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# INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/50

10:00 a.m., March 29, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

| Executive Directors | Alternate Executive Directors |
|---|---|
| | L. K. Doe |
| C. H. Dallara | M. K. Bush |
| J. de Groote | H. G. Schneider |
| | X. Blandin |
| | T. Alhaimus |
| H. Fujino | M. Sugita |
| | B. Goos |
| | T. Sirivedhin, Temporary |
| | L. Leonard |
| A. Kafka | H. A. Arias |
| | A. K. Juusela, Temporary |
| | S. M. Hassan, Temporary |
| | M. A. Weitz, Temporary |
| Y. A. Nimatallah | J. E. Suraisry |
| P. Pérez | |
| | J. de Beaufort Wijnholds |
| | A. V. Romuâldez |
| G. Salehkhou | O. Kabbaj |
| | A. S. Jayawardena |
| | T. A. Clark |
| | N. Coumbis |
| | Wang E. |

J. W. Lang, Jr., Acting Secretary
S. L. Yeager, Assistant

Also Present

European Department: L. M. Beleza. Exchange and Trade Relations Department: M. Nowak. External Relations Department: D. M. Cheney, P. E. Gleason. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman. Research Department: L. Alexander. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, J. E. Blalock, W. L. Coats, Jr., D. Gupta, Q. M. Hafiz, T. Leddy, A. F. Moustapha, T. M. Tran, B. B. Zavoico. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, G. E. L. Nguyen, D. C. Templeman, N. Toé. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, W.-R. Bengs, G. Biron, M. B. Chatah, J. de la Herrân, R. Fox, V. Govindarajan, N. Haque, G. D. Hodgson, H. Kobayashi, J. A. K. Munthali, K. Murakami, J. Reddy, A. J. Tregilgas, A. H. van Ee, E. L. Walker.

1. LEVEL OF FUND SDR HOLDINGS - REVIEW

The Executive Directors considered a staff paper reviewing the level of the Fund's SDR holdings (SM/85/81, 3/7/85).

Mr. de Groote said that he supported the proposed decision, which he considered was consistent with previous decisions taken by the Board concerning the level of the Fund's SDR holdings. That the Fund could use a considerable amount of the existing stock of SDRs for financing members' use of its resources was a revealing indication of that instrument's financial usefulness, which had much in common with the proposal for conditional use of an SDR allocation. Such a proposal was, in fact, equivalent to a quota increase with the settlement in reserve assets of a fraction of the subscription payment taking place through a simultaneous allocation of SDRs. The mechanism by which the Fund used SDRs in financing its lending policy was an essential feature of the Fund's monetary nature; he regretted that the amount of SDRs available for that use was limited.

Mr. Kafka stated that the Fund should husband such wholly liquid resources as SDR holdings. The question of an SDR allocation would be considered by the Interim Committee at its forthcoming meeting, and the reduction of the Fund's SDR holdings at present would reduce them to a low proportion of total liquid assets even if an additional modest SDR allocation were agreed. He was concerned that by deciding upon a further reduction of the Fund's SDR holdings at the present meeting, the Executive Board would be sending a signal that could be interpreted to mean that it had abandoned the expectation of further SDR allocations in the foreseeable future.

Mr. Leonard saw no reason to doubt the earlier view of the Board that Fund members and not the Fund should hold the bulk of SDRs. Moreover, experience had shown that the Fund did not need to hold large amounts of SDRs to meet its operating requirements. At present, the Fund held a much higher proportion of total SDRs than it needed; it also had available to it ample supplies of usable currencies. Indeed, the ratio of usable assets to liquid liabilities had actually improved over the past year, despite a decline of more than SDR 2 billion in SDR holdings.

Although the impact of a reduction of SDR holdings on the Fund's net income might be cause for concern, Mr. Leonard concluded, he did not consider that factor to be crucial to the decision; accordingly, he agreed to the staff proposal to reduce further the Fund's SDR holdings to about SDR 2.5 billion by May 1986.

Mr. Goos remarked that he supported the proposed decision, albeit with some reservations. As his chair had indicated at the previous review of the level of the Fund's SDR holdings (EBM/84/23, 2/13/84), it would have preferred to see a faster reduction to the target level of SDR 1.5 billion. Whereas the staff aimed at reaching that level only in 1987, he considered that it could be attained already in the next financial year if the Fund's SDR holdings were reduced by a similar amount--some SDR 3 billion--as in the current financial year. Such an accelerated reduction would meet all relevant considerations to be taken into account in determining the appropriate level of the Fund's SDR holdings, including those which were most important--namely, the need to preserve the reserve asset and transaction functions of the SDR and the Fund's need to hold appropriate working balances of SDRs. He asked whether the staff agreed that those requirements could be met by reducing the Fund's SDR holdings to SDR 1.5 billion, or even SDR 1 billion, in the next financial year.

Liquidity and income arguments carried less weight than other considerations, Mr. Goos said in recalling his chair's position at the previous review. That suggested that the Fund's SDR holdings could be minimized. While he certainly agreed with the staff that such holdings were highly liquid, he nevertheless considered that the overall liquidity position of the Fund would not be affected by increasing the use of SDRs within the operational budget because the need for including freely usable currencies would be reduced to the same extent. Finally, his authorities continued to feel that undue emphasis on the income argument in considering the appropriate level of the Fund's SDR holdings could set a bad example for participants in the SDR Department, leading them to base their reserve management decisions increasingly on yield and profit considerations, and thereby threatening the cooperative spirit of the SDR system.

Mr. Juusela stated that in the opinion of his authorities, it was appropriate to limit the Fund's SDR holdings to a level that was sufficient to satisfy the Fund's operational and liquidity needs. He therefore supported the staff's proposal to reduce gradually the Fund's SDR holdings to SDR 2.5 billion by the end of May 1986. Before that time, the Board should again review the matter to determine whether a further reduction was desirable.

Mr. Nimatallah recalled that when the Board previously discussed the level of the Fund's SDR holdings, he had commented that there was a case for the Fund to reduce its holdings in a steady and orderly manner. He therefore noted with satisfaction that those holdings had already been substantially reduced and should be close to the agreed level of SDR 4 billion by the end of May 1985.

In principle, Mr. Nimatallah remarked, he believed that a further substantial reduction of the Fund's SDR holdings was justified. The SDR had been created primarily as a reserve asset for Fund members; the Fund should, therefore, use its own SDRs in transactions with members to the maximum extent possible to promote the SDR as a reserve asset and as a means of payment. Moreover, the Fund was also in a strong financial position, and its holdings of usable currencies were presently at a relatively high level. Scope therefore existed for a further reduction of the Fund's SDR holdings in the period to May 1986 to about SDR 2 billion without impairing the Fund's liquidity. Such a reduction would be fully consistent with the Fund's operational requirements and would have little effect on the Fund's income position. Moreover, the Fund had been able to dispose of SDR 3 billion since early 1984 in a smooth and orderly way; he therefore saw no reason why it could not dispose of a further SDR 2 billion in the coming year without creating difficulties. That action could be facilitated by the projected developments in the Fund's overall liquidity position.

If the Board considered a more reduced target level to be reasonable, Mr. Nimatallah concluded, the proposed decision could be amended to indicate a target level for May 1986 of "approximately SDR 2 billion" rather than "approximately SDR 2.5 billion," as proposed at present.

Mr. Romuáldez supported the proposal to reduce the Fund's holdings of SDRs to approximately SDR 2.5 billion by May 31, 1986. Such a rate of reduction would be similar to that resulting from the Board's previous decision on the level of the Fund's SDR holdings. Moreover, the proposed reduction would not unduly compromise the Fund's net income position, nor would it run counter to the Fund's need for working balances of SDRs. In addition, in forthcoming operational budgets, the implied transfer of SDRs would maintain the proportion of SDRs to total transfers of approximately one half. He also agreed that there should be a further review of the Fund's SDR holdings prior to April 30, 1986.

Mr. Fujino supported the staff's recommendation to reduce the Fund's SDR holdings to about SDR 2.5 billion by the end of May 1986. Reducing the Fund's holdings of SDRs in relation to the total amount allocated would help to preserve the reserve function of the SDR. Moreover, the proposed target of SDR 2.5 billion seemed to be adequate to meet the Fund's liquidity and operational needs. He therefore supported the proposed decision.

Mr. Dallara stated that the arguments presented in the staff paper concerning the reduction in the Fund's SDR holdings appeared balanced and reasonable, with the timing and percentage rate of reduction broadly similar to that agreed in the past. While the exact target was always a matter of judgment, he considered that the proposed reduction was broadly appropriate, and he supported the proposed decision.

Mr. Salehkhou remarked that the staff paper had reiterated a number of considerations that had justified the earlier Board decision to reduce the level of the Fund's SDR holdings, including the relation of those holdings to total SDR allocations and the Fund's need for working balances, and had proposed a further reduction of the Fund's holdings to SDR 2.5 billion by May 1986. In his view, in reaching a decision, account should be taken of the impact of SDR holdings on the Fund's net income position and thus on the rate of charge--particularly as there seemed to be no evidence that the apparent concentration of SDR holdings had had any adverse effect on SDR transactions. He would thus prefer a somewhat slower reduction, but if a majority of the Board supported the staff proposal, he could also support it.

Mr. Pérez; Messrs. Alhaimus, Blandin, Clark, Coumbis, and Wijnholds; Mrs. Sirivedhin, and Mr. Weitz indicated their support for the proposed decision.

The Treasurer, commenting on Mr. Goos's proposal for a faster reduction of the Fund's SDR holdings toward the target level of SDR 1.5 billion and the possible impact on the Fund's financial operations, remarked that the staff had regarded SDR 2.5 billion as an adequate target, taking into consideration all relevant factors. While those were clearly matters of judgment, a target of SDR 2.5 billion would maintain the approximate mix in the sale of currencies in the operational budget; if the rate of reducing SDR holdings was increased significantly, the use of currencies would be diminished, which could lead to an unequal use of usable currencies in the execution of the operational budget. The net reduction would therefore be more orderly if the proportion of SDRs to usable currencies in the budget were approximately similar to the current amounts, keeping in mind that the volume of purchases would eventually determine how many SDRs could be sold on a gross basis. Moreover, in proposing a target of SDR 2.5 billion, the staff also had in mind the consideration mentioned by Mr. Kafka--namely, the need to avoid giving an inappropriate signal regarding the possibility of future SDR allocations; therefore, the proportions and the rate of reduction that had prevailed in the past had been maintained.

Furthermore, the Treasurer noted, SDR 2.5 billion was a target; whether it could be achieved and with what degree of precision depended on a number of factors, many of which were beyond the Fund's control. The word "approximately" therefore indicated a margin in the order of SDR 100-200 million. Since the staff paper had been issued, events had made it less likely that the target for the current year would be reached; delays in making some large purchases because of slippages might recur.

Given the differential between the rate of remuneration and the present SDR interest rate, the effect on the Fund's net income for FY 1986 would be about SDR 13 million, the Treasurer observed. If the target was SDR 2.0 billion instead of SDR 2.5 billion, as Mr. Nimatallah had proposed, the Fund's net income would be reduced further by approximately SDR 4.25 million. The effect on the rate of charge would probably be less than 0.02 percent, which would disappear in rounding.

The Executive Board then took the following decision:

> In determining the amounts of SDRs to be transferred in purchases under the operational budgets, the Fund will be guided by the aim of reducing the Fund's SDR holdings to a level of approximately SDR 2.5 billion by May 31, 1986. Prior to April 30, 1986, the Fund will review the level of its SDR holdings to determine whether and to what extent they should be reduced further.

Decision No. 7941-(85/50) S, adopted
March 29, 1985

## 2. LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors considered a staff paper on the Fund's liquidity position and prospective financing needs through the end of 1985 (EBS/85/56, 3/7/85).

The Treasurer remarked that since the staff paper had been issued, the Executive Board had approved an operational budget in which Venezuela's balance of payments and reserve position had been judged to be sufficiently strong to allow the use of the Venezuelan bolívar in the Fund's transactions. Consequently, the Fund's stock of usable currencies had been augmented by about SDR 700 million.

Mr. Jayawardena observed that the Fund's present liquidity position was apparently comfortable, and, based on current projections, it might not have more than a small commitment gap in 1986. He welcomed that development to the extent that it indicated that the Fund was managing its receipts and payments well; a financially strong Fund would be able to serve its members better. He was, however, somewhat concerned that a liquidity balance was being achieved through a contraction of the Fund's activities, because that would impair the capacity of the Fund to assist needy members with adequately appropriate levels of financing, especially at a time, when large numbers of major debtor countries and low-income countries were approaching the Fund for assistance. He wondered whether the Fund was compressing the demand for its resources to match the existing supply rather than working to increase the supply of resources in order to meet all legitimate demands of its members.

As the Ministers of the Group of Twenty-Four had mentioned in their communiqué of September 21, 1984, the evolution of Fund policies since 1983 had tended to reduce member countries' access to Fund resources and to increase the burden of adjustment, Mr. Jayawardena continued. At present, the staff projected that members might not need to borrow large amounts even in 1986; moreover, because of large repayments by members, the Fund could end up with a net surplus, especially from April 1986 onward. That picture contrasted sharply with the assertion made in September 1983 that even with an access limit of 102 percent of quota, the Fund would need to borrow SDR 8 million before April 30, 1986. That dramatic turnaround was the result of several policies, inter alia, a substantial reduction in access limits under the enlarged access policy and special facilities; the constraint of actual access under the reduced limits in an effort to match the intensity of adjustment and access; and, as many countries were perceived to have problems that would take a long time to resolve, the need to conserve available limited resources for future use. Consequently, in his view there had been a tightening of conditionality under the general access policy as well as under the special facilities.

Achieving liquidity balance through demand contraction was not consistent with the Fund's role at the center of the international adjustment process, Mr. Jayawardena remarked. While it was true that the Fund was not a development institution, the Fund should not be antidevelopment;

hence, it must start evaluating its policies with a view to improving them. First, given the harsh adjustment efforts being undertaken by many countries, current access limits should be reviewed, because many countries were reaching the upper end of their access limits. Second, the process of calibrating resource availability and the degree of adjustment should also be reviewed, as resource rationing appeared to have lost its influence in the international adjustment process. Third, an increasing number of countries, other than the major debtors, were having serious balance of payments problems and were not even able to meet their obligations to the Fund. Their cases, along with those of small-income, small-quota countries, should be studied to determine how the Fund could help them. Fourth, the Board should consider restoring access to the special facilities to the former levels. The World Economic Outlook forecast clearly indicated that commodity prices were likely to weaken; hence, members might be faced with sharp export shortfalls in the near future. Moreover, a number of countries were reaching the maximum access limit under the compensatory financing facility; in his view, the conditionality attached to upper tranche compensatory financing drawings might also be reviewed. To meet the increased demand for Fund resources that was likely to ensue, the Fund might consider negotiating new borrowing arrangements, which it could undertake prudently. The Board should also start thinking about the ninth quota review.

The Fund should take those steps, Mr. Jayawardena concluded, in order to fulfill its role as set forth in Article I(ii) of the Articles of Agreement--namely, "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."

Mr. Kafka remarked that he shared Mr. Jayawardena's impression that the staff paper had approached the problem backward. That no new borrowing need was foreseen for the time being, and only a modest one for 1986, reflected not so much the improving balance of payments position of member countries or even existing maximum access limits but rather the particularly restrictive manner in which access policies were being applied within the maxima. That was true of the Fund's policies on use of the credit tranches as well as of its special facilities, which had been transformed into unrecognizable appendices to the tranche policies. No doubt the staff forecast also reflected the attitude of potential official lenders and their refusal to allow the Executive Board to let the Fund approach the private market, even on an experimental basis.

The staff was well advised, Mr. Kafka continued, to warn Executive Directors that "notwithstanding the apparent strengthening in the Fund's liquidity position, a series of uncertainties exist which can change the prospects, and this can happen quite rapidly." Those uncertainties included the external position of some Fund creditors, including industrial countries, and the weakness of commodity prices.

The Fund's financial position, even if momentarily safe because the Fund was lending too little as a result of its restrictive policies, was not a wholly comfortable one, Mr. Kafka concluded. He regretted in particular the potential for nonuse of the General Arrangements to Borrow (GAB) by nonmembers of the GAB, and the absence in the international financial system of institutional bridging financial facilities for the great majority of the Fund's member countries. He agreed with Mr. Jayawardena that the Executive Board should reconsider both the Fund's need to borrow and an early enactment of a ninth quota increase.

Mr. Doe recalled that on the occasion of the previous review in September 1984 (EBM/84/134 and EBM/84/135, 9/5/84), concerns had been expressed about a possible weakening of the Fund's liquidity position, and a commitment gap of SDR 1 billion had been projected for the second half of 1985. He was pleased to note that the expected weakening had not occurred and that no gap had emerged; instead, the Fund's liquidity position had continued to be quite comfortable and was expected to remain so throughout 1985. According to the staff's assumptions, a marginal commitment gap of borrowed resources amounting to SDR 0.4 million could emerge at the end of 1986. Considering the highly tentative nature of that projection, he agreed with the staff that no new borrowing arrangements were required at present; the financing of the commitment gap, if any, could be appropriately dealt with later in the year when more information on the demand for Fund resources had become available.

The improvement in the Fund's liquidity position, Mr. Doe continued, reflected, inter alia, the reduction in the access ratios, their restrictive application, and the tighter adjustment required of borrowers in the form of lower imports and reduced government spending. On that particular point, he fully shared the views expressed by Mr. Jayawardena. Moreover, from 1986 onward, the Fund would benefit from substantial inflows of resources stemming from repurchases by member countries; according to staff estimates, those inflows would reach SDR 8 million annually from 1987 to 1989, thereby strengthening the Fund's liquidity position. In his view, those developments should not be construed as reflecting reduced need for Fund financial assistance, or as a justification for either further reductions in access limits or the termination of the enlarged access policy.

Mr. Salehkhou stated that the present review of the Fund's liquidity and financing needs clearly indicated the continuation of a comfortable financial position through 1986, despite traditionally conservative and prudent assumptions by the staff in estimating the availability of usable resources. Staff projections showed no commitment gap for 1985 and only a small gap of SDR 0.4 billion for 1986. Thus, as there would be a positive net balance of undisbursed credit lines at the end of 1986, and as the projection was highly tentative, he concurred with the staff that consideration of how to deal with the projected gap could be postponed until the next review of the Fund's liquidity.

Besides the availability of usable ordinary resources, the most important element of the staff estimates related to the expected net use of Fund resources, which was projected to decline to SDR 3.3 billion in 1985 and to SDR 0.3 billion in 1986, compared with SDR 5 billion in 1984, Mr. Salehkhou added. That trend reflected in part higher repurchases by Fund members, particularly of compensatory financing drawings, and much lower new commitments under stand-by and extended arrangements, which, in the staff's view, reflected the improved reserve positions and strengthened current accounts of non-oil developing countries. For a number of reasons, however, that explanation seemed to be too narrow. The staff had not assessed to what extent the lower demand for Fund credit might reflect reduced formal as well as actual access to Fund resources since the previous quota increase or the tightening of Fund conditionality. Whereas the 1984 review of Fund liquidity had outlined the basic assumptions with respect to the distribution of access between stand-by and extended arrangements and to the expected average level of access under individual programs, the present staff paper provided only broad figures for new commitments. It would also have been illuminating to assess the possible impact on the demand for Fund resources of the increasing cost of the use of those resources, which, in the past two years, had seemed to have reduced the concessionality and the attractiveness of Fund financing.

The Board's discussion of trade issues and developing countries' foreign indebtedness (EBM/85/44, 3/18/85; EBM/85/45 and EBM/85/46, 3/20/85) had clearly indicated that the improvement in those countries' overall external positions needed to be qualified to take into account its uneven character and the uncertainties with respect to its sustainability, Mr. Salehkhou recalled. The discussions had also underlined the crucial role the Fund was expected to play in helping to remove those uncertainties. Thus, the tendency toward reduced Fund financing and the pronounced shift from extended to stand-by arrangements appeared to be inappropriate and hardly consistent with the balance of payments needs of member countries or with a role of the Fund commensurate with the considerable adjustment efforts yet required. He therefore believed that the present and prospective liquidity of the Fund amply justified a reversal of those tendencies, which would also strengthen the Fund's credibility--an issue which had increasingly become a concern of some of his colleagues during recent Board discussions.

Mr. de Groote observed that the need to preserve the revolving character of the Fund's resources had been at the center of Board discussions on the Fund's financing role over the past few years. Directors had agreed that the prolonged use of Fund resources would impair the Fund's ability to monitor and finance balance of payments maladjustments. And some Directors considered that the revolving character of the Fund's resources might have been endangered by the financing policies that had been implemented following the second oil shock. The analysis in the present staff report demonstrated that the successful implementation of the adjustment policies advocated by the Fund and undertaken by the large majority of deficit member countries had contributed to a reduction in the Fund's lending activity.

The revolving character of the Fund's resources had to be appreciated in a medium-term framework and in relation to the impact of variable economic conditions on member countries' external positions, Mr. de Groote considered. For a while member countries had had to rely substantially on Fund resources to ease their adjustment process because of the world economic environment. The Fund's ability to respond rapidly and in appropriate amounts to those requests had been decisive in helping those members to re-establish viable external positions and obtain from other sources the complementary financial assistance needed during the initial phase of the adjustment process. The improved economic environment at present afforded the Fund an opportunity to replenish its financial resources without impeding access by member countries who were still in the process of correcting their economic imbalances under Fund-supported adjustment programs. The current trend in the Fund's lending activity should therefore be welcomed and supported.

Another reason for reconstituting the Fund's resources, Mr. de Groote remarked, was the need to increase the Fund's capacity to intervene more intensively in the years ahead if required. In view of the degree of uncertainty of some assumptions on which the staff had based its assessment of the world economic outlook, the baseline scenario was far from certain, and the evolution of output in the industrial world and exchange rate developments might create tensions in the international monetary system in coming years. Developing countries in particular might have to appeal more actively for Fund assistance if appropriate policies were not pursued in the OECD countries.

Because of its limited magnitude--SDR 0.4 billion--the commitment gap of borrowed resources projected for 1986 did not seem to be very relevant, Mr. de Groote commented. The staff's presentation could even lead to the conclusion that the enlarged access policy, as presently defined, could be maintained without giving rise to financing constraints. Indeed, the forecasts suggested that the enlarged access policy might be financed in the future by ordinary resources if no particular tension arose in the international payments system. In conformity with the requirements for the activation of the GAB, resources could be used if the situation of some countries with large quotas threatened the international payments system.

Mr. Nimatallah stated that it was clear from the staff paper that the Fund's liquidity position was comfortable at present. That was encouraging and meant that the Fund was well placed to respond more flexibly to the expected financing needs of its members. Moreover, he agreed with the staff's general assessment that the Fund's liquidity position was likely to remain comfortable for the rest of 1985, barring any major shocks. There was therefore no need for the Fund to consider further borrowing at present.

For 1986, Mr. Nimatallah remarked, the position was inevitably less clear, but present indications were that it should remain broadly satisfactory. Considering the tentative nature of the staff's projections, he believed that it would be prudent for the Board to wait until the next liquidity review before coming to any conclusion regarding borrowing needs.

Finally, Mr. Nimatallah said that he appreciated the clear presentation in Table 1 for assessing the various ratios of Fund liquidity. Those ratios were very useful tools. He noted with satisfaction that Appendix Table 2 showed that the quota ratio was moving in the right direction. The liquidity ratio, however, was expected to decline to about 65 percent at the end of 1985: that ratio should be monitored very carefully. As a minimum, he hoped that it would stabilize in 1986 as the staff had projected, and he looked forward to that ratio again approaching the December 1981 level of 85 percent. He also noted the projected fall of the asset ratio below 100 percent, and hoped to see that ratio move upward toward the December 1981 level in the near future.

Mr. Goos considered that the staff had provided a thorough examination of the factors bearing on the Fund's liquidity position. While that examination had necessarily rested to a large extent on various estimates and adjustments which were difficult to verify, he felt that the liquidity projections presented in the staff paper were reasonable. He therefore agreed that the Fund's liquidity position could be considered to be comfortable, even taking into account the various uncertainties affecting the evolution of the stock of usable currencies in the foreseeable future. In that context, he welcomed the Treasurer's statement that the stock of usable currencies had been increased by the inclusion of the Venezuelan bolívar in the currency budget. Consequently, like the staff, he did not envisage any need to increase the Fund's credit lines or to activate the GAB for the remainder of 1985.

With regard to the possible commitment gap of borrowed resources that might emerge in 1986, Mr. Goos supported the staff's proposal to reconsider that issue later in the year in the light of the results of the forthcoming review of access limits and firmer indications of prospective drawings on the Fund's resources.

Mr. Weitz noted that no important changes had occurred in the Fund's liquidity position since the previous review in September 1984. The liquidity position at present was comfortable and likely to remain so for the remainder of 1985; the relevant ratios used in assessing the appropriateness of the liquidity position remained within desirable levels and represented objective indicators that the stock of available resources was in line with the financial commitments and other demands on the Fund's resources. He therefore shared the staff's view that no action by the Board was required at present and that the coming half-yearly review of the Fund's financial position would provide a more appropriate basis for assessing whether a need existed for further borrowing by the Fund to meet a possible commitment gap for 1986.

An important aspect of developments in the Fund's liquidity position was the decline in the net expansion of outstanding Fund credit, which, according to staff projections, would increase by only 6 percent in 1986 compared with 1984, Mr. Weitz continued. Moreover, scheduled repurchases in the years ahead--in particular in 1987-89--would be substantially greater than in 1985-86, which could easily lead to a net contraction of outstanding Fund credit if the projected use of Fund resources continued its current trend. That should be borne in mind when the Board again considered access limits to Fund resources and the appropriate mix of ordinary and borrowed resources within the context of the enlarged access policy. The present comfortable liquidity position reflected to a large extent the restrictive access to resources and the increasing conditionality that most developing countries currently faced when embarking on adjustment programs supported by the Fund.

The strengthening of the Fund's liquidity position as well as the Fund's income position were welcome developments, Mr. Weitz concluded. However, they were not goals per se, but rather a means for achieving the ultimate objectives of the Fund--namely, to promote orderly adjustment in countries facing external imbalances through appropriate corrective measures and adequate financial support.

Mr. Leonard remarked that within the present framework of Fund activities, the Fund's liquidity position for 1985 seemed very comfortable. Nevertheless, apart from the several caveats with which the staff had prudently qualified its conclusions, he had a further concern: the staff paper did not indicate whether overdue obligations had been taken into account in estimating the resources available to the Fund in 1985, although they might have been considered in estimating the use of resources. If they had not been fully taken into account, the situation presented in the staff paper would not accurately represent the Fund's real liquidity and financing needs and there might be reason to take action of some kind. He asked the Treasurer for further clarification on that point.

Although there was a possibility of a commitment gap appearing in 1986, Mr. Leonard noted, the projected gap was small. He therefore agreed with the staff that a decision on any action by the Executive Board should await the review of the Fund's financial position for 1986, at which time the Executive Board would be able to take into consideration any policy developments on access limits.

Finally, Mr. Leonard stated, some of his authorities felt that in view of the continuing need for adjustment and external financing in many developing countries, the implications of the projected decline in the net use of Fund resources should be kept under review.

Mr. Pérez commented that the staff report clearly showed the strengthening of the recent trend toward a more comfortable liquidity position, which should provide more room for maneuver in meeting members' demands for Fund resources. The Fund's liquidity position was expected to continue to improve in 1985 and 1986, which should also allow the Fund to implement policies with a longer-run perspective. Considering the traditional conservatism of the staff's estimates on liquidity matters, the projections for 1986 could be viewed as an indication of the absence of liquidity constraints in the near future, which would enable the Fund to continue operating on the assumption that additional borrowed resources were not immediately needed.

The coexistence of a comfortable liquidity position and restrictive financing policies could be seen as a paradox, Mr. Pérez considered. The trend toward reduced access limits to Fund resources clearly indicated a tight access policy that appeared even more restrictive when effective limits were considered. Moreover, the conditionality attached to Fund-supported programs added further stringency. Both reduced access and increased conditionality were forcing countries to implement stronger programs with higher social and economic costs than would be required under less stringent Fund policies. A reconsideration of the essential function of the Fund's liquidity position was therefore timely. While a satisfactory liquidity level had to be maintained for the Fund's working balances, a comfortable liquidity position should have a direct bearing on the degree of restrictiveness of the Fund's policies and on the supply of additional resources available to its members. Although the liquidity problem suffered by the Fund since 1983 could explain the move toward more cautious policies, in his view, there was no clear justification at present for applying restrictive access policies and stringent mechanisms that imposed greater conditionality.

In the light of the current state of the Fund's liquidity, Mr. Pérez concluded, he urged the Executive Board to reorient part of the expected flow of repurchases to ease the excessive burden being carried by debtor member countries.

Mr. Fujino remarked that the staff's projection that the Fund's liquidity position was likely to continue to be comfortable during the remainder of 1985 seemed to be broadly reasonable as was its forecast for 1986, assuming that policies on access to the Fund's resources remained unchanged. However, the Fund's liquidity position should be carefully watched, given the uncertainties and downside risks pointed to in the staff paper.

As to the commitment gap of SDR 0.4 billion in borrowed resources projected for 1986, Mr. Fujino supported the staff's proposal to examine that question on the occasion of the next liquidity review in the latter half of 1985 when a clearer picture of the Fund's liquidity and financing needs had emerged.

Mrs. Sirivedhin noted with satisfaction that the Fund's liquidity position was better than had been expected during previous reviews. In September 1984 the staff had expected that a small commitment gap of about SDR 1 billion would arise in the second half of 1985; at present, a much smaller gap was projected, but not until the second half of 1986, if at all. She agreed with the staff that no action was called for by the Executive Board at present.

The causes and consequences of those favorable developments deserved close scrutiny for several reasons, Mrs. Sirivedhin continued. New commitments by the Fund during 1984, which had amounted to SDR 4.1 billion, were far below the SDR 7.5 billion projected in March 1984. New commitments for 1985 and 1986 were expected to be slightly below those for 1984, reflecting not only the trimming of access limits, but also a trend toward smaller purchases in relation to those limits. Moreover, it was unlikely that the improvement in the Fund's liquidity could be wholly attributed to the improved current account positions of its members; tighter conditionality associated with Fund arrangements had undoubtedly played a role.

Repurchase amounts would increase substantially over the next two years, Mrs. Sirivedhin observed. In 1986, repurchases were expected to actually outpace new commitments. If current account developments in borrowing countries did not progress as expected, the onset of repurchases might have adverse implications for their economies. The Fund's comfortable liquidity position would not preclude a more liberal access policy; indeed, a more liberal policy might be justified by future developments.

In concluding, Mrs. Sirivedhin expressed the hope that those points would be borne in mind during future deliberations on access limits and conditionality as well as on the world economic outlook.

Mr. Blandin fully concurred with the staff's assessment that the Fund's liquidity position appeared comfortable for 1985 and that it would remain broadly satisfactory in 1986. It was noteworthy, however, that that development reflected a sharp decrease in the net use of Fund credit, which was projected to reach only SDR 3.3 billion in 1985 and to disappear almost completely in 1986. The staff had attributed that favorable trend to the sharp increase in repurchases--SDR 6 billion in 1986, compared with SDR 2.3 billion in 1984--and to the improved underlying economic conditions, in particular the strengthening of the current account and reserve positions of the non-oil developing countries. That improvement was, in turn, reflected in the sharp decrease of purchases from SDR 12.6 billion in 1983 to SDR 7.2 billion in 1984 and SDR 6.8 billion in 1985. Considering the difficult economic conditions that member countries continued to face, the consequences of those trends should undoubtedly be kept under careful review.

The commitment gap projected for the first half of 1986 was very small, Mr. Blandin remarked. Also, the projection was subject to a number of uncertainties, especially with respect to the issue of access limits, which would be re-examined later in 1985. He therefore agreed with the staff that there was no need at present to consider additional borrowing to cover the gap; that decision could be delayed until the next review of the Fund's liquidity position in light of the Board's review of access limits and prospective borrowing needs for 1986. It would then be helpful also to consider whether a new mix of borrowed and ordinary resources--with an increase in the proportion of ordinary resources--would not be sufficient to fill the projected gap, if it actually developed.

Mr. Wang stated that the Fund's liquidity position was at present comfortable and likely to be so until the end of 1986. A large number of Fund members, especially debtor and low-income countries, were still in urgent need of resources. Consequently, there was not only a need, but also ample room for the Fund to provide more assistance to those countries while maintaining adequate safeguards for its own liquidity; that should be kept in mind when Directors evaluated the major policy issues regarding the use of the Fund's resources in order to better serve the interests of members. His chair also supported the comments made by Mr. Jayawardena in that respect.

Mr. Alhaimus said that the considerable improvement in the Fund's liquidity was welcome, and he had no difficulties with the staff's calculations and projections. The only problem foreseen was the possible emergence of a commitment gap of borrowed resources in 1986; that did not seem to be a cause for concern, as the projected magnitude of the gap was small and the estimates were still highly tentative.

Actual implementation of access limits had contributed to the high level of liquidity, Mr. Alhaimus remarked. The expectation that by 1986 no net flow of Fund credit would occur did convey an indication of the Fund's attitude toward its financing role in the current circumstances. However, that issue was perhaps more relevant to the Board's consideration of the world economic outlook and its future discussions on access to Fund resources.

Mr. Romuáldez agreed with the staff's assessment of the Fund's current and prospective liquidity position and thus no action was called for at present. In addition, he supported the suggestion that the Fund's borrowing needs in 1986 be considered in connection with the reviews of the Fund's liquidity and access limits, which were scheduled for later in the year.

Mr. Wijnholds remarked that staff estimates showed that the Fund's liquidity position in 1985 and 1986 would again be more favorable than had previously been assumed. The addition of the Venezuelan bolívar to the usable currencies had also been unexpected. The possibility that a smaller number of usable currencies would be available in the future or that new credit commitments would turn out to be larger than estimated did not seem likely to threaten a substantial deterioration of the liquidity position in the short run.

Against that background, Mr. Wijnholds added, the relatively small commitment gap projected for 1986--which was clearly within the margin of error--was not a cause for action at present. However, the Fund's possible borrowing needs in 1986 should be considered, together with the normalization of access limits, later in the year. He continued to believe that a shortage of borrowed resources--as had briefly occurred in 1983--should be avoided.

Mr. Clark stated that like most other speakers, he believed that the Fund's liquidity situation remained comfortable, as far as could be assessed given the many uncertainties that underlay the staff's projections. Among those uncertainties, he joined Mr. Leonard in asking the staff to indicate in particular how overdue obligations might affect the position on borrowed resources. While the scale of the overdue payments problem remained large or continued to grow, the Fund must be very cautious about its liquidity position.

As only a modest commitment gap for borrowed resources was envisaged, and then only in the first half of 1986, Mr. Clark continued, the discussion of how to finance that gap could be postponed. In view of the uncertainties in the world economic outlook, however, he would have liked to see the staff make some quantification of the effect of downside risks. He wondered, for instance, whether the improvement in the liquidity position since the previous review had been very significant compared to the margins of error surrounding the exercise; at the moment, however, he had no idea of what those margins were. Although a full-fledged sensitivity analysis might be too elaborate, an indication of orders of magnitude should be provided for the next review.

In considering ways of financing the prospective commitment gap for 1986, Mr. Clark considered that a flexible approach should be maintained. For example, a review of the mix of ordinary and borrowed resources and the implications for the Fund's liquidity would be of interest.

Mr. Coumbis said that his authorities agreed with the staff analysis of the overall position of Fund liquidity, in particular that the liquidity position was comfortable at present and would continue to be so for the remainder of 1985. They also supported the staff's suggestion to consider the Fund's borrowing needs for 1986 later in 1985. In addition, he noted the considerations enumerated by the staff concerning future economic developments that might seriously affect the Fund's liquidity and looked forward to discussing those considerations during the Board's review of the world economic outlook. Finally, he considered that the concern raised by Mr. Jayawardena and others would be more properly discussed in the context of the Board's consideration of conditionality or the world economic outlook.

Mr. Juusela stated that at present the Fund's liquidity was at an acceptable level with respect to both ordinary and borrowed resources, but that according to staff projections a small commitment gap of borrowed resources might emerge in 1986. Many uncertainties, however, underlay the staff's projection regarding the use of Fund resources in 1986, including those associated with the review of guidelines on access limits scheduled for the fall. Therefore, consideration of possible further borrowing by the Fund could be postponed until the next liquidity review later in 1985.

Mr. Dallara remarked that he was heartened to learn that the Fund's liquidity position was at present comfortable and that it should remain so through 1985 (based on current projections), especially since the staff had previously projected a commitment gap for the end of 1985. A number of developments had given rise to the more favorable liquidity position. The lower than anticipated operations of the Fund, to which many Directors had referred, was due to a variety of factors. The adjustment efforts of many Fund members, along with the world economic expansion presently under way, were, as Mr. de Groote had noted, two important factors which, along with the need to ensure the revolving character of the Fund's resources, had played an important role in achieving the current position. Indeed, continued adjustment efforts and the further expansion of the world economy would provide the basis for continuing the policy of phasing out enlarged access as well as for the implementation of other aspects of access policy.

Mr. Hassan welcomed the comfortable liquidity position projected for 1985, which had resulted largely from a significant slowdown in demand for Fund credit. He doubted, however, that the slowdown could be explained solely by improvements in the underlying balance of payments positions of member countries, because the pickup in the world economy was still limited to the industrial countries, and many developing countries were still in the throes of recession. It was especially noteworthy that the heavy debt burden, and in some developing countries--particularly in Africa--the vagaries of weather conditions, had resulted in a further deterioration of balance of payments positions, making the need for Fund support even more critical.

Considering that the balance of payments need of many countries had so far not abated, Mr. Hassan continued, clearly the reduction of the enlarged access limits to 95 percent and 115 percent of quota, coupled with further deliberate management policies resulting in effective limits not exceeding 60 percent of quota, as well as the continued tightening of conditionality, had served to constrain demand for the Fund's resources. That constraint was in part evidenced by the expectation that a total of 11 arrangements involving SDR 2.3 billion would either not be concluded or would be delayed until 1986.

The improvement in the Fund's liquidity position in 1985 was therefore an anomaly brought about by the artificial suppression of demand for Fund resources, which his chair could not support, Mr. Hassan remarked. The suppression of demand was particularly unfortunate at a time when compelling reasons existed for strengthening the Fund's support of the adjustment process. If care were not taken, the apparent improvement in the Fund's liquidity position might create the false impression that members' financing needs no longer warranted the continuation of the enlarged access policy; it could even be used to blunt arguments for new quota increases, with dire consequences for the international monetary system. In the next few years the external indebtedness of developing countries would remain burdensome. Furthermore, access to private capital markets, particularly for most African countries, had been virtually closed while their share of official development assistance had been seriously eroded. In the circumstances, a meaningful and durable adjustment could only take place if Fund support were sustained in substantial amounts.

In concluding, Mr. Hassan said that he supported the suggestion that the commitment gap that might emerge toward the end of 1986 be considered at the next half-yearly review of the Fund's liquidity position.

The Treasurer, commenting on the effect of overdue obligations on the Fund's liquidity, remarked that the stock of usable currencies reported by the staff did not include repurchases that had not been made on schedule. The projections for 1986 did not take into account possible delays in payments to the Fund for two reasons: the staff did not wish to make an assumption about an increase in those arrears that would reduce the projection of the stock of usable assets in the future, and current arrears were in the order of SDR 220 million, which, compared with the stock of usable currencies and the overall liquidity of the Fund, was of marginal importance. The staff had indeed considered what amount of the total repurchases due in 1985 might be at risk; although that was an extremely difficult judgment to make, the staff felt that the amount was not a substantial proportion of the total and therefore had decided not to refer to the issue in its report. If the staff had concluded that there were substantial risks which would affect the Fund's liquidity, it would have so informed the Board.

The reduction in the concessional element in the Fund's charges was more the result of declining market rates than of increases in the Fund's charges, the Treasurer noted. Increases in the Fund's charges had been relatively small compared with the reduction in market interest rates, which were used as a standard of comparison to calculate the concessional element. More important, the Fund's rate remained concessional, and as long as there was a choice between two sources of credit--all other things being equal--members would be expected to turn to the cheaper source. Consequently, in his view, a reduction in concessionality had not been an important consideration in members' requests for the use of Fund resources.

Noting that some Executive Directors had spoken about a slowdown in demand for Fund resources, the Treasurer observed that the wording used by the staff--on page 4 of EBS/85/56 in referring to a slowdown in the rate of net credit expansion--had been more precise in that it drew a distinction between gross demand, which was continuing at a high level, and net demand. For example, Table 2 indicated under heading B(1)(a) that purchases under arrangements had been SDR 2.9 billion in 1984, would be SDR 2.1 billion in 1985, and rise again--to SDR 2.9 billion--in 1986. Moreover, total purchases had been SDR 3.7 billion in 1984, were estimated to be SDR 3.1 billion in 1985, and SDR 3.9 billion in 1986. The gross demand for Fund resources, therefore, continued to be quite significant, although there was a net slowdown--and perhaps a standstill in the course of 1985-86--as a result of a reflux of resources following large-scale lending by the Fund.

The Chairman, in summing up the discussion, noted that the Fund's liquidity position was at present comfortable and should remain so throughout 1985. Given the small commitment gap of borrowed resources foreseen for 1986, Directors had agreed that no action was called for at present. The Fund's borrowing requirement would be reviewed by the Board during the next half-yearly review of the Fund's liquidity position. The factors giving rise to a more comfortable liquidity position had been foreseen in previous staff papers; they were related to a variety of developments, including the improvement in the world economic situation, and the favorable impact of adjustment efforts on the balance of payments positions in several member countries. Some Executive Directors had underlined the positive aspects of the improved liquidity position, stressing the revolving character of the Fund's resources and the normal reflux of funds following the large expansion of credit by the Fund at the peak of the debt crisis. Other Directors considered that the reduction of access limits--and in particular, the application of the access policy in individual cases--had played a major role in the improvement of liquidity. Considering the circumstances that those countries engaged in adjustment efforts faced, those Directors had called for some review of Fund policies toward "less strict" conditionality. The situation for 1986 was more difficult to assess, given the uncertainties relating to the world economic situation, the balance of payments trends in some industrial countries, and the possible impact of overdue obligations on the Fund's liquidity position. A number of Directors had underlined the need for the Fund to remain in a strong financial position and to monitor the liquidity situation very closely.

Management had sought to apply the policy on access prudently, the Chairman observed, taking into account the need--strongly expressed by the Board--to avoid excessive, prolonged use of large amounts of Fund resources as well as to keep the Fund in a position in which it could continue, albeit in a more catalytic fashion, to help countries that were engaged in a long-term adjustment process. The very large repurchases that were to take place in 1985, and to increase even more rapidly in 1986-89, represented the normal reflux of the very large disbursements that the Fund had made to assist countries over the past few years.

In view of all those considerations, the Chairman urged Executive Directors to examine carefully all the elements of the problem before reaching conclusions regarding the Fund's access policy. Given the uncertainties prevailing in the world economy and in the years ahead, he considered that a flexible and cautious approach to access was called for, and that the liquidity position of the Fund must be kept very strong in order to face the possibly difficult payments situations that might arise.

## 3. KIRIBATI AND TONGA - MEMBERSHIP - COMMITTEE

The Chairman informed the Executive Board that applications for membership from both Kiribati and Tonga had been received in the Fund on July 18, 1984 and January 16, 1985, respectively. He proposed the establishment of a joint ad hoc membership committee to consider the two applications consisting of Mr. Joyce, Chairman; Mr. Ismael; Mr. Pérez; Mr. Rye; Mr. Sengupta; and Mr. Wicks.

The Executive Directors approved, without discussion, the Chairman's proposal.

## DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/49 (3/25/85) and EBM/85/50 (3/29/85).

## 4. GHANA - FUND REPRESENTATIVE

The Executive Board approves the proposal to open a Fund resident representative post in Accra, Ghana, as set forth in EBAP/85/74 (3/21/85).

Adopted March 25, 1985

## 5. STAFF RETIREMENT PLAN - SUPPLEMENTAL BENEFIT PLAN

The Executive Board approves proposal to establish a supplemental benefit plan as set forth in EBAP/85/75 (3/21/85).

Decision No. 7942-(85/50), adopted
March 27, 1985

## 6. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/85/78 (3/25/85).

Adopted March 27, 1985

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/77 (3/25/85) and EBAP/85/79 (3/26/85) and by an Assistant to Executive Director as set forth in EBAP/85/76 (3/22/85) is approved.

APPROVED: January 31, 1986

LEO VAN HOUTVEN
Secretary