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Minutes of Executive Board Meeting 85/102

10:00 a.m., July 1, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. R. Ismael, Temporary
	M. K. Bush
J. de Groote	
B. de Maulde	
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
J. E. Ismael	Jaafar A.
	L. Leonard
A. Kafka	H. A. Arias
H. Lundstrom	
E. I. M. Mtei	A. Abdallah
	M. A Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
J. J. Polak	
C. R. Rye	
	R. Msadek, Temporary
	A. S. Jayawardena
	V. Govindarajan, Temporary
	T. A. Clark
	I. Angeloni, Temporary
Zhang Z.	

L. Van Houtven, Secretary
B. J. Owen, Assistant
J. Oppenheim, Assistant

Also Present

Asian Department: Tun Thin, Director; K. A. Al-Eyd, W. G. L. Evers, S. Kohsaka, L. Mendras. Exchange and Trade Relations Department: M. Guitián, Deputy Director; J. P. Guzman. IMF Institute: C. Tognetti. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, A. O. Liuksila, S. A. Silard, J. V. Surr. Research Department: R. R. Rhomberg, Deputy Director. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; K. Boese, D. Gupta, Y. Kawakami, M. A. Lumsden, O. Roncesvalles, T. M. Tran. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. M. Ainley, J. Hospedales, H.-S. Lee, G. Nguyen, G. W. K. Pickering, T. Sirivedhin, A. Vasudevan. Assistants to Executive Directors: W.-R. Bengs, Chen J., J. de la Herrán, G. Ercel, R. Fox, S. Geadah, L. Hubloue, Z. b. Ismail, J. M. Jones, A. K. Juusela, H. Kobayashi, M. Lundsager, K. Murakami, A. Mustafa, M. Rasyid, J. E. Rodríguez, M. Sarenac, A. A. Scholten, B. D. White.

1. VIET NAM - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Viet Nam, together with a proposed decision concluding the 1985 Article XIV consultation (EBS/85/147, 6/10/85). They also had before them a report on recent economic developments in Viet Nam (SM/85/170, 6/17/85).

The staff representative from the Asian Department stated that information had been received about the decisions taken at the Party Congress held in Hanoi in June. Those decisions authorized included measures to increase productivity, to improve the quality of output, and gradually to achieve a balanced budget and control over the money supply. Among the more specific measures, it had been decided to eliminate subsidies on both prices and wages and to move to a price system based on costs. Wages in kind would be eliminated, and wage rates would be based on performance rather than on need. A reasonable exchange rate would be determined and export industries would receive high priority in the allocation of investment and inputs. Procurement prices in the export sector would be increased, and exporters who fulfilled their quotas would be allowed to retain 10 percent of their export earnings. All administrative units in factories would be given financial autonomy in that they would be held responsible for their losses and be permitted to benefit from their profits. All subsidization would be removed from both the central budget and the local budgets, and bank credit would henceforth be granted more on the basis of the productivity of the projects that were to be financed. He emphasized that although the Party Congress had taken those decisions in principle, it would take some time for the Government to design the implementing regulations.

The communication from Viet Nam had been incomplete, and the complete version would be circulated as soon as it was available, the staff representative said.

Mr. Ismael made the following statement:

General developments

Despite experiencing more rapid growth in the last four years, Viet Nam's economy is still beset by a number of very substantial internal and external imbalances due to many factors. The country is still vulnerable to food shortages, and the overall balance of payments outlook is not favorable. In view of these imbalances, the authorities have undertaken certain adjustment measures; and, at present, they are in the process of reviewing policies in a number of areas.

The Vietnamese authorities have recognized the need to provide adequate incentives to producers, to decentralize the decision-making process in the economy, and to pursue more prudent demand management policies combined with appropriate external policies in order to address the imbalances. These are measures that have been advocated by the Executive Board. My Vietnamese authorities, however, would like the Executive Board to bear in mind that Viet Nam is a centrally planned economy, and implemented gradually. As such any departure from existing policies can only be implemented gradually.

Notwithstanding the gradual approach, the measures taken have met with encouraging results, particularly in stimulating domestic production. There is no doubt that over the last four years Viet Nam has made a major step forward in increasing domestic production and improving the standard of living of its people. Gross domestic product rose in real terms by a relatively high rate of 5.5 percent in 1984 and by an average of 6.4 percent in the previous three years. In 1985, total output has been projected to increase by 6.9 percent, with agriculture and manufacturing expected to remain the major contributors supporting some other sectors such as trade and coal mining.

The steady growth in total output reflects the use of better cultivation techniques, more fertilizer and high-yielding seeds in foodgrain production, as well as the recent increases in industrial capacity. More importantly, it also reflects the shift in the focus of policy strategy toward agriculture and light industries since 1981 and the adoption of more incentive-oriented policies since 1980. The measures taken by the Vietnamese authorities include the introduction of sharply higher administered prices for agricultural products, an extension of two-way contract system of procurement, more decentralization of economic decisions, and wider application of the merit system in wage determination. More recent measures to provide greater autonomy to state enterprises include the introduction of higher profit margins, the inclusion of major input costs in their sales prices, permission to retain depreciation allowances, a higher share of profits, and part of export earnings. In the second half of 1985, measures to decentralize will be further extended from the district to the unit level, and plans to further decentralize decision making in agriculture are also being studied. Many of these measures are in line with recommendations of the staff.

Demand management

My Vietnamese authorities are aware that the relatively strong economic growth in recent years has been accompanied by an excessive growth of the money supply with its inevitable pressures on the price level and the balance of payments. While they view that some increases in the inflation rate are to be expected as a consequence of increased domestic activities, the major objective of economic management remains keeping the growth of domestic demand at a reasonable rate. Some progress has been made toward this end in the area of fiscal and monetary policies.

In the fiscal sector, the reduction in fiscal deficit as a ratio of GDP has been quite significant, although some allowances have to be made for the use of unrealistic official prices in some expenditure categories. The overall deficit of the government budget decreased from 19.5 percent of GDP in 1982 to 8.8 percent in 1984. Only a small portion of the deficit has been financed domestically. The need for bank financing has also been reduced from 2.4 percent of GDP in 1982 to 0.9 percent in 1984. Even though some receipts of the Government are based on stable official prices, the growth of total revenue has been maintained in the last three years at no less than the inflation rate. The introduction of import duties planned for the second half of 1985 is expected to contribute substantially to the government revenue. On the expenditure side, the eligibility rules governing the subsidized foodgrain distribution is being tightened. In this process, some 20,000 people have been removed from the list of beneficiaries, and 30,000 have been required to pay less-subsidized prices.

On monetary policy, despite some relapse in 1984, the Vietnamese authorities have succeeded in reducing the rate of liquidity expansion from 98 percent in 1981 to 46 percent in 1984. This has resulted mainly from a sharp deceleration of lending to public enterprises and cooperatives. In 1985, working capital lending to these enterprises will be made even more restrictive, and the rate of liquidity expansion is projected to come down further to 25 percent. Interest rates on time and savings deposits have been increased, and credit cooperatives have been allowed to charge an interest rate of 6 percent per month on loans and 5 percent per month on deposits. The inflation rate is not expected to be significantly different from the previous year's rate of 50 percent.

External developments and policies

The large imbalance affecting the external sector in the past few years is a matter of serious concern to my Vietnamese authorities. Notwithstanding the marked decline in capital goods imports in recent years, export expansion has not been able to match the steady growth of imports to meet the needs for productive inputs and some food items not sufficiently produced domestically. The external imbalance has been further enhanced by a deterioration in the capital account with the convertible area. Capital inflow from the convertible area has been negative over the past several years, while the trade account continued to register substantial deficits. These developments have led to the exhaustion of Viet Nam's international reserves and the accumulation of external arrears on debts to creditors in the convertible area, including the Fund. The foreign exchange reserves position has declined to a very low level of $12 million at the end of 1984, and external arrears accumulated to $637 million during the 1981-84 period. At the present level, the international reserves position is equivalent to less than two weeks imports from the convertible area.

Recognizing the need to correct the external imbalances, Viet Nam has taken a number of necessary actions in response to the deterioration in the balance of payments. These actions cover three important fronts: debt rescheduling, exchange rate adjustment, and other export incentive measures. On debt rescheduling, Viet Nam is expected to conclude agreements with some banks and official creditors for rescheduling of $480 million in debts. This rescheduling will eliminate $288 million from the total amount in arrears at the end of 1984 and relieve Viet Nam of some of its debt service obligation in 1985 to 1988. On exchange rate adjustment, following a 70 percent devaluation in 1981, the Vietnamese authorities are currently considering another major devaluation of the dong and the adoption of a flexible exchange rate policy thereafter. In this connection, the exchange rate applicable to inward remittances has been increased from D 60 = $1 in 1984 to D 150 = $1 in May 1985. On export incentive measures, an export incentive system is in effect whereby state enterprises receive export premiums ranging from D 35 to D 50 per dollar of their export earnings, and local export companies are entitled to retain 70 percent of the foreign exchange earnings from exports up to the assigned quota and 90 percent of the earnings from exports in excess of quota. In 1984, the authorities re-established the freedom of trading companies to import and export at uncontrolled prices. The authorities also decided in December 1984 to allow state enterprises to retain part of their export earnings and to establish joint ventures with foreign or domestic private companies. In addition, in an effort to stimulate foreign investments, the authorities are currently revising the foreign investment code with the help of foreign consultants.

Economic prospects

My Vietnamese authorities are aware of the issues confronting them. This is borne by the recent measures that have been implemented in agriculture, manufacturing and trade, with encouraging results. It remains certain, however, that Viet Nam still has a long way to go in addressing its economic imbalances. More comprehensive measures of structural nature need to be undertaken. But as the Executive

Board is fully aware, the Vietnamese authorities have adopted a gradual approach in this matter. In this regard, they seek the continued understanding and support of the Board.

Mr. de Maulde noted that the summary description by the staff in its report of the views expressed by Executive Directors on the occasion of the 1984 Article IV consultation with Viet Nam had made discouraging reading. The various recommendations made at that time had not been followed up, and the Vietnamese authorities were still debating what to do in spite of a continued deterioration of their external situation. Adjustment in Viet Nam had clearly been delayed too long. However, Mr. Ismael had drawn attention to some better news, including the increase in real GDP by 5.5 percent in 1984 after three previous years of steady growth. Nevertheless, that growth had been realized at the expense of fundamental equilibria: inflation, the budget deficit, the money supply, and the external accounts. In the real economy, despite some improvements, industry was functioning at half its potential owing to mismanagement and supply bottlenecks, and the country still faced food shortages. The large and growing external debt clouded economic prospects: the debt service burden would be equivalent to 100 percent of export earnings in 1987, and, as a result, external arrears had continued to build up, leading the country into de facto bankruptcy.

If he understood him correctly, Mr. Ismael considered that the centrally planned nature of the Vietnamese economy precluded anything but a gradual approach to adjustment, Mr. de Maulde continued. On the contrary, the nature of Viet Nam's problems argued strongly for putting into effect a drastic and comprehensive adjustment program. The Fund's experience with other centrally planned economies had shown that the latter approach was feasible. The authorities would have to shift their priorities and introduce greater freedom of economic choice, steps that they did not seem ready to take despite certain statements to that effect. For instance, heavy industries were underperforming, whereas light industries were quite successful; yet despite the scarcity of available resources and the subsequent reduction in investment outlays, the only data available indicated that heavy industries' share of total investment had continued to rise from 1979 to 1982. Another example could be found in the authorities' stop-and-go policy of economic management, which consisted of continuous hesitation between maintaining centralized decision making and allowing some decentralized initiative through market incentives, thereby creating considerable disruptions in the conduct of economic affairs.

He agreed fully with the staff appraisal and in particular with the emphasis on improving the public finances and controlling the growth of monetary aggregates in order to lower inflation and bring the balance of payments back into equilibrium, Mr. de Maulde went on. On the fiscal side, expenditure would have to be cut--on subsidies in particular--and additional revenue raising measures adopted. On the monetary side, the expansion of credit would have to be restrained together with a more active interest rate policy. He would, of course, await with great interest the full text of the decisions that had recently been taken by the Vietnamese Party Congress.

A flexible exchange rate policy was of the utmost importance, Mr. de Maulde noted.

Some of Viet Nam's problems fell within the province of the World Bank rather than of the Fund, Mr. de Maulde commented. Two basic problems were reforestation and demography. According to a recent World Wildlife Fund publication, the forests would disappear before the end of the century unless steps were taken soon. Less than 23 percent of the land area was still wooded compared to 44 percent 40 years earlier. With the expertise that the World Bank had acquired in India, it would certainly have a role to play in Viet Nam. The policy of demographic control followed by the authorities had had certain results but the latest official estimate of the rate of growth of the population--2.4 percent per annum--was unsustainable in the medium term. He had been encouraged to learn that the authorities were considering a more restrictive policy. The World Bank could also be of assistance in that respect.

The Chairman's summing up of the 1984 Article IV consultation with Viet Nam remained entirely appropriate, Mr. de Maulde noted in closing. Moreover, adjustment measures should be delayed no further, and the issue of Viet Nam's overdue obligations with the Fund should be settled rapidly.

Mr. Fujino said that he could generally endorse the staff appraisal and that he supported the proposed decision. Although the Vietnamese economy had shown a relatively high rate of economic growth since 1980, aided by the introduction of some incentive-oriented measures, the economy was still suffering from serious internal and external imbalances. The fiscal position remained weak even though the size of the budget deficit in terms of GDP had declined further in 1984. The inflation rate had not yet subsided, reflecting continued rapid monetary expansion. Perhaps the most serious and acute problems were the accumulation of external arrears to a wide range of creditors, including the Fund, and the depletion of foreign exchange reserves. Total outstanding arrears with the convertible currency area at the end of 1984 amounted to \$637 million, or approximately 240 percent of the value of Viet Nam's exports to that area in 1984. Foreign exchange holdings had declined to a minimal level of about 10 days of imports. The staff projection indicated that even based on the rather optimstic assumption that exports would grow by 15 percent and imports by 5 percent a year, the overall balance of payments would continue to show a substantial deficit in the years to come and would inevitably accumulate further arrears and depletion of reserves. Given the limited inflow of capital from abroad, the authorities must strive to promote exports to the convertible currency area and to reduce significantly internal imbalances in order to eliminate payments arrears. The adoption of strong and comprehensive adjustment measures for those purposes could be delayed no longer.

Recent experience had shown that decentralized management and flexible pricing policies could contribute to improving economic efficiency even in a planned economy, Mr. Fujino continued. Relatively high growth rates had been achieved in the agricultural and light industrial sectors, where those incentive-oriented policies had been applied, whereas the output of the coal mining sector, which was under central management, had been rather stagnant. Greater reliance on measures such as those adopted recently to provide greater autonomy to, and to strengthen the financial position of, state enterprises would also help to improve Viet Nam's export performance.

Although the output of light industry had grown by about 80 percent since 1980, exports of light industrial products had increased only marginally during the same period, Mr. Fujino observed. While increased domestic demand and the quality of the products might have been partly to blame, an important reason seemed to be the lack of price incentives to exporters. The official exchange rate had been adjusted little since 1981 yet the annual rate of inflation had been consistently over 50 percent. The unrealistic official exchange rate resulted in sizable losses on the exports of most state enterprises. An immediate and substantial exchange rate adjustment was essential. Such a step would also significantly increase the inflow of private remittances through the banking system and help to ease the foreign exchange position even in the short run. The dismal outlook for the medium-term balance of payments suggested that an active exchange rate policy should be accompanied by a more cautious import policy. In particular, a thorough re-examination of investment policy was necessary, aimed at shifting the emphasis toward more export-oriented projects.

The budgetary situation seemed to be much more serious than the deficit of 8.8 percent in terms of GDP might indicate, Mr. Fujino considered, owing to the increasing distortions in domestic prices and the unrealistic official exchange rate. A major cut in the fiscal deficit was urgently needed not only to reduce inflationary pressures but also to tackle the serious external imbalances. He welcomed the authorities' intention to introduce import duties and to raise the agricultural tax, but those measures should be regarded as merely an initial step toward the adjustment needed. As for monetary policy, he hoped that the recent measures taken to strengthen the financial position of state enterprises would increase their ability to use their own deposits and thus enable the authorities to adopt more restrictive credit policies as far as those enterprises were concerned.

The lack of adequate and timely statistical information on many areas of the economy was a matter of serious concern, Mr. Fujino stated. The provision of further technical asistance by the Fund would be helpful.

Finally, Mr. Fujino urged the authorities to do their utmost to settle their overdue obligations to the Fund. He hoped that the management and staff would keep in touch with the authorities on that matter.

Mr. Grosche said that he was in broad agreement with the staff analysis and that he supported its policy recommendations. Viet Nam's internal and external imbalances were indeed cause for great concern. Although the authorities had adopted more incentive-oriented policies since 1980, he was by no means convinced that their gradualistic approach would suffice to tackle the large problems with which the economy was beset. The intention of the authorities to move ahead with the collectivization of agriculture in the south was particularly worrying. It had become evident that output had been affected in the more advanced stages of collectivization due to management and organization problems. Throughout its report, the staff had made it abundantly clear that production had improved only in those sectors benefiting from incentives and decentralization in decision making. In the coal mining sector, where no such policies had been introduced, output had even fallen.

In addition to more forceful decentralization, it was absolutely essential to improve the finances of the public sector and to reduce the growth of monetary aggregates, Mr. Grosche considered. More restrictive financial policies were indispensable for attaining a better balance of payments position and lower inflation. The staff had mentioned a number of measures needed to improve the budgetary position. The recent decisions taken in principle by the Party Congress seemed to go in the right direction, and they should be introduced promptly.

One of the greatest problems currently facing Viet Nam was the inability to conceptualize the best way to deal with external imbalances and mounting arrears. The introduction of a more flexible exchange rate policy was certainly one of the necessary measures, but it would probably not be sufficient. It was regrettable that the authorities could not rely on a Fund program to overcome their serious problems, even if they wished to do so, because Viet Nam had had to be declared ineligible to use Fund resources. Therefore, the first step in the right direction would be to repay the Fund.

He regretted in particular that the authorities had not yet made a commitment on dates for the settlement of Viet Nam's overdue obligations to the Fund, Mr. Grosche added. The payment of SDR 5.9 million promised for January had not been made. It was also disappointing to have no new information from Mr. Ismael about the payment of arrears, which had risen further since the staff report had been issued. While it was true that Viet Nam's convertible foreign exchange holdings were very low at present, the country had sold considerable amounts of gold during the course of 1984 for which it had received about $108 million. Yet only minor payments had been made to the Fund. Furthermore, the fact that only a small proportion of private inward remittances had been received through the banking system in 1984, due to inappropriate exchange rate policies, undercut the authorities' argument that their weak reserve position was a reason for their inability to settle arrears. In the circumstances, he suggested that the proposed decision be amended by the addition of a reference to the urgent need for Viet Nam to settle its overdue obligations to the Fund.

Mr. Clark recalled that it had been nearly six months since Viet Nam had been declared ineligible to use the Fund's resources, and the present review of the economy was therefore timely. Despite progress in some areas, the main problems identified by the staff were much the same as those existing at the time of the 1984 Article IV consultations. Those sectors of the economy where greater liberalization had been introduced had performed better. The authorities themselves seemed to recognize the advantages of such liberalization, although they also emphasized that they expected the process to be slow because of their wish to maintain an overall framework of central planning. However, he hoped that that approach would not prevent early action in some key areas, especially in the external sector.

Whatever the policy intentions, it was clear that monitoring was still being hampered by the lack of adequate statistics, Mr. Clark continued. The authorities should move promptly to improve the situation, with the assistance the Fund was to provide in the compilation of statistics, and make whatever data were compiled freely available to the Fund staff.

It would be helpful to have further information from the staff on the reasons underlying the losses in handling materials, which were running at the extraordinarily high rates of between 15 percent and 30 percent of production depending on the sector, Mr. Clark said.

The prospects for the medium-term external position were for continuing large current account deficits and a further substantial accumulation of arrears, Mr. Clark observed. Whether that position was sustainable would of course depend to some extent on the level of inflows from the Soviet Union and other COMECON countries. With present policies, however, it was hard to foresee a restoration of the external position insofar as trade and financial relations with the convertible currency area were concerned. He joined the staff in encouraging the Vietnamese authorities to focus on that issue and to implement an adjustment program that would strengthen the current account and establish adequate incentives for engaging in foreign trade. A substantial depreciation would necessarily be a major component of such a program. Perhaps Mr. Ismael could explain more fully the authorities' own assessment of their external problem and how they intended to tackle it.

In the framework of Viet Nam's overall payments difficulties, his authorities continued to attach special importance to the early discharge of arrears to the Fund, Mr. Clark commented in closing. The authorities' statements on that point were disappointingly vague. As experience had shown, the restoration of normal relations with the Fund could be of great help to countries in implementing a successful overall adjustment program.

Ms. Bush remarked that the 1985 Article IV consultation with Viet Nam was occurring at an important point in its membership in the Fund. It had been almost six months since Viet Nam had been declared ineligible to use Fund resources owing to its failure to meet its financial obligations to the Fund. The Executive Board had had no opportunity since then to discuss that matter, and it should profit from the present occasion to convey two important messages to the Vietnamese authorities. The first was that prompt repayment of overdue obligations to the Fund was necessary in order to avoid serious strains in Viet Nam's relations with the international financial community and to protect the Fund's financial position, which was jeopardized by overdue payments. The second message concerned the appropriateness of Viet Nam's current economic policy stance, which had fallen far short of the policy recommendations made during the 1984 Article IV consultation.

Since 1980, the authorities had improved producer incentives in the agricultural sector by increasing producer prices and by permitting the sale of output exceeding producer quotas at free market prices, Ms. Bush observed. Those measures were welcome, as was the increased autonomy of the state enterprises. In addition, worker incentives had been recognized to have a significant impact on productivity, as shown by the newly liberalized rules for performance bonuses. The decentralization of control over production decisions accompanying that increased reliance on market forces should also increase the potential for growth. However, contrary to those apparently positive steps in the public enterprise sector, other changes were moving additional segments of the private economy into the socialized sector. The authorities should realize that those moves would stifle initiative and growth in the private sector and would in general offset the effect of positive steps being taken in the public enterprise sector. It was discouraging to learn that private enterprises were being reorganized into cooperatives and that the ownership of land was being collectivized. The incentives to farmers would no doubt be reduced, dampening the stimulus generated by the adjustments in producer prices. Management problems had already surfaced in some areas.

Fiscal developments were not encouraging either, Ms. Bush remarked, with the budget deficit remaining high, at almost 9 percent of GDP in 1984. A smaller deficit had been projected in the official budget for 1985, but because full account had not been taken of already approved expenditure increases, such as the salary increase late in 1984, the expectation was that the deficit would be higher. Furthermore, unless monetary growth was curtailed, the rate of inflation would increase more rapidly, and the poor performance in the foreign sector would continue. External arrears would then grow to the point at which foreign suppliers would cease to provide additional goods. That point could not be far off, given Viet Nam's poor relations with external creditors and, especially, its current account deficit in the convertible area. It would be useful to have more detailed information on the likelihood that the projected inflow of capital from that area of $162 million would materialize in 1985.

The large imbalances in Viet Nam's economy were reflected clearly in the exchange rate and the external accounts, Ms. Bush commented. The wide disparity between the official and parallel market rates indicated a serious disequilibrium requiring a major adjustment in the official rate.

With official foreign exchange reserves having been exhausted and gold holdings having been diminished in 1984, no margin was left for postponing decisive action to reverse the deterioration in the external accounts.

The proposed decision urged Viet Nam to eliminate exchange restrictions, including those in the form of external arrears, but made no specific mention of arrears to the Fund, Ms. Bush noted. Since the Executive Board had few opportunities to indicate directly its concern to the authorities, she joined Mr. Grosche in suggesting that a more specific reference in the decision to the urgency of Viet Nam meeting its obligation to settle overdue payments to the Fund might be opportune. She understood that decisions relating to Article IV consultations were limited by the second amendment to the Articles of Agreement to the obligations of Articles VIII and XIV, but as arrears to the Fund were a relatively new phenomenon, she wondered whether there was any room for reinterpreting that decision to permit the Executive Board to decide that Viet Nam should be called upon to make immediate repayment of its arrears to the Fund.

Mr. Govindarajan said that Viet Nam's achievement of an average growth rate of about 6 percent in the past four years was striking, not merely because the rate itself was impressive but also because it had occured during a severe worldwide recession and because of numerous internal and external difficulties in Viet Nam itself. The country had experienced its worst floods in recent memory, and its balance of payments was under extreme pressure. In that context, it was heartening to note that Viet Nam expected to achieve a further 6.9 percent growth rate in 1985.

Several steps had contributed to that healthy growth performance, Mr. Govindarajan observed. Better cultivation techniques, together with greater use of fertilizers and high-yielding seeds, had enabled the Government's targets for the agricultural sector to be met. Output had also responded to incentive policies--the introduction of sharply higher administered prices for agricultural products, the extension of the two-way contract system of procurement, more decentralization of decision making, and performance-oriented wage systems. Industrial growth, especially in light industries, had benefited from those policies.

Nevertheless, Viet Nam needed to cope with a number of severe internal and external imbalances, Mr. Govindarajan continued. In spite of several steps that the authorities had taken, the country remained vulnerable to food shortages. The balance of payments, even under the most optimistic assumption, was expected to continue to be in an unsustainable position in the medium term. Inflation continued to be high and was in urgent need of containment. The latest information provided by the staff representative indicated that the authorities were aware of the problems confronting them and were contemplating appropriate action. It was particularly gratifying to note that they recognized the need to keep the growth of domestic demand within reasonable limits.

The overall fiscal deficit had been reduced sharply from about 19.5 percent of GDP in 1982 to 8.8 percent in 1984, Mr. Govindarajan observed. A plan to introduce import duties in the second half of 1985 should lead to a further improvement in the fiscal position. The Government was also planning to reduce certain expenditures during the year. Measures had been taken to reduce liquidity quite substantially, and the projected reduction in the rate of monetary expansion to about 25 percent in 1985 should act as a brake on the inflation rate. It would be essential for Viet Nam to continue its fiscal and monetary efforts in order to control inflation and bring about internal balance; the staff had made a number of suggestions in that respect which deserved favorable consideration.

The external sector reflected considerable imbalances in the economy, Mr. Govindarajan stated. In the past three years, the deficits on the trade and current accounts had widened greatly. Capital inflows from the convertible area had been negative, depleting reserves which were at the precarious level of only two weeks of imports. Arrears had mounted to about $637 million during that period. Needless to say, Viet Nam would have to act decisively to reverse that situation promptly and to settle its overdue obligations as soon as possible. The authorities were taking action in the right direction by rescheduling debt, adjusting the exchange rate, and introducing other export incentives. A higher exchange rate for inward remittances and exports were among those incentives.

For the correction of those imbalances over the longer term, comprehensive structural measures would have to be undertaken, Mr. Govindarajan noted. Evidently the Vietnamese authorities were confronted with a policy dilemma: the deep-rooted problems of the economy called for quick and major remedies, but drastic steps could affect adversely the poorer sections of the socialistic country. Therefore, the authorities seemed to have adopted a cautious gradualist approach, which the Fund might do well to accept, given its limited experience with the working of planned economies.

In conclusion, Mr. Govindarajan said, in Viet Nam's present circumstances, international institutions, the international community as a whole, and Viet Nam itself would need to cooperate and show understanding if the Vietnamese economy were to progress toward longer-term viability.

Mr. Suraisry said that he agreed with the main points in the staff appraisal and that he supported the proposed decision. Despite the increase in output in recent years, there were still major internal and external imbalances in Viet Nam's economy. As a result of inappropriate demand mangement policies, the budgetary position was weak. The growth of monetary aggregates had been excessive, and inflation was running at about 50 percent. Inefficiencies and distortions persisted on the supply side, leading to serious misallocation of resources. The external position was at best precarious, and the outlook for the balance of payments was bleak.

The authorities claimed to recognize the need for adjustment, but although a few corrective measures had been introduced, they had a long way to go to resolve their fundamental problems, Mr. Suraisry commented. He endorsed the staff recommendations designed to restore producer incentives, streamline decision making, and improve productivity; and the growth in output since 1980 showed that a more incentive-oriented strategy could work. Combined with a more realistic public investment program, such a strategy would offer the best chance of success over the medium term.

There was an urgent need to strengthen the public finances, particularly as the growing budgetary deficit was being financed by inflationary means, Mr. Suraisry added. The authorities should give serious consideration to the revenue-raising measures recommended by the staff. They should also continue with their efforts to strengthen the financial position of the public enterprises.

External adjustment would be a very long process, even on the most favorable assumptions, and to be successful Viet Nam would have to come to terms with the international financial community, Mr. Suraisry stated. For that to be possible, Viet Nam must settle its mounting external arrears and obligations, accepting the fact that it had both rights and obligations within the international financial community. One of those obligations was to repay its debt as agreed. It was extremely disappointing that Viet Nam had made no serious effort to repay the Fund; moreover, he understood from the staff that the authorities' attitude remained noncommittal. They were hurting their country by missing the opportunity to adjust the economy with the Fund's assistance. He urged them to normalize their relations with the Fund and get on with the task of tackling their fundamental economic problems.

Finally, because of the importance of the issue of overdue obligations to the Fund, Mr. Suraisry considered that the proposed decision should be amended to urge Viet Nam to settle its overdue obligations.

Mr. Rye noted that in general the discussion of centrally planned economies was circumscribed by political philosophy, although in varying degrees. Viet Nam was no exception, Mr. Ismael having cited that argument for stating that "any departure from existing policies can only be implemented gradually." That statement was an acknowledgment of the rigidities of a centrally planned economy, although not all such economies were so bound. Indeed, Viet Nam's relatively high rates of economic growth owed much to the more incentive-oriented policies introduced in 1980. Light industries under local management that had been granted greater autonomy had recorded growth of 16 percent on average from 1981 to 1984 compared with 8 percent for heavy industries under central management. Thus, even if the claim for gradualism had some validity, the changes made seemed to be in the right direction. Yet the Vietnamese authorities had continued to emphasize investment in heavy industries and centrally managed enterprises, with the inevitable result that the availability of products for export had been more limited and imports had increased rapidly.

There was a comparable point to be made in regard to agriculture, Mr. Rye remarked. Over the period from 1976 to 1984, the average annual growth rate of foodgrain production had been 6 percent in the south, where agriculture was only partly collectivized, compared with 2 percent in the north, where it was fully collectivized. Nonetheless, the collectivization of agriculture in the south was being continued. That policy seemed perverse, at least in its economic effects, and called for a change of course. Pricing and decentralization policies were the core issue, and it was encouraging to note that some of the measures that had been adopted or were still being formulated went in the right direction.

While the authorities had encouraged an improvement in the financial position of the public sector by permitting the retention of a larger share of profits and not requiring the transfer to the Government of the depreciation allowance, the result would presumably be to slow the rate of growth of government revenue, thereby requiring further measures to reduce the budget deficit and government borrowing, Mr. Rye stated. Thus, the authorities' current plans to introduce import duties during the second half of 1985 were appropriate.

The greater freedom granted to local trading companies in the procurement and pricing of exportable commodities was expected to lead to a rapid expansion in exports, Mr. Rye commented, but the overall balance of payments position was not sustainable. The debt service burden was high and increasing, with the debt service ratio vis-à-vis the convertible area expected to remain between 70 percent and 100 percent until 1987. Foreign exchange reserves were low. Viet Nam had limited access to international capital markets. In the circumstances, urgent adjustment measures were called for, particularly with regard to the exchange rate. The recent decision of the Party Congress to establish a reasonably determined exchange rate was ambiguous and seemed to add little to the authorities' previous position that they were currently considering a substantial adjustment of the exchange rate and the adoption of a policy of keeping the rate in line with developments in foreign and domestic prices. He urged the authorities to bring their consideration of such a policy to a speedy and positive conclusion.

The Vietnamese authorities should make prompt settlement of their overdue obligations to the Fund, thereby opening up the prospect of securing a viable external position, Mr. Rye said in closing. Unless there were good reasons to the contrary, he would join other Directors in supporting Mr. Grosche's proposed addition to the decision.

Mr. de Groote said that he could support Mr. Grosche's proposed amendment to the decision.

The staff representative from the Asian Department said that the rather high production and handling losses--such as in construction, the assembly of equipment, and foodgrain storage--were a major reason for the low growth in productivity in the Vietnamese economy. The authorities themselves had paid considerable attention to the problem and had concluded that those losses were due in large part to the lack of accountability of individual enterprises. The recent decision to concentrate more on decentralization had probably been motivated by that conclusion.

The projected inflow of capital from the convertible area in 1985 had been based on the assumption that all the debt rescheduling negotiations planned for the current year would be brought to a favorable conclusion, the staff representative added. No information had been received so far about the discussions on the rescheduling of debt to Algeria, India, and Libya. However, a debt rescheduling agreement with Japan had been signed in June, with the proviso that the initial downpayment of $8 million would be made in two equal installments, in July and October, rather than upon the signing of the agreement with the banks.

The Deputy Director of the Exchange and Trade Relations Department noted that Article IV consultations with members encompassed broader issues than those of a purely jurisdictional character. However, since the adoption of the Second Amendment to the Articles of Agreement, the Fund's policy had been to confine Article IV decisions to matters pertaining to Fund jurisdiction over exchange practices under Article VIII and Article XIV. At the same time, the Executive Board had instituted a new procedure consisting of a summing up by the Chairman that would summarize and convey to the member the views of Executive Directors on general policy issues arising from the consultation with members. Although in principle there might be some logic in the Board expressing its views on the status of a member's financial obligations to the Fund in the context of the Article IV consultation, there was also merit in continuing to limit decisions to the exercise of the general jurisdiction of the Fund, as opposed to the financial operations of the institution. Nevertheless, the Executive Board could decide, if it wished, to establish a separate procedure for conveying its views to members on the discharge of their financial obligations to the Fund. The staff's preference would be to take up the general policy issue that arose on that subject when the Executive Board reviewed the six-monthly report on overdue payments to the Fund, which was scheduled for issuance in September. However, if the Executive Board so wished, it could decide to deal with the matter of Viet Nam's overdue obligations to the Fund in a separate decision. In such a decision, Executive Directors in effect could state their regret at the failure of the member to observe its financial obligations and urge Viet Nam to settle them promptly.

Ms. Bush reiterated her view that it would be helpful to adopt a decision that would emphasize the urgent need for Viet Nam to repay the Fund. It was particularly vexing to learn that the Vietnamese authorities had entered into a debt rescheduling agreement with private banks that included a commitment to repay debt in the near future but that they had made no commitments to repay the Fund.

Mr. Govindarajan asked under what Article such a decision would be taken and by what majority and whether there was any precedent for taking such a decision in connection with an Article IV consultation. It seemed to him that an additional procedure that was not generalized was unwarranted at the present stage. After all, the views of the Executive Board had been conveyed in the strongest possible way to the Vietnamese authorities through the decision declaring Viet Nam ineligible to use the Fund's resources.

The staff representative from the Legal Department responded that a decision under the first sentence of Article XII, Section 8 relating to a member's overdue payments to the Fund could be adopted by a simple majority. A number of decisions had been adopted in reviews of the overdue payments of members that had not been declared ineligible to use the Fund's resources. No review had taken place of the overdue obligations of any member that already had been declared ineligible. Statements about overdue payments apparently had not been included previously in any decisions relating to Article IV consultations, but the inclusion of such a statement in a decision at the present meeting was not legally precluded.

Mr. Suraisry remarked that his preference was to amend the proposed decision to refer to Viet Nam's overdue obligations to the Fund, as suggested by Mr. Grosche. However, he could also accept a separate decision. As Ms. Bush had observed, the problem of overdue obligations was a new but very important problem from the standpoint of the Fund.

Mr. Ismael observed that Viet Nam's overdue obligations to the Fund had been discussed at length on separate occasions in the past. As a result, the Executive Board had adopted a decision declaring Viet Nam ineligible to use the Fund's resources. While he shared the Executive Board's concern over Viet Nam's overdue obligations, he would object to any proposal to take advantage of the regular Article IV consultation to adopt additional, new decisions, on those obligations. However, he would not object if the Chairman included a request to Viet Nam to settle its obligations in his summing up, under the regular procedures for conducting Article IV consultations.

Mr. Clark said that the discussion appeared to demonstrate the need for a broader discussion in the Executive Board of how to deal with members having overdue obligations to the Fund that had already been declared ineligible to use the Fund's resources.

The Deputy Treasurer observed that the staff intended to take up, in the six-monthly report on overdue obligations, not only the procedural question but broader substantive issues relating to the problem of overdue obligations by members that had been declared ineligible. The procedures for reaching decisions that might lead to a declaration of ineligibility had been established, but as had been pointed out during the present discussion, the Executive Board had had no separate opportunity to consider the overdue obligations of Viet Nam since it had been declared ineligible to use the Fund's resources in January 1985.

Mr. Grosche remarked that his intention was simply to convey to the Vietnamese authorities in an appropriate way the serious concerns of the Executive Board about Viet Nam's overdue obligations that were preventing the member from seeking the assistance that it needed from the Fund in order to overcome its serious economic and financial problems. Thus, he saw a connection with the Article IV consultation discussion. He would be willing to accept an amendment to the proposed decision for a separate decision. At the very least, the Executive Board should convey its views to the Vietnamese authorities through the Chairman's summing up.

Mr. Arias said that he supported Mr. Ismael's position. Decisions relating to Article IV consultations should be kept separate from decisions on overdue obligations.

Mr. Mtei considered that it was important for the Executive Board to inform the Vietnamese authorities about the serious attitude of the Fund to overdue obligations. However, because Viet Nam had been declared ineligible to use the Fund's resources and because the staff had not yet made proposals for dealing with postineligibility cases of overdue obligations to the Fund, he suggested that the Chairman should convey that message to the authorities in his summing up.

Mr. Weitz said that he had doubts about accepting a new procedure without further discussion, and he therefore suggested that the Executive Board avoid taking an additional decision on Viet Nam's overdue obligations.

Mr. Msadek stated that it would be wiser to limit any mention of Viet Nam's overdue obligations to the Fund to the Chairman's summing up. Otherwise, a precedent would be created for bringing up the subject of overdue obligations in the context of all Article IV consultations. The issue should be discussed on its merits, based on further studies, at an appropriate time.

Mr. de Maulde commented that an allusion to the issue in the Chairman's summing up would not be strong enough, whereas an addition to the proposed decision or a separate decision might be too strong. He suggested that the decision should make no mention of the overdue obligations but that the summing up should reflect the full discussion and that in addition the Managing Director should send a special letter to the Vietnamese authorities drawing their attention to the seriousness with which the Executive Board viewed their failure to settle their overdue obligations to the Fund.

Ms. Bush remarked that the most important issue of principle was to convey once again to the Vietnamese authorities the urgency with which the Executive Board viewed the problem of overdue obligations and with which it wished the authorities to view those obligations. She could accept the suggestion made by Mr. de Maulde although she would have seen some benefit in a separate decision calling for the repayment of the arrears.

Mr. Suraisry remarked that he would have preferred a separate decision to emphasize the critical importance of the issue to the Fund. However, he could go along with Mr. de Maulde's suggestion, provided that Executive Directors soon received a staff paper on how to deal with the problem so that it could formalize a procedure for dealing with cases such as that of Viet Nam.

Mr. Leonard said that he agreed with Mr. Suraisry that a staff paper was necessary. Meanwhile, he was prepared to support Mr. de Maulde's proposal.

The Chairman said that he would write a special letter to the authorities of Viet Nam, as the Executive Board wished, stressing the importance that Executive Directors attached to prompt settlement of arrears to the Fund. The staff would take up the general issue of what action the Executive Board might take when a country had become ineligible to use the Fund's resources in the context of the next six-monthly review of overdue obligations.

Mr. Ismael thanked Executive Directors for their comments, which he would convey with urgency to the Vietnamese authorities.

The Chairman made the following summing up:

> Executive Directors expressed their broad agreement with the thrust of the views expressed in the appraisal of the staff report for the 1985 Article IV consultation with Viet Nam and their disappointment with Viet Nam's failure to follow up in a comprehensive manner on the views expressed by the Executive Board on the occasion of the 1984 consultation. Directors focused their remarks on the considerable problems that continue to beset the Vietnamese economy, in particular the deteriorating balance of payments, the high rate of inflation, the low productivity in many key sectors, and the rapid accumulation of external payments arrears. While noting the favorable growth performance of Viet Nam in recent years, they expressed concern that the policy response of the authorities to the deep-seated domestic and external imbalances in the economy had remained timid and, in the view of most Directors, inadequate.
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> Directors noted with interest the indications received regarding a number of decisions on economic policy taken in principle at the recent Party Congress and urged that these be

urgently followed up and implemented. In that regard the elimination of consumer subsidies, increased flexibility in wage policy, decentralization of decision making, and more flexibility and efficiency in credit allocation could be significant steps in the right direction.

Directors noted the reintroduction of greater freedom for local trading companies in the procurement and pricing of exportable commodities but felt that in the absence of more comprehensive measures the balance of payments outlook would remain unsustainable. They stressed their concern about the mounting external arrears to the convertible currency area which are now equivalent to more than two times annual exports of goods to that area. They noted that a substantial exchange rate adjustment and the adoption of a policy whereby the rate would be kept flexible after the initial adjustment was under consideration, and they urged the authorities to implement without further delay the needed adjustment of the exchange rate. To be effective, the exchange rate measures would have to be fully reflected in administered prices of imports and exports and would have to be accompanied by greater autonomy of state enterprises so as to restore profitability in the export sector. Directors felt strongly that balance of payments improvement would also be contingent upon a more careful evaluation of the foreign exchange cost and yields of investment projects and the allocation of inputs. Unsatisfactory developments in the coal mining sector were cited as an example of the need for reform.

Directors emphasized the need to reduce the rapid growth of monetary aggregates. Although they welcomed recent measures aimed at easing the financial position of state enterprises, they believed that the likelihood of increased bank borrowing by the public sector in 1985 underscored the need for expenditure restraint and early decisions on such revenue measures as a rise in agricultural taxation and imposition of import duties in order to improve the fiscal position. The elimination of consumer subsidies would not only benefit the Government's budget but also improve the efficiency of the official distribution system.

In view of the divergence in performance between centrally and locally managed enterprises and between socialized and nonsocialized agriculture, Directors suggested an acceleration in the decentralization of decision making and in the adoption of flexible prices, and recommended caution in the further collectivization of agriculture.

Directors regretted that Viet Nam has persisted in its failure to fulfill its financial obligations to the Fund since early 1984, and that in recent discussions with the staff the authorities had been noncommittal about the timing of the settlement of these obligations. Directors showed extreme concern about that situation. They again urged the authorities to settle their overdue obligations promptly. They emphasized the serious consequences for the Fund which stemmed from such a situation and stressed that restoration of Viet Nam's eligibility to use Fund resources would clearly be in the country's interest at a time when it needed external resources in support of comprehensive adjustment measures.

Directors stressed the importance of timely availability of adequate data on the overall performance of the economy and welcomed recent efforts to improve monetary statistics.

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

The Executive Directors then took the following decision:

1. The Fund takes this decision relating to the Socialist Republic of Viet Nam's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1985 Article XIV consultation with the Socialist Republic of Viet Nam, in light of the 1985 Article IV consultation with Viet Nam conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Viet Nam maintains restrictions on payments and transfers for current international transactions, including external arrears and multiple currency practices, as described in EBS/85/147 and SM/85/170. The Fund urges Viet Nam to take comprehensive measures to improve its balance of payments and to abolish the restrictions and multiple currency practices as soon as possible. The Fund also urges Viet Nam to terminate bilateral payments arrangements with Fund members.

Decision No. 8017-(85/102), adopted
July 1, 1985

2. SDR VALUATION - REVIEW

The Executive Directors considered a staff paper on the review of the valuation of the SDR (SM/85/163, 6/7/85).

The Deputy Treasurer stated that the last quarter data for 1984 for France had become available subsequent to the issuance of the paper. However, recalculation of the shares accorded to the five currencies in the basket did not appear to call for any adjustment of the currency shares.

Mr. Grosche noted that the results of the staff calculations had broadly confirmed the percentage weights used to determine the amounts of currency in the SDR basket. In contrast to the 1980 decision, major deviations from the rounded percentage weights were neither necessary nor appropriate. The calculations also allowed the valuation of the SDR basket to take into account the growing importance of the Japanese yen in international trade and reserves. An unchanged percentage rate of 19 percent for the deutsche mark was fully justified, as was the unchanged 42 percent for the U.S. dollar. If the SDR was to act as an alternative asset to the dollar, it was critical that the dollar should not be given too heavy a weight in the basket.

Expressing his support for the proposal that the market instruments for the five currencies in the SDR interest rate basket should remain unchanged, Mr. Grosche stated that he agreed that developments in that area should be closely monitored in order to see whether alternative instruments became available that might be better suited for the interest rate basket.

Despite certain reservations, Mr. Grosche said in concluding, he looked forward to the staff memorandum that would deal with the possibility of determining the representative rates of all the currencies in the SDR valuation basket in one common foreign exchange market.

Mr. Polak said that he agreed with the conclusion that the decision taken in 1980, with regard to the number of currencies and the formula to derive their initial weight in the SDR basket, had worked out reasonably well and should be continued. There still remained, however, a small technical problem relating to the calculation of the precise quantities of each currency in the basket on the final day of the year. The rounding provisions in steps C and D in Appendix III remained unsatisfactory, and revision of the formula was necessary.

Mr. de Groote said that he agreed with the conclusions of the staff paper. Although the review of the SDR valuation was generally only an exercise in the verification of an existing methodology, the staff analysis had revealed a number of interesting issues of relevance to any future methodology. The share in world exports of goods and services of the five countries whose currencies were included in the present basket had fallen from 48 percent to 44 percent between the periods 1975-79 and 1980-84. The trend should be carefully monitored, not least because it showed how difficult it was to satisfy both the simplicity of the present SDR formula and the principle that the basket be representative in terms of trade flows. The need to ensure that the SDR was attractive as a unit of account in private transactions or as a reference peg for national currency exchange rates did not, once and for all, imply that the basket should be constructed on the basis of the present formula. It might be wise to make the SDR attractive on a different basis--for instance, by increasing its stability in terms of a wider range of currencies. The intention to realize the minimum possible covariance between the fluctuations in the exchange rates of the currencies in the basket was not achieved if the SDR did not show a high degree of overall stability in its value.

The experience of the past three or four years had shown how greatly the value of the SDR was affected by the movement of the U.S. dollar, Mr. de Groote continued. The present valuation of the SDR in terms of other currencies was more than 50 percent determined by movements in the U.S. dollar. If the objective was that the SDR should offer more stability, it would be interesting to know how the present method of valuation could be amended to lessen the effect on the valuation of the SDR of fluctuations in its major component currencies. It remained an open question whether that could be accomplished by more frequent revisions of the basket or by evaluating the currency shares in the basket on the basis of world exports and official reserve holdings, denominated in constant rather than in current prices. While changes in trade volumes and unit values over a five year period might be expected to offset the consequences of exchange rate movements, the correction might be only partial and, in any event would not affect the measurement of the other component of the formula--official reserve holdings.

There appeared to be a bias against European currencies in favor of the U.S. dollar in the proposed revision of the basket, Mr. de Groote commented. It considered the dollars swapped by central banks of the members of the European Monetary System (EMS) against ECUs as dollar reserves, inflating the dollar component of official reserve holdings, whereas the central banks themselves considered those holdings as ECUs. In addition, the annual conversion of the five basket currencies into SDRs for the purpose of allocating relative shares artificially increased the share of appreciating currencies in the SDR basket. If the figures in Tables 2 and 5 of Chapter 2 of the draft Annual Report for 1985 (CW/AR/85/1, 6/12/85) were used, ECUs would be considered separately and changes in reserve holdings would be broken down into price and quantity changes, offering a different picture for the percentage share of the five currencies in the SDR basket. Table 2 of SM/85/163 suggested that between 1980 and 1984, the U.S. dollar had accounted on average for 76 percent of official holdings of the currencies included in the SDR valuation basket, the deutsche mark 14.3 percent, the French franc 1.4 percent, the Japanese yen 5.2 percent, and the pound sterling 3 percent. If one were to include a proper calculation of the holdings of ECUs in member governments' reserves, and evaluate reserves at constant prices, the new percentages would be 69.4 percent for the U.S. dollar, 19.4 percent for the deutsche mark, 2.3 percent for the French franc, 5 percent for the Japanese yen, and 3.9 percent for the pound sterling. There were of course methodological problems with those calculations, not least because of the conceptual difficulties underlying any quantitative definition of reserves. Nevertheless, it remained the case that a quantitative definition was used in the Annual Report. When the new calculations for the reserve criterion were added to the figures contained in the staff report in Table 1 for the trade criterion, and assuming that the relative weights of each criterion were preserved, then the composition of the basket would be somewhat different. The U.S. dollar would fall to 40.7 percent instead of 42 percent of the basket, the deutsche mark would rise to 20 percent from 19 percent, the French franc to 12.1 percent from 11.98 percent, the Japanese yen would be somewhat less than was the case under the present calculations, and the pound sterling somewhat more. Although there was no need to reconsider the staff calculations in the present staff paper, it might be useful to consider those methodological issues at the time of any future review of the SDR basket. It was important to realize that the methodology proposed by the staff was not the only one available.

The quantitative notion of changes in official reserves was derived by multiplying the changes in official holdings of each currency from the end of one quarter to the next by the average of the two SDR prices of that currency, corresponding to each date, Mr. de Groote said. The most important thing, however, was to recognize the need to include the European currency unit in the official currency holdings of member countries when estimating the reserve criteria which underlay the valuation of the SDR. The Fund already performed such an exercise in its Annual Report and there was no reason why it could not make a similar judgment in the case of the SDR valuation.

Mr. Fujino noted that as the staff had rightly concluded, the five-currency valuation basket of the SDR used since 1981 had been successful mainly because of its simplicity and greater acceptability in the market. There was no reason at the present stage to change the basic approach of the five-currency basket. On the list of the currencies, the implementation of the decision adopted in 1980 would lead to the same list of currencies for the next five years as in the present basket; his authorities had no difficulty in supporting that part of the conclusions of the staff paper.

In determining the weights of the currencies in the valuation basket, Mr. Fujino went on, it would be desirable to take a decision that was in conformity with the results of the studies to be undertaken as part of the comprehensive review of the role of the SDR in the international monetary system. At the same time, however, it was important to make the determination on a basis that would adequately reflect the current functions of the SDR as a unit of account or standard of value in Fund transactions and to take into account the fact that the SDRs already allocated constituted a part of reserve asset holdings.

With regard to the criteria and procedures for determining the weight of the currencies in the basket, consistency with past practice was important to ensure the stability of transactions, Mr. Fujino stated. The criteria that the Board had adopted were the importance of individual currencies in the international monetary system and, more precisely, the value of exports of goods and services and the balances of the currencies held as reserves by other countries. While his authorities admitted the importance of those points, they had one fundamental reservation in that respect. The criteria set out in the 1980 decision leaned too much toward trade and finance and did not take adequate account of the real economy, which in the final analysis backed up confidence in the currency concerned.

One way to resolve the problem, Mr. Fujino commented, would be to use GNP as an indicator of the relative strength of countries' economies and of the potential importance of their currencies in international trade and financial transactions. The ECU incorporated GNP as a factor in determining the weights of the currencies in its valuation basket. Because the Japanese yen was one of those currencies, his authorities had requested him to ask the staff to prepare a paper which would discuss the advantages and disadvantages of the addition of GNP as a criterion for determining the relative weights of the currencies in the SDR basket, with illustrative calculations of those weights. Various other possible methods should also be evaluated in such a paper. It would be a mistake not to take the rare opportunity afforded by the quinquennial review to examine thoroughly alternative methods for determining the weight of currencies in the basket. There was still time to undertake and to analyze a further in-depth and comprehensive review of the matter, and it was the strongly held wish of his authorities that that should be done.

A discrete change in the SDR interest rate would arise from the revision of the SDR valuation basket, whatever the relative weights of the currencies, Mr. Fujino remarked. Since it was unlikely that such a shift would change the effective yield on the SDR to any appreciable extent, it would be better to defer the question of any change in the SDR interest rate resulting from a new valuation basket until the time of its introduction.

Mr. Rye, endorsing the staff proposals, suggested that the new weights were in line with what might have been expected in terms both of their composition and weighting. Accordingly, there was no need for the calculated weights to be adjusted, either for ad hoc reasons or on account of any supplementary criteria. The procedures that had been agreed in 1980 remained appropriate.

The staff paper seemed to be unnecessarily lengthy, technical and, particularly in its later parts, difficult to follow, Mr. Rye considered. The Board would have been better served by a more determined effort to capture the essence of a matter that in the end required the exercise of not inconsiderable judgment rather than by a counterproductive welter of formulas and statistics. Certainly, it was appropriate for the staff to describe fully the procedures and assumptions underlying its proposals, especially as it was five years since the SDR valuation method had been adopted. However, the finer points could have been relegated to the appendices in order not to obscure the main thrust of the arguments and issues.

Mr. Nimatallah said that he agreed that the standard basket method of valuing SDRs had worked satisfactorily and should be retained. There was no need to change the criteria for selecting the currencies in the valuation basket or for determining their initial weight in that basket.

There were good reasons for keeping the present principles and procedures unchanged, in the interests of stability, simplicity, and continuity. Although the combined share of the members with the five largest shares in world trade had declined slightly since the 1980 review, it continued to account for about half of the value of that trade.

It remained appropriate to look not just at trade flows but also at the share of currencies in the foreign exchange reserves, Mr. Nimatallah noted. Given the significant exchange rate changes since 1981, realigning the currency weights would lead to substantial changes in the amounts of the five currencies in the new basket. That was inevitable and indeed appropriate, since the objective of periodic revisions was to reflect changing circumstances. What was perhaps more important was that changes should not introduce any particular bias into the way that the SDR was valued.

Changes in the valuation basket would inevitably affect the currency amounts in the SDR interest rate basket, Mr. Nimatallah commented. That would, in turn, affect the SDR interest rate with implications for the rate of remuneration and the rate of charge. Those precise effects could be examined later in the year. It was reassuring that the effective yield of the SDR was not expected to change to any appreciable amount. It would also be correct to retain the market instruments for short-term rates used in calculating the interest rate basket. The staff should keep a close watch on money market developments in the five countries concerned. Finally, although no change in the method of SDR valuation was being proposed, it remained important for the Fund to continue to consult, at least informally, its creditors and other holders of SDRs before any valuation review was conducted by the Board. Those consultations would be helpful to avoid any possible difficulties and smooth out the transition to the changes made at the time of each review.

Mr. Jaafar commented that the method of valuation, based on a basket of five currencies, had not achieved all the aims of the 1980 decision. The attractiveness of the SDR either as a reserve asset, or as a unit of account in the private market, had not significantly improved. Nevertheless, the performance of the standard basket for the valuation of the SDR had not given rise to any major problems and could be regarded as broadly satisfactory. It was possible, therefore, for him to support the proposal to base the SDR valuation during 1985 to 1990 on the methods specified in 1980, as well as the revised weights, which were in line with the calculations prescribed by that decision. It was a good practice to adhere to an agreed forumla and not to open the door to practices which might give rise to questions. It should be noted that the supplementary criteria supported the proposed weights, and if anything, lent weight to a rounding of numbers in the direction opposite to that which had occurred in 1980.

The substantial appreciation of the U.S. dollar had resulted in a greatly increased share of the U.S. dollar in the SDR basket, from 42 percent to 54.3 percent, Mr. Jaafar noted. Given that the U.S. dollar was presently overvalued, it was difficult to support the conclusion of the staff that its movements would not significantly alter the value of the SDR in a predetermined direction. The essential point was that a more stable exchange rate environment was necessary if the SDR was to be really stable.

While he had no objection to the proposal to maintain the present system for determining the SDR interest rate, Mr. Jaafar said, his concern was that the interest rate would be calculated in such a way as to result in a discrete jump when the new basket was put into operation. Therefore, the SDR interest rate should be reviewed at the beginning of 1986.

Mr. Leonard noted that experience over the past five years showed no need to change the standard basket approach used to value the SDR. The method of calculating the SDR interest rate basket also remained acceptable. However, it remained important to review the question of a discrete change in the SDR interest rate later in 1985, closer to the date of the expected changeover to a new valuation basket.

As a general principle, the revision of the valuation basket every five years seemed to strike a reasonable balance between the stability of the SDR's composition, and its representativeness, Mr. Leonard continued. Nevertheless, it was worth noting that the actual shares of currencies in the basket had moved significantly from the weights initially established in 1980, with the U.S. dollar's share increasing by a considerable amount. It would be interesting to know whether that change had created a perception that the SDR had become less representative, thereby discouraging the use of the SDR as a currency of denomination, particularly at a time when the use of the ECU had grown. If the U.S. dollar were to weaken appreciably in 1986, the currency shares could again begin to deviate significantly in the opposite direction. It might therefore be appropriate to hold a review after a shorter time period than five years only if the shares were to change substantially once again.

In view of the possible discontinuity in the SDR interest rate at the time of revaluing the currency basket it would be right to err on the side of caution in any calculations using the SDR interest rate which extended into 1986, Mr. Leonard said. Issues such as the Fund's income position or the rate of charge should be dealt with carefully, and at a minimum should utilize alternative scenarios whenever the SDR interest rate was used to estimate financial flows.

Mr. Kafka noted that the method chosen to value the SDR had stood the test of time quite well, but that it might be appropriate to consider whether reviews should take place at shorter intervals. It might also be a useful exercise to re-estimate the shares of currencies in international reserve holdings in light of the growing importance of the ECU. The suggestion that real GNP should be incorporated as one of the criteria for valuation was an idea that merited consideration. The interest rate basket should be reviewed before the end of 1985 in order to avoid discontinuities.

Mr. Lundstrom said that he agreed with the staff that it was important to aim at a method of valuation for the SDR that led to representativeness, stability, and continuity. Moreover, experience confirmed the usefulness of as objective a method as possible. He could therefore endorse the conclusions that the present method of value should remain unchanged, that the existing rule for rounding the weights be maintained, that a study be instigated of the possibility of determining the representative rates on a more uniform basis, and that there should be further consideration of the effects on the SDR interest rate of the realignment of weights before January 1986. There was, however, reason to study alternative methods of valuation of the SDR in order to stabilize its value. As part of the comprehensive review of the role of the SDR, the staff should examine ways to avoid undesirable changes in the actual shares in the valuation basket resulting from substantial changes in exchange rates. The use of a geometric rather than an arithmetic average and shorter intervals between each review might help to stabilize the SDR over time. The aspects of the valuation problem pointed out by Mr. de Groote merited further examination.

Mr. Jayawardena remarked that he agreed with the conclusions of the staff paper and supported the idea of an early review of the interest rate basket.

Mr. Mtei stated that the five-currency basket, which had been used as the standard of valuation for the SDR, had worked satisfactorily over the past four years. If the SDR was to play the role of a reserve asset, it was necessary to avoid frequent changes in the method of its valuation. Stability in the currency composition of the basket was important. The criteria for revising the basket indicated that its present make-up would remain the same for some time to come. Some adjustments had had to be made in terms of the relative weights of currencies in the basket, based on the shift from 1982 to 1984 in the percentage shares of exports of goods and services for the five countries and the role of their currencies in the international financial system. The Japanese yen and deutsche mark had played an increasing role as reserve currencies. The major gain had been by the Japanese yen, whose relative share in the currency basket had risen from about 12 percent in 1980 to 15 percent at present, while the shares of the pound sterling and French franc had been reduced by only one percentage point each. The rounding that had taken place had been small and, in any event, had been in a direction that was consistent with changes in the underlying economic conditions in the world economy.

Realignment of currencies in the interest rate basket could be expected as a result of the adjustment in currency shares in the SDR valuation basket, Mr. Mtei stated. It was likely that the discrete change in the SDR interest rate would be in an upward direction, which of course meant a higher rate of remuneration and consequently a higher rate of charge. The combined market rate was likely to be adjusted in an upward direction by one fifth of a percent. There should therefore be a review of the SDR interest rate at the end of 1985.

Mr. Clark said that he endorsed the conclusions of the staff review. He had some sympathy with the views of Mr. de Groote, who had mentioned the need to take fuller account of the ECU in international reserve holdings. In any event, the methodology, which involved adding a stock of reserve holdings to flows of trade, was not easy to explain. Nevertheless, it was right that the determination of currency weights should focus principally on external factors. More frequent reviews would only add further unwelcome uncertainty to potential holders' assessment of the SDR.

Mr. Pérez stated that the decision adopted by the Board in 1980 on the valuation of the SDR and the method of calculating the SDR interest rate had worked quite satisfactorily during the previous five years. There was no need for any change in the method, and he supported the conclusions of the staff paper.

Ms. Bush explained that the present approach to the valuation of the SDR reflected the Executive Board's response to some fundamental questions that had arisen about the SDR's value in the late 1970s. The method provided a combination of the continuity with which the value of the SDR was determined and an option for change in the basket at specific intervals to accommodate shifts in the importance of the basket currencies in the world economy. The present review met those two concerns by examining relevant data on the role of the basket currencies in the world's economy. The 1985 review provided current data by which new weights for the currencies in the basket could be determined and, at the same time, incorporated some very interesting supplementary data on the use of currencies both as a unit of account and as a means of payment for international transactions in capital markets. The context in which the 1980 decision was taken was quite different from the present one, since at that time the size and composition of the basket were the principal issues at hand. The need for a continued review of the valuation of the SDR remained important, particularly in light of the attention that the Board had given to the need for an in-depth assessment of the role of the SDR in the international monetary system.

There were a number of methodological questions relating to the determination of currency weights within the basket, Ms. Bush continued. The addition of reserves and exports as a basis for calculating percentages was perhaps too simplistic. It was not clear that the size of exports was three times more important than the extent to which currencies were used in reserves. That was the way the basket worked, since exports were 79 percent of exports and reserves, when added together, and reserves only 21 percent. Giving a heavier weight to reserves in the calculation would better reflect their importance in the system. It should be noted that even in Mr. de Groote's recalculation of the shares of various currences in reserves, the U.S. dollar continued to have a large role. On the other hand, it might not be desirable to give equal weighting to exports and reserves, since that would significantly raise the weight of the U.S. dollar in the basket.

Supplementary criteria had been introduced in 1980 in order to give additional indications of the relative importance of currencies in international financial transactions, Ms. Bush went on. The usefulness of those supplementary criteria had been confirmed. The data in SM/85/163 showed that the dominant role of the U.S. dollar had been reinforced, emphasized the increasing relative importance of the Swiss franc in international capital markets, and gave a clear indication of the relative decline in usage of the French franc. Table 5 on relative shares based on external capital market data was particularly significant because the denomination of bond issues was a good reflection of the willingness of a country to let its currency be used, the openness of a country's international capital markets and the desirability of a country's currency. Countries which had a strong interest in maintaining the role of their currencies in the international financial system--a role which should be broadly reflected in the SDR basket--should take steps to enhance the use of their currencies in international capital markets. Japan, for example, had already taken concrete steps toward internationalizing the yen--a move which would be reflected during the next few years in the international capital markets. Additional steps to internationalize the yen would promote that trend.

The supplementary criteria were significant in demonstrating the relative importance of currencies in the world markets and could be complementary to the other data used to calculate the SDR basket, Ms. Bush stated. Further work, therefore, should be undertaken to determine the various weighting arrangements that would take into account the supplementary criteria relating to capital markets' use and turnover of currencies; and the work could also incorporate an adjustment in the weighting between exports of goods and services and holdings of currencies. That data should be kept in mind during the overall review of the SDR, including its usefulness in world capital markets. Nevertheless, she could go along with the new weights proposed in the staff paper, which would give the U.S. dollar 42 percent of the basket at the start of the new valuation period.

Changes in the weights of the valuation basket and of the interest rate basket would be identical, Ms. Bush observed. On the basis of the revised baskets, a new SDR rate of 7.85 percent would apply to three-month maturities, somewhat higher than the current rate of 7.75 percent. While that difference was not substantial, it would signal a reduction in the recently projected net income level--at the current rate of charge--for FY 1986 of SDR 50 million. It would be interesting therefore to hear more about the consequences that the new SDR basket could have, through the interest rate basket, on the Fund's income position.

The limited choice of instruments in the SDR interest rate basket reflected the underdevelopment of various domestic financial markets, Ms. Bush said in concluding. Countries needed to develop more fully their markets for short-term, highly liquid, financial instruments bearing market-determined interest rates.

Mr. Ismael stated that he supported the staff conclusions on the valuation of the SDR because the continuity and stability of the asset would be maintained. The present procedures for determining representative rates of exchange had worked quite well and should be maintained.

Mr. Zhang remarked that he endorsed the staff proposal.

Mr. Alhaimus stated that the present basic approach to the SDR valuation had worked rather well, and it would therefore be possible for him to support the staff proposals to maintain the present five-currency basket and the suggested relative weights.

Mr. Msadek said that the present method of valuing the SDR was only a partial reflection of its role as a reserve asset in the international capital market. Trade-related criteria bore no specific determinable relationship to the importance of a currency in international capital markets, since trade might be lagging at the same time as the capital role of the currency might be strengthened, or vice versa. Furthermore, the role of other currencies, not included in the basket, might have greater importance in international financial markets than some of those currencies included in the basket. The Swiss franc was an example. There was no international consensus on the need to strengthen the role of the SDR in the international financial markets because of the predominance of other currencies. The fluctuations in the valuation of certain currencies within the basket rendered the present system unstable in the long run, thereby deterring the use of the SDR as an international reserve currency. A study should be made on ways to improve the stability of the basket composition in the face of discrepancies in the values of major currencies in respect of their real role in the international market. In the meantime, the present valuation could be maintained.

Mr. de Maulde commented that he could go along with the proposed decision. He agreed that consideration should also be given to the best way to incorporate the ECU in any definition of international reserve holdings.

Mr. Weitz said that he agreed fully with the staff proposals. It might be useful to include real economic factors among the criteria.

Mr. Angeloni remarked that he wondered whether there might be an advantage in having a system whereby the weights of the currencies were revised whenever there was a certain minimum discrepancy between the actual weights and those that had been computed in the most recent review. It might be worthwhile to study the possibility of such a mechanism that would avoid the need for reviews. He could support the staff proposals.

Mr. Nimatallah asked whether it might not be worthwhile to incorporate, as a supplementary criterion, the rate of change in countries' exports and in the international reserve holdings of their currencies, especially in the light of Japan's export performance in the past five years.

The Deputy Treasurer explained that the current rounding procedure was detailed in Steps C and D in Appendix III of SM/85/163. Step C stated that the currency amounts of the new basket should be expressed to two significant digits, provided that the percentage deviation over the agreed weight for each currency in the value of the SDR resulting from the application of the average exchange rates for the relevant three-month period ending on the transition date was the minimum on average and did not exceed one half percentage point for any currency. Step D stated that if no solution were found under Step C, the significant digits to which currency amounts might be expressed could exceed two for one or more currencies, but could not exceed four for any currency, provided that the shares of component currencies over a three-month averaging period, when appropriately rounded, were the same as the agreed percentage weights. The objective of those steps was to maximize the simplicity of the rounding procedure subject to the constraint that there should be a minimum possible divergence between the official and market SDR values. If rounding to the same number of significant digits for each currency meant that there would be a significant divergence between the official SDR rate and the rate that the market calculated for itself on the basis of its own exchange rate calculations then it might be appropriate for rounding to take place to more than two significant digits for some of the currency amounts. There remained a case, however, for reconsidering the rounding procedures adopted in 1980, and the staff would examine the issue in the paper on the calculation of the currency amounts to be issued later in the year.

The staff had taken the view that the ECU was a U.S. dollar, because it was created through a swap system, the Deputy Treasurer continued. The argument that ECUs were not U.S. dollars had been considered previously. In the draft Annual Report, the ECU had been treated as a memorandum item and, accordingly, corresponding amounts of dollars had been taken out of the reserves of the four currencies concerned. The result of that set of calculations in the draft Annual Report had been exactly the same as those in the paper under discussion. The principle involved might be reconsidered.

The argument that the valuation of the SDR should be based on real data and quantitative changes in reserves on a quarter-by-quarter basis raised difficult issues, the Deputy Treasurer continued. One of the most vexing issues was the period on which to base the analysis.

It would be possible to include GNP in the determination of the currency weights in the basket, the Deputy Treasurer said. However, the original idea of the SDR had been to capture the relative external financial importance of members, and that idea had led to the use of exports or imports of members and the inclusion in the basket of currency held in reserves of members. The SDR had been intended to be an externally oriented asset, based on the relative commercial importance of countries in international trade and finance. In the 1978 review, it had been suggested that quotas--or even calculated quotas--should be included in the determination of currency weights. Again, the same sort of idea had surfaced when the base had been broadened to include currency holdings as well as imports. The inclusion of GNP could, however, be considered, although it would reorient the calculations more to the domestic aspects of the relative economic size of a member.

If the dollar were to depreciate after the realignment of currencies within the basket, its currency share in the basket would start falling from the amount projected on the basis of the present exchange rate, the Deputy Treasurer noted. There would simply be a reversal of the mechanics that had operated between 1982 and 1984 when the dollar had been rising sharply.

The question of whether there should be more frequent reviews of the currency amounts and perhaps of the basket, if the currency shares departed substantially from those at the beginning of 1986 was an important one, the Deputy Treasurer stated. The currency amounts and exchange rates were equal only at one point of time--the last business day in 1985. Thereafter they would change as the exchange rates diverged. The extent of that divergence would depend very much on the volatility of the exchange rates. It was inevitable that there would be a divergence between the currency amounts as determined at the beginning of the year and the shares of currency in the basket over time. Maintaining the currency weights unchanged for five years was beneficial to official users of the SDR, particularly because of the certainty and predictability that that implied. That stability was also significant for the market. In the 1970s, the SDR valuation had changed fairly frequently. There had been a new basket in 1974; a review in 1976 had added to uncertainty; a substantial change had occurred after the review in 1978; and the new valuation basket had been introduced in 1980, after which it had been considered opportune to leave the basket alone for a while. The possibility of frequent reviews could be destabilizing. Moreover, the departure of the currency amounts from their original determination at the beginning of 1986 would not have significantly unfavorable effects on the SDR. Given that the SDR was a standard basket, it had to reflect movements in exchange rates, and it would not necessarily be helpful for the stability of the SDR if the Fund were seen to put a limit on the extent of fluctuations in that basket.

Many Directors had also raised the issue of the discrete jump that might occur in the SDR interest rate, the Deputy Treasurer commented. The staff had not proposed to review the concept underlying the interest rate basket but simply to examine the implications of a discrete jump in the SDR combined market rate to the attention of the Board as a policy matter. It was unlikely that using a geometric average would have an enormous impact on making the SDR a more stable asset or the SDR interest rate a more stable price.

Reserves were given equal weight with trade flows in the determination of currency shares in the SDR basket, the Deputy Treasurer noted. Since the addition of a stock and a flow was essentially illogical in any event, it would not necessarily be more logical to give different weights to those determining variables. However, that matter also could be looked into.

There was now a fairly long time series of data for the supplementary indicators, the Deputy Treasurer continued. A more substantive incorporation of those data might have a major impact on the valuation of the SDR, and any study of that matter might be embodied within the general program of work on the SDR.

The remarkable growth of Japanese exports had been reflected in the proposed change in the weight of the Japanese yen in the basket from 13 percent to 15 percent, the Deputy Treasurer said in concluding. There appeared to be no other obvious way of reflecting the change in Japan's share in exports without altering the determining criteria in a fundamental way, which was not being suggested at present.

Mr. de Maulde commented that the table on the currency composition of official reserve holdings included the ECUs in the same way as any other reserve asset. In fact, ECUs accounted for about 10 percent of total world reserves.

The Deputy Treasurer noted that the ECU had been treated in both ways in different tables in the Annual Report. Whether it was considered as a separate asset or as being swapped for dollars, currency weightings within the SDR basket would not be affected.

Mr. de Groote said that gold was not included in some tables on official reserve holdings and a gold swap would increase the effective proportion of ECUs in total world reserves.

Mr. Fujino commented that the incorporation of GNP as a determining variable in the weighting of currencies in the SDR basket was only one way of giving greater emphasis to real economic factors. The staff should consider a broad set of alternative ways of giving greater emphasis to the relative strengths of economies, which ultimately provided the basis for international confidence in any specific currency.

The Chairman stated that many Executive Directors had said that the valuation method established in 1980 had worked reasonably well. The conclusions of the staff had been broadly endorsed: on the basis of the existing criteria, the currencies in the basket would remain the same, the percentage weights of those currencies in the basket would be updated, according to the existing criteria, for the revision of the SDR valuation basket effective January 1, 1986. A number of Directors had expressed a strong desire for as stable as possible a method of SDR valuation in order to maintain the maximum continuity and certainty in the value of the SDR on the markets. The impact of the revised valuation on the SDR interest rate would be reviewed later in the year.

In spite of broad agreement on the new SDR valuation that would result from the application of the present methods for its calculation, a number of suggestions had been made for further work, the Chairman noted. Mr. de Groote had suggested a fresh examination of the ECU component in countries' reserves and of the possibility of modifying the calculations by a shift in emphasis toward denominating the variables in constant rather than in current prices. Mr. Fujino had made a suggestion to reconsider the criteria for determining the weights of currencies in the basket, perhaps to include a parameter for GNP. Ms. Bush had suggested taking a closer look at the supplementary indicators and giving greater emphasis to criteria relating to reserves and the use of currencies on the financial markets and in trade. Another idea that had been put forward by Mr. de Groote, Mr. Lundstrom, and Mr. Leonard, among others, was to study ways of reducing the variability of the shares of different currencies in the basket stemming from the sharp exchange rate changes that had been occurring in exchange markets; more frequent reviews might be called for in that context. Those different suggestions would be examined in due course, perhaps in the context of the broad review to be undertaken on the role of the SDR in the international monetary system.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/101 (6/28/85) and EBM/85/102 (7/1/85).

3. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to an Executive Director as set forth in EBAP/85/168 (6/28/85) is approved.

4. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/85/167 (6/27/85) is approved.

APPROVED: April 9, 1986

LEO VAN HOUTVEN
Secretary