON ENLARGED ACCESS

The Executive Directors continued from the previous meeting (EBM/86/204, 12/19/86) their consideration of a paper on borrowing by the Fund from the Government of Japan (EBS/86/265, 11/25/86), together with a paper on management of the Fund's liquidity in connection with the borrowing agreement with Japan and the extension of drawdown periods under the borrowing agreements with the Saudi Arabian Monetary Agency (EBS/86/266, 11/25/86). They also had before them a paper on borrowing by the Fund from the Saudi Arabian Monetary Agency (EBS/86/250, 11/12/86; and Sup. 1, 12/8/86).

Mr. Posthumus made the following statement:

As others have indicated, at this stage the Fund's liquidity does not require new loans. But the liquidity position may change when resources borrowed earlier are repaid and outstanding credit does not decrease pari passu. Furthermore, the accelerated use of proceeds from the SAMA loan makes it possible that a certain mismatch between repayments and outstanding credit would arise. This chair therefore welcomes the offer made by Japan, and we support the decision proposed in EBS/86/265. It was perhaps not the intention of the staff to raise an issue of principle for Fund financing. However, like others, we would like to maintain the principle that quota resources are the normal source of financing for Fund credit, which means that permanent facilities, in principle, should be financed with ordinary resources. In this light, the proposals of the staff to use proceeds of the Japanese loan for financing stand-by credits and extended arrangements constitute a change in the practice followed thus far. We would, however, favorably consider the proposed mix between ordinary and borrowed resources to finance enlarged access credits so that a larger share of these credits would be financed out of borrowed resources. I should say, in addition, that it is my understanding that the Fund's lending policies are not now under discussion and that they are therefore not being changed.

I would welcome some information on why the authorities in Japan prefer so strongly that the use of the loan be related to the use of Fund resources subject to the credit tranche policies, as suggested in EBS/86/265.

Mr. Salinas made the following statement:

We warmly support the proposed borrowing from the Government of Japan and the conditions of the offer outlined in the attachment to EBS/86/265. It is uncertain whether the Fund's liquidity position will remain in future as satisfactory as it is perceived to be today, given the severe difficulties in the balance of payments positions of many Fund member countries. In the circumstances, the possibility of drawing up to SDR 3 billion in the flexible manner as contemplated in the draft borrowing agreement constitutes a welcome strengthening of the Fund's financial position.

In the present circumstances, it is appropriate for management to seek support for the Fund's liquidity, and the arrangement under consideration should play a useful role in assuring members that no liquidity constraints will limit their access to Fund resources. Thus, we want to express our strong support for management's initiative. At the same time, we commend the Japanese authorities for their cooperation in helping the institution perform its tasks. The loan should facilitate an appropriate response by the Fund to members' needs.

On the techniques for using the Japanese loan in Fund transactions, I have the impression from the analysis of the factors bearing on demand for and supply of Fund resources that the Fund's holdings of usable ordinary resources are at a reasonable level. There are indications of a shift toward greater use of ordinary resources and lesser use of borrowed resources, because of changes in members' positions in the Fund and in the composition of members seeking Fund arrangements. Also, the shorter maturities expected for drawings during the extended drawdown periods under the SAMA arrangement will have some impact on the Fund's liquidity. However, even taking these factors into account, it appears that there will be no excessive decline in ordinary resources. As we understand the situation, the availability of the loan from the Government of Japan is valuable as a reserve against unexpected demands for Fund financing, but there is no pressing need to use the resources specifically as a way of conserving ordinary resources.

On the proposals of the staff in EBS/86/266, we note that both have the effect of increasing charges for the use of resources. Even assuming only a minor increase in charges under any of the alternatives, there does not appear to be sufficient justification for adopting these courses of action if ordinary resources are available, particularly given the likelihood that such ordinary resources will increase in connection with the next general review of quotas. Also, we understand that as the Japanese loan will be available for some four years after May 1, 1987, we can always use the resources in future if events lead to a reduction of ordinary resources. For the time being, it would be most appropriate to treat the borrowed resources from Japan in the same way that those under the SAMA arrangement were treated, i.e., in line with the current guidelines governing the enlarged access policy and without any change in the mix of ordinary and borrowed resources.

Based on the considerations I have mentioned, my authorities would prefer to postpone discussion on the alternatives presented by the staff until after the review of the enlarged access policy and some indication on the timing and likely outcome of the Ninth General Review of Quotas. However, if management and the majority of my colleagues consider that some action should be taken to avoid the risk that members will face restrictions in their access to Fund resources, our preference is for the first alternative in EBS/86/266.

Mr. Lundstrom made the following statement:

My authorities appreciate the Japanese Government's loan offer and SAMA's readiness to extend the drawdown periods for the existing agreement. These accommodations will substantially strengthen the Fund's liquidity and provide room for flexibility in its operations while awaiting the conclusion of the Ninth General Review of Quotas. However, like most previous speakers, I wish to stress that the Fund's external borrowings must not be considered a substitute for quota increases. It is important that the forthcoming quota review be conducted and completed as scheduled.

The terms of the extension of the SAMA lending agreement make a case for disbursing the resources under that agreement as quickly as possible. They should get priority as a source of finance for drawings under the enlarged access policy.

The basic view of my authorities is that lending by the Fund in normal cases should be based on Fund quota resources. In times when ordinary resources are insufficient--for example, in awaiting a quota review or when member countries' financing needs have grown particularly large--external borrowing may be appropriate. But it should be regarded as a secondary method of financing, and mixing borrowed and ordinary resources should be done with restraint. The borrowed resources should then, to the extent possible, be separated from the ordinary resources in various ways, for example, by assigning different lending terms, including interest rates.

In a state of an "excess" of borrowed resources, a changed mix of resources in lending within the enlarged access policy should be considered. Use of ordinary resources outside the enlarged access policy should not be replaced to any greater extent by borrowed resources. Consequently, we are not in favor of using borrowed resources in stand-by arrangements currently involving only ordinary resources under the Fund's regular credit tranche policies. In cases where a quicker disbursement of borrowed resources is desired, there would seem to be a case for studying the effects of changing the mix supplied within the enlarged access policy, not only in the second through the fourth credit tranches but also in the first credit tranche. For example, the mix could be changed from the current 2:1 to, say, 1:1. I should like to reiterate that this is our basic position on managing the Fund's liquidity and that we welcome the Japanese loan offer in itself.

Should the Board decide on a disposition of the Japanese resources along the lines proposed by the staff--i.e., so that they more directly replace ordinary resources--the question of the choice of a method for calculating charges arises. In this situation, we prefer the first alternative, namely, pooling the whole loan stock of ordinary resources in addition to the Japanese resources. We find this method more simple and more just, as the Fund's interest income from lending the Japanese resources does not contribute to covering deferred income in the same manner as other interest income of the Fund.

In conclusion, I support the proposed decision on the borrowing agreement with Japan. Regarding the management of the Fund's liquidity, several speakers have raised their concerns on the implications of the proposed decision. Earlier, Mr. Zecchini provided three good reasons for not taking a decision at the present meeting. On these grounds, I would not oppose a delay until early next year, perhaps January 1987, as suggested by some speakers.

Mr. Dai made the following statement:

We are pleased that a provisional agreement has been reached on borrowing by the Fund from the Government of Japan. We can see from the draft that the thrust of the agreement is to strengthen the financial position of the Fund and facilitate a flexible response in accordance with the Fund's policies to assist members in overcoming their balance of payments difficulties. The terms and conditions of the borrowing agreement are reasonable and favorable. In my view, this agreement truly represents a spirit of international cooperation at a time when many members are confronting severe difficulties with their external payments. For this reason, I would like to express our great appreciation to the Japanese authorities, and I can therefore support the proposed decision on page 6 of EBS/86/265.

I now turn to the proposals contained in the companion paper, EBS/86/266. Although the objective of the staff's proposal of obtaining a more desirable and effective pattern of use of the Fund's resources in the context of the loan from Japan and the extension of the drawdown periods under loans from SAMA is an important issue, and while the staff's concern expressed in the paper is understandable, there are still several points which warrant our attention. First, the use of the loan from Japan as a substitute for ordinary resources to finance purchases under stand-by or extended arrangements would involve a question of principle regarding the nature of ordinary Fund financing. Since one of the fundamental principles of Fund financing is that the source of such financing should be based on quotas, borrowing is to be only a supplement to quota resources in specific cases. The proposed extensive use of borrowing and the greater scope for substituting borrowed funds for general resources could give rise to a number of policy implications. This is by no means simply a technical problem; rather, it's a matter of principle, which needs more careful and comprehensive consideration by the Board.

Second, with respect to any increase in charges for borrowing members that might result from implementation of the staff proposals, no matter how minimal the impact might be, we must listen seriously to the voice of our borrowing members, especially the poorer and debt-burdened developing countries.

Third, I wonder whether, technically, we can find a way to tackle the problem of the "mismatch" while at the same time taking fully into account the desires of the lender. One must ask whether it is feasible or logical not to restrict or cut down the use of general resources for regular purposes while treating the lending commitments as "secondary reserves." Whenever the Fund's liquidity position is constrained as a result of extensive use of general resources, we can draw down the borrowed funds to replenish the general resources. In these circumstances, the use of borrowed resources is directed toward strengthening the financial position of the Fund and thus the financing of the adjustment needs of members, which would still be consistent with the original purpose of the borrowed funds. I hope the staff will explore this issue further.

In view of the foregoing, I do not think it appropriate to make decisions hastily at the present stage; and further study and exchange of views are needed.

Mr. McCormack noted that the generosity of the Government of Japan in offering to lend SDR 3 billion to the Fund was evidence of Japan's continued commitment to international monetary cooperation. The staff had put the loan offer in context by referring to the continuing uncertainty about the world economy, an uncertainty that made it essential that the availability of resources to the Fund be continually monitored. In that respect, the diversity of uses envisaged for the Japanese loan was particularly welcome, and he could support the proposed decision in EBS/86/265. However, he had reservations about the recommendations in EBS/86/266 and went along with those who felt it would be better to defer any decision on those recommendations until they could be studied more fully.

Mr. Khong made the following statement:

I join other Directors in welcoming the generous offer by the Government of Japan to enter into an arrangement to lend SDR 3 billion to the Fund. The terms and conditions of the arrangement pose no difficulty for me. The arrangement provides sufficient flexibility for the Fund to use the loan to strengthen its financial position or to respond flexibly to meet the financing needs of members in the next few years. I can therefore support the decision proposed in EBS/86/265. However, I share the misgivings of other Directors concerning proposals in the second paper to phase in this loan, and the extension of the arrangement with SAMA, into the Fund's financing operations with member countries.

First, while agreeing that the future holds considerable uncertainty, I feel that EBS/86/266 has not established clearly a need to change the ratio of ordinary and borrowed resources in meeting drawings under stand-by and extended arrangements, especially those arrangements already approved by the Fund. To do so would change the fundamental character of the international cooperative arrangements the Fund has thus far been promoting, particularly the principle that additional resources to finance drawings should come mainly from quota increases and not from borrowed resources.

Second, a major question that is not answered in EBS/86/266 concerns the liquidity position of the Fund after the Ninth General Review of Quotas. I agree with other Directors that a change in the mix for stand-by and extended arrangements should not be considered until the future liquidity position of the Fund can be determined more clearly, bearing in mind the increase in ordinary resources likely under the Ninth General Review.

Third, I have the impression that the proposed phasing in of the Japanese loan has been somewhat "forced," in that an attempt has been made to make use of a source of financing without adequate consideration of the fundamental changes in principles that are involved. Given these considerations, I would prefer that the Japanese loan be regarded as a contingency line of credit, the use of which can be determined later in light of developments in the demand for the supply of ordinary resources, as well as the Fund's liquidity position. In conclusion, I support the views of those Directors who feel that consideration of the second paper should be postponed to a later date.

Mr. Chatah made the following statement:

Like others, we welcome the offer of Japan to lend the Fund the equivalent of SDR 3 billion. We also welcome the flexibility shown by the Japanese authorities with regard to the terms of the loan and its utilization.

On the modalities of utilization proposed by the staff, and after listening to other Directors and to the comments of the staff, we find there are a number of issues that warrant further examination before the specific modalities can be finalized. This is particularly true with respect to the proposed change in the mix of ordinary and borrowed resources, especially in the credit tranches. In our view, the need for a change in the mix should be judged on its merit and may warrant, therefore, a further look. In this connection, I wonder whether consideration has been given to the possibility of a broader use of the loan through a modified access policy. This may not deal directly with the "mismatch" problem but would, in a way, make the contribution of Japan more direct and transparent.

Mr. de Groote observed that acceptance of the offer by the Japanese Government would increase the ratio of borrowed resources to quota-based ordinary resources in the Fund. The question of the relationship between the envisaged borrowing and possible quota increases had been raised by a number of Directors. If quotas were sufficiently large and distributions were ideal, borrowing would not be necessary. However, even if quotas could be significantly enlarged, it would be unwise to think that the Fund would never again need to consider borrowing operations. It was highly improbable that, whatever the size of quotas that would become the source of ordinary resources in future, those quotas would necessarily accurately reflect surpluses and deficits in individual countries, and it might very well be that some surpluses would always be out of balance with quotas, even given a significant overall increase in quotas.

As far as the mix was concerned, most Directors seemed to be distinguishing between enlarged access policy and the regular credit tranche policy, Mr. de Groote continued. He was grateful to the staff for having clearly indicated that the problem was mainly one of a "mismatch," under which ordinary resources must be used to repay loans maturing before the corresponding repurchases. In the circumstances, it was reasonable to consider a change in the mix of borrowed and ordinary resources under the enlarged access policy. Without such a change, it would be necessary to set aside larger amounts of ordinary resources in order to meet possible reimbursement of borrowed resources. On balance, and despite the concerns of some of his colleagues, he could go along with the proposed mix.

Mr. Foot considered that Japan's offer in September 1986 of SDR 3 billion had been a welcome signal of Japan's support for the Fund and an appropriate response in the country's circumstances. Since then, as

EBS/86/265 made clear, constructive discussions had moved rapidly forward to the point at which the staff was able to offer fully articulated proposals. He had no difficulty endorsing the decision set out in EBS/86/265, and he particularly welcomed the flexibility built into the proposals that allowed, for example, quite sizable drawings by the Fund within a short span of time should the need arise.

On a technical matter, Mr. Foot observed that the U.K. element of the six-month interest rate proposed for the loan would be for high quality private sector, not public sector, debt. The U.K. Government did not issue debt with an initial maturity of six months, and there was no way that a rate for such debt could be constructed. Nevertheless, it was clear from the staff papers that under most circumstances, the cost to the Fund of medium-term money would be encouragingly modest, even if based primarily on the yield on private sector instruments.

On the recommendations in EBS/86/266, Mr. Foot said that he saw a number of conflicting objectives. Like others, he considered the Fund to be a quota-based institution and believed that the aim over time should be to return to a quota-based Fund financed by ordinary resources. Therefore, a strong case would have to be made for diluting that principle before substituting borrowed for ordinary resources. On the other hand, he shared the Treasurer's view that there were uncertainties in the period ahead and that the Fund should think carefully before deciding not to make early use of borrowed resources that were readily offered.

Another concern was that whatever was done should not significantly increase the cost to borrowers of Fund resources, Mr. Foot commented. That concern was not easy to relate to the present discussion, however. No two borrowers' use of Fund resources was quite the same. More important, perhaps, was the fact that the cost to borrowers of deferred income was met by a levy only on ordinary and not on borrowed resources. That, together with the variable gap between the cost of different types of borrowed resources, made it difficult for him to be confident about the effect on overall costs of different options. For the time being, his preference was for the Japanese loan to be used primarily to support the policy of enlarged access. To take advantage of the volume of funds currently available, he would be prepared to see a change in the mix of ordinary and borrowed resources under the enlarged access policies and would be prepared to go along with the proposals in EBS/86/266 to change the mix of ordinary to borrowed resources from 1:1 to 1:2.

However, Mr. Foot said, he was concerned about the cost of such a move to new borrowers, a concern which led to two additional thoughts. The first was that in deciding the source of additional borrowed funds, the Treasurer's Department should take account of both the prospective drawing periods of the SAMA and Japanese money, respectively, and of the need to limit any increase in costs for the borrowing membership as a whole. Clearly, the Board would need to keep the Fund's liquidity and use of resources under close review, but it would seem to be appropriate to give the Treasurer considerable flexibility between reviews. The second observation was that, particularly if it was the only way to restrain borrowing costs for Fund members, he would be prepared to consider, possibly on a trial basis, the substitution of some of the Japanese loan for ordinary resources.

Mr. Dallara indicated that, like others, he welcomed Japan's willingness to provide the Fund with a loan to be used in support of members' economic adjustment programs. He also appreciated the flexibility and cooperation exhibited by the Japanese authorities in negotiating the terms of the loan with a view to helping facilitate its use on terms that were compatible with Fund lending operations and other considerations. In the circumstances, he could fully support the draft decision in EBS/86/265 and the attached proposed borrowing agreement, although he wished to raise an issue relating to the terms and conditions of the loan and to the manner in which the resources were to be used.

The Fund's liquidity position appeared to be quite strong at present, inevitable uncertainties notwithstanding, Mr. Dallara continued. Moreover, he had taken note of the statement in EBS/86/266 that "borrowed resources for use under the enlarged access policy remain relatively high in relation to foreseeable demands." Taking those points into account, as well as the range of existing and prospective payments problems of Fund members, he wondered whether the interests of the Fund and Japan might not have been better served by the development of some approach that would have enabled at least part of the Japanese loan resources--perhaps in the range of one third--to be used in conjunction with the structural adjustment facility. He recognized, of course, that the terms and conditions of that facility were such that it would have made it exceedingly difficult for Japan to provide support through its loan that was fully consistent with the terms and conditions of the structural adjustment facility. Nonetheless, one had to wonder whether provisions for the loan could not have been designed in a way that would have charged members borrowing under the structural adjustment agreement a blended rate that was somewhat higher than the current rate, although still highly concessional. He recognized and fully respected the prerogative of the Japanese authorities in determining the uses to which its loan would be put, and he raised his question in the context of the current discussion only in light of the clear effort that had been put forward by the Japanese authorities to take into account the broader considerations of the Fund of its own circumstances and of the circumstances of its members in developing and negotiating programs.

The loan provided by the Japanese authorities in conjunction with the recent extension of the drawdown periods under the SAMA agreement raised a number of fundamental questions, Mr. Dallara remarked. First, there was the question of how the loan fitted into Fund access policies. He had noted the references to the enhanced flexibility that the loan provided the Fund, references which he found consistent with the guidance provided by Ministers and Governors at the Interim Committee. At the same time, his authorities felt that such flexibility should not be taken to mean an increase in average access that might be possible in light of considerations that were not explicitly related to the Fund's liquidity position. His comments, of course, should not be interpreted as suggesting that the United States would deny the possible use of the Japanese resources in connection with exceptional circumstances that members might face.

The second fundamental question--which was related to the mix of ordinary and borrowed resources in Fund operations--was whether the Fund was an institution that intended indefinitely to rely on borrowed resources or whether it should adhere to its traditional nature as a quota-based institution. He associated himself with those who felt that the Fund should continue to rely on ordinary, quota-based resources as the fundamental source of Fund financing. It was in the context of temporary strains on Fund resources and expanding needs of members that lending operations to the Fund in the 1970s and 1980s had emerged. It was in the same context that the temporary policy on enlarged access had been adopted. The loan agreement with Japan would enable the Fund to draw upon the resources of the loan for a period of four years, and the question arose whether and to what extent the resources would be used to finance enlarged access. He himself found it odd that Directors would be willing to see the Japanese loan used exclusively to finance a policy that many--including his chair--continued to believe should be phased out at some point. In that connection, and in light of various conflicting considerations, he was prepared to support the mix of the Japanese loan with ordinary resources in a 2/3 to 1/3 ratio for arrangements that would otherwise be financed with ordinary resources. Given the likely constraints that would face the Fund in the management of its liquidity, he was prepared to support both of the mixing proposals put forward by the staff, proposals which he considered to be consistent with other decisions adopted by the Board. It was his hope that action on those proposals could be adopted quickly, on the understanding that the issue would be reviewed in six months.

The Treasurer noted that various points of principle had been raised in the course of the discussion. One of the most important of those points concerned the use of the resources provided by Japan, in particular, the idea advanced by Mr. Dallara that a certain portion of the resources might be used in conjunction with the structural adjustment facility. There was nothing in the agreement that would prohibit the use of the Japanese resources in the way suggested by Mr. Dallara. However, such use would not be consistent with the spirit in which the loan had been discussed, because the Japanese authorities had made clear their desire that the resources should be used in conjunction with Fund resources disbursed under the credit tranche policies. Mr. Dai had asked another question related to the use of the Japanese resources in wondering whether the "mismatch" problem could not be alleviated by drawing on the Japanese line of credit if and when there was a need to replenish the Fund's ordinary resources and not necessarily in connection with repayments to another lender or with the purchase of resources by members. Again, the legal possibility existed, but it would not be in the spirit in which the loan had been offered. Of course, it was always possible that the lender might change its views about how its resources should be used; but for the time being, the approaches suggested by Mr. Dallara and Mr. Dai were not consistent with the preferences of the lender.

In making its proposals for borrowing by the Fund and for using borrowed resources in Fund operations, the staff had in no way intended to depart from the principle that quotas were and should continue to be the primary source of Fund financing, the Treasurer said. Of course, if that principle were carried to the extreme, one could ask why the agreement with Japan should even be concluded. The answer, which had been echoed by many Directors, was that the various uncertainties regarding the Fund's future liquidity situation made it useful to have the loan on the books. It was clear, as Mr. Dallara had noted, that such borrowing would directly or indirectly involve a saving of ordinary resources, although the amount would be relatively small in relation to the total outstanding lending by the Fund. In that respect, he had not been surprised to hear the suggestion raised by at least one Director that consideration should perhaps be given to increasing the size of lending from Japan in future.

It was impossible to answer with any precision questions on the Fund's liquidity situation following the Ninth General Review of Quotas, the Treasurer remarked. At present, he was unsure even how long it would take to complete the review, and he certainly had no answers about how large an increase it might yield. It was in that context, in fact, that the staff had felt that the loan from Japan would give some flexibility to the Fund's operations in a period of uncertainty.

In response to a question from Mr. Grosche on the impact of the Japanese loan on the allocation of currencies in the operational budget, the Treasurer noted that if the Fund made use of the loan, Japan would obtain a loan claim on the Fund that would be part of the total Fund position of Japan. However, under the operational budget, the loan claim would not be treated as part of the reserve tranche position, which was harmonized in relation to the gold and foreign exchange reserve position of the country. Such an approach would be consistent with the decision adopted by the Executive Board some three years previously on how to treat loan claims that arose out of lending for enlarged access from SAMA and other sources. Only loan claims arising from the General Arrangements to Borrow were presently treated as equivalent to reserve tranche positions. Those lines of credit would be used in accordance with the same general principles underlying the operational budget; that was not, however, true for the loan from Japan. In passing, he noted that some gradation had been established in the use of resources that the Fund had available. The largest borrowing arrangement on the books was the General Arrangements to Borrow, and Saudi Arabia, for example, could be asked for resources under its associated agreement under the GAB. These agreements were treated as similar, although not identical, to quota resources. In that respect, there must be a contingent ability, economically speaking, to create in effect a temporary extension of quotas to forestall and cope with an international monetary crisis at a time when the Fund was particularly short of liquidity. There must be a way, without going through the time-consuming process of approval by Parliaments, to support the Fund's resources quickly and in large measure. He raised the point as a way of clarifying where the Japanese loan stood in relation to other forms of Fund borrowing. The Fund treated the resources under the General Arrangements to Borrow pretty much like quota resources, and the Japanese loan and other loans available for use under the enlarged access policy were viewed as different gradations of borrowing, distinct from the GAB resources and less "legally" usable as a supplement to quota resources. As might be expected, therefore, the Fund preferred quota resources to borrowed resources for a variety of reasons, not least of which was that quota resources were under the sole control of the Fund and tended to be generally cheaper than borrowed resources.

Some Directors had argued that there was no clear and pressing need to conserve the ordinary resources of the Fund, the Treasurer recalled. While that was true purely from the point of view of the immediate liquidity position, it was also clear that over the next two years ordinary resources would be used to repay large-scale, short-term borrowing in the past. Moreover, while the Fund currently had some SDR 30 million in usable currency holdings, some of those could quickly become unusable. The world economy was in a fragile state, and any shift in the use of Fund resources by members with combined quotas of, say, $500-800 million, could change the financial picture substantially. As he saw it, the uncertainties he had mentioned tended to underline the need to preserve flexibility for the Fund. That was why he believed that if a choice had to be made between preserving the Japanese loan for future contingencies as a kind of reserve and using the loan to conserve ordinary resources, he would prefer the latter.

Mr. Zecchini observed that two fundamental points raised in the course of the discussion had not been dealt with at any length in the papers under discussion. First, Mr. Dallara had raised from both an intellectual and an operational perspective, the issue of the link between the need to phase out enlarged access and the need for the Fund to borrow. At the same time, the Treasurer had remarked on the importance of borrowing as a way of providing the Fund with additional flexibility. Within that framework, it was clear that the moment enlarged access was discontinued, borrowed resources would be used as a perfect substitute for ordinary resources. The issue was a fundamental and important one that must not be overlooked in the discussion on the management of the Fund's liquidity. And until it was clarified, he could not go along with the proposals in EBS/86/266.

Mr. Fujino remarked, first, that his authorities greatly appreciated the welcome reception that their initiative in lending SDR 3 billion to the Fund had received from Executive Directors. In participating in negotiations on the arrangement, he had done his best to accommodate the needs of the institution as well as the desires of the staff and other Directors. The outcome had been a loan of five years' maturity, which his authorities hoped would be used, when there was a need for it, in a flexible and diversified manner, consistent with Fund policies. The loan had not been offered with the intention that it should be used purely as a safety net.

The Chairman made the following summing up:

Executive Directors warmly welcomed the offer by Japan, first announced by the Minister of Finance at the 1986 Annual Meetings, to lend the equivalent of SDR 3 billion to the Fund, with a view to strengthening the Fund's financial position. Commending the Japanese authorities for their initiative in making the offer and for the cooperative spirit in which the authorities had participated in the negotiation of the draft agreement, Directors welcomed the flexible use of the resources envisaged in the arrangement and unanimously approved the terms and conditions of the proposed agreement as set out in the attachment to EBS/86/265 (11/25/86).

On the management of the Fund's liquidity in connection with the borrowing agreement with Japan and the extension of the drawdown periods under the borrowing agreements with the Saudi Arabian Monetary Agency (SAMA), reservations were noted with respect to some of the proposals in EBS/86/266 (11/25/86). A great many speakers stressed that the Fund is a quota-based institution and that a strong case would have to be made before they could agree to substitute borrowed for ordinary resources. A number of them observed that the Fund's liquidity position at present was satisfactory and did not require a rapid drawdown or use of new borrowed resources.

Several Directors indicated that they had problems of principle with the notion that the regular operations of the Fund--as opposed to enlarged access transactions--should be financed even in part with borrowed resources. A number of them were concerned in that connection that the proposals in EBS/86/266 could entail an increase in charges for countries using Fund resources.

On the other side, some Directors made the point that, although the liquidity position of the Fund at present was favorable, the world financial situation was uncertain and the Fund's liquidity could change rapidly. It was also observed that some of the borrowing arrangements into which the Fund had entered were approaching maturity and that increasing problems of mismatching should be taken into account when managing the rate of drawdown of these loans.

The complexity of the issues relating to the management of the Fund's liquidity in connection with borrowing agreements with the Fund is reflected in the complex split of positions taken by

Directors on these matters. In outlining these positions, I have taken into account clarifications offered by several Directors in an effort to move matters forward toward a conclusion.

- Six Directors representing some 20 percent of the voting power in the Fund took the view that the loan from Japan should be used only as a contingent reserve or line of credit for cases of emergency or to alleviate liquidity problems if and when they arose.

- Two Directors representing over 8 percent of the voting power expressed a preference for postponing the adoption of any decisions relating to the use of the loan from Japan until after the Board had had an opportunity to reflect further on the discussion and on the proposals in EBS/86/266.

The two groups described above can be treated as one group--representing 28 percent of the total voting power--which favors taking no action at present.

Those favoring some action can be placed in two additional groups.

- Five Directors, representing 35 percent of the voting power, indicated that they could go along with the proposal in EBS/86/266 to use the resources from the Japanese loan for a specified percentage of all purchases under the stand-by and extended arrangements, including purchases under the enlarged access policy.

- Nine Directors, representing 37 percent of the voting power, noted that they could accept using the loan from Japan, blended with other borrowed resources, only in the framework of the enlarged access policy.

On the issue of the particular ratio of ordinary to borrowed resources that should be used in financing purchases under the policy on enlarged access, nine Directors from among the latter two groups above, representing some 57 percent of the voting power, indicated that they could accept a change in the mix to double (from 1:1 to 1:2) the proportion of borrowed resources used in financing enlarged access policy purchases in the second to fourth credit tranches.

Only seven speakers addressed the issue of the charges on and repurchases of purchases that might be financed by the loan from Japan in lieu of ordinary resources. Six expressed a preference for applying the Fund's regular policies relating to charges on and repurchases of ordinary resources. One felt that a separate schedule of charges should be established for purchases financed by the loan from Japan.

> On balance, and after further discussion, Directors were willing to support an approach that would enable the Fund to begin using the loan offered by Japan to help finance purchases under stand-by or extended arrangements approved in accordance with the enlarged access policy, increasing at the same time to 1:2 the ratio of borrowed to ordinary resources. The approach would of course be subject to review as needed, but at least in connection with the semiannual reviews of the Fund's liquidity position.

Mr. Dallara asked for confirmation of his impression that it was not in the spirit of the Japanese authorities' offer to put the loan on the shelf as simply a contingent reserve.

Mr. Fujino replied that his authorities hoped the loan would be put to effective and operational use, if possible in a diversified and flexible manner. That was not to say that the loan might not play a useful role as a contingent reserve; but that should be only one of its uses. At the same time, the loan could be used, for example, to help member countries in their adjustment efforts. His main concern was that the use of the resources should not be limited to a single function.

Mr. Nimatallah agreed with the Chairman that the Board should return to the question of the use of the Japanese loan as soon as possible. After all, Japan's comfortable surplus position might not last. When the matter was taken up again, he would urge his colleagues to consider the possibility of utilizing the loan rather than simply holding it as a contingent reserve.

The Chairman reiterated that there appeared to be a clear tendency in the Board toward an effective use of the Japanese loan within the enlarged access policy. Of course, the modalities of use had to be worked out; and if the 1:1 mix were not changed, injecting the Japanese loan into other borrowed resources would do little more than slow down the use of other lines of credit. In the circumstances, there seemed to be a case for expanding the use of borrowed resources within enlarged access.

Mr. Zecchini considered that a number of points still required clarification, and he would prefer a more extensive Board discussion based on a more detailed staff paper. Of course, the Japanese loan could be used for the part of borrowed resources reserved for the enlarged access policy so that, even without changing the financing mix, the Japanese loan could be used. However, given the Japanese authorities' desire to consider a flexible use of the loan resources, he wondered how there could be any fundamental objection to using them through some kind of bridging device to extend, de facto, the impact of borrowed resources. In other words, would it be possible to have a relay between the SAMA resources and the Japanese resources with some financial "wizardry" that would allow a blurring of the financial picture?

Mr. Salehkhou recalled that he had earlier proposed that should there be any changes in the mixing ratio, those members with existing arrangements should have the option of choosing the mix; otherwise, the change would be a unilateral decision on the part of the Fund.

The staff representative from the Legal Department replied that Mr. Salehkhou's point was dealt with in the decision on enlarged access, which stated that "from time to time the Fund will review the proportions of ordinary and borrowed resources and may modify them." The decision also stated that the amounts purchased under existing arrangements after the modification would be subject to the modified proportions.

Mr. Nimatallah remarked that the proposal of Mr. Zecchini for a relay between the SAMA and Japanese resources would be helpful. However, the amounts were quite small, and not enough of the two loans would be used if the 1:1 ratio were maintained.

Mr. Lundstrom recalled that he had earlier been among those who had not wished to press for a decision at the present meeting but he had then changed his mind; and he was happy to have been included in the Chairman's summing up among those prepared to go along with the use of the Japanese loan under the enlarged access policy and with the recommended changes in the mix.

Mr. Foot asked for clarification of the impact on charges of introducing the Japanese loan into the enlarged access financing.

The Deputy Treasurer replied that because the cost of the Japanese loan was below the existing rate of charge under enlarged access, the effect of introducing the Japanese loan into enlarged access financing would be to reduce the overall charge somewhat. However, the effect was quite small because charges on enlarged access resources were established on the basis of the total cost of enlarged access and total balances outstanding. At least at the beginning, relatively small use would be made of the Japanese loan; in fact, it would be very small.

Mr. Zecchini said that he would appreciate knowing the rates of charge on the SAMA loan and on the Japanese loan, so that he could have a clearer idea about the impact on the basic rate of charge of increasing the share of borrowed resources as a replacement for ordinary resources.

The Deputy Treasurer replied that the current rate of charge on enlarged access--which was determined by loans from SAMA as well as loans from the BIS and other loans arranged in 1984--was just above 7 percent. The rate on the Japanese loan had recently averaged about 6.14 percent. However, the two rates could not be simply averaged, because the higher rate applied to balances of some SDR 10 billion, which dominated the calculations. Introducing some of the financing from the Japanese loan into the calculation would lead to a downward movement in charges, but the change would be marginal at best.

The Treasurer added that, indeed, the change would be nearly invisible, and he would not wish to create the hope or the expectation that introducing the resources from the Japanese loan into those already available under enlarged access would suddenly cheapen the cost of those resources. Even if only resources from the Japanese loan were used--which would mean avoiding the use of SAMA resources entirely--one could expect the use of no more than SDR 300 million, which would have little impact on a base of SDR 10 billion. At best, the cost might decline by one basis point.

Mr. Vasudevan wondered whether, since a change in the mix might mean a greater and more diversified use of the Japanese loan, Mr. Fujino would agree to a change in the mix.

Mr. Fujino replied that, as an Executive Director of the Fund, he could go along with a staff proposal to change the mix; however, in offering the loan, his authorities were not expressing such a preference. The two issues for them must be kept separate.

Mr. Vasudevan, noting that the review of the Fund's liquidity would take place in March, wondered whether decisions on the issue at hand could not be put off until that time.

The Chairman observed that a majority of Directors was apparently willing to use the Japanese resources under enlarged access, with a change in the mix from 1:1 to 1:2. Such an approach would meet Mr. Fujino's concerns about using the loan resources and would have a favorable, albeit marginal, impact on charges. But it should be understood that the changes were open to review and that the approach should not preclude different uses for the Japanese loan in future.

Mr. Vasudevan said that he remained unclear about the rationale for using the Japanese loan in the way outlined by the Chairman. The changes would affect all borrowed resources, not just those under the Japanese agreement, and he was troubled that a decision would be taken in the context of the management of the Fund's liquidity in respect of a particular borrowing arrangement instead of in the more general context of a liquidity review of the sort that would take place in March 1987. Put another way, he was unhappy that the staff had latched upon the opportunity provided by the Japanese borrowing arrangement to slip through a proposal that might have received greater scrutiny from different angles if it had been presented at the time of the liquidity review, when the staff itself had earlier stated it would introduce the issue. That having been said, he did not see any way other than to go along with the majority view.

The Executive Board then took the following decisions:

Borrowing Agreement

Pursuant to Article VII, Section 1 of the Articles of Agreement, the Executive Board approves the agreement for borrowing from the Government of Japan, in terms of the draft set out in the Attachment to EBS/86/265, and authorizes the Managing Director to take such action as is necessary to conclude and implement the agreement.

Decision No. 8486-(86/205), adopted
December 19, 1986

Management of Fund Liquidity - Use of Ordinary and Borrowed Resources Under Policy on Enlarged Access

The Fund decides that, after December 31, 1986, the proportions of ordinary and borrowed resources to be used under stand-by or extended arrangements approved in accordance with Decision No. 6783-(81/40) on the Policy on Enlarged Access will be as follows:

a. Under a stand-by arrangement, purchases will be made with ordinary and borrowed resources in the ratio of 2 to 1 in the first credit tranche, and 1 to 2 in the next three credit tranches. Thereafter, purchases will be made with borrowed resources only.

b. Under an extended arrangement, purchases will be made with ordinary resources and borrowed resources in the ratio of 1 to 2 until the outstanding use of the upper credit tranches and the extended Fund facility equals 140 percent of quota. Thereafter, purchases will be made with borrowed resources only.

Decision No. 8487-(86/205), adopted
December 19, 1986

2. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Fujino at the conclusion of his service as Executive Director for Japan.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/204 (12/19/86) and EBM/86/205 (12/19/86).

3. JAMAICA - OVERDUE FINANCIAL OBLIGATIONS - SETTLEMENT, AND EXTENSION OF REVIEW PERIOD

Paragraph 4 of Executive Board Decision No. 8431-(86/173), adopted October 24, 1986, is hereby amended by deleting in line 2 "within a period of two months" and substituting "not later than December 29, 1986" (EBS/86/239, Sup. 3, 12/16/86).

Decision No. 8488-(86/205), adopted
December 19, 1986

APPROVED: August 6, 1987

LEO VAN HOUTVEN
Secretary