ECONOMIC NOTES

INTERNATIONAL INSTITUTIONS: RECENT DEVELOPMENTS

The 1984 joint annual meetings of the International Monetary Fund (IMF) and World Bank were held in Washington in September. Discussions at the meetings focussed on the role that the Fund and the Bank should play in strengthening and broadening the world economic recovery in light of the changing international environment and the changing needs for financial resources.

The World Bank

The World Bank[1] in its annual report stated that its lending and investment commitments for the year ended June 1984 amounted to US$16.2 billion, compared with US$15.3 billion for the June year 1983. Lending by the IBRD totalled US$11.9 billion in 1984, up 7.3 per cent on 1983, while lending commitments of the IDA, the World Bank's 'soft-loan' arm, totalled US$3.6 billion, an increase of 7 per cent in the 1984 June year. (See table 1).

TABLE 1
WORLD BANK LENDING ACTIVITIES
(billions of US dollars, June years)

	1980	*1981*	*1982*	*1983*	*1984*	*1985*[1]
IBRD lending commitments	7.6	8.8	10.3	11.1	11.9	13.0
IBRD lending disbursements	4.4	5.1	6.3	6.8	8.6	10.2
IDA lending commitments	3.8	3.5	2.7	3.3	3.6	3.1
IDA lending disbursements	1.4	1.9	2.1	2.6	2.5	2.9

Source: World Bank
1 Budgeted commitments, projected disbursements

The IDAs financial position has been substantially affected by lower than expected commitments under the last two rounds of fund-raising, IDA – 6 and IDA – 7. Although the World Bank had an original target of US$18 billion for IDA – 7, the final amount agreed on in January 1984 was only US$9 billion. In addition, the IDA had a mandate to raise additional resources amounting to US$3 billion, aiming to close the gap between the US$9 billion agreed upon and the US$12 billion that most members regarded as the minimum level of resources needed by the Association. However, efforts to raise the additional US$3 billion through a special fund were unsuccessful and were finally abandoned at the annual meeting in September. It was decided to both review the IDAs financial position again in 1985 and discuss the future funding of the IBRD.

The World Bank group is currently undertaking an in-depth review of how it should respond to the circumstances confronting developing countries. As part of this review, the Bank is considering forming a subsidiary multilateral investment insurance agency to encourage an expanded flow of resources to productive enterprises in its member countries.

International Monetary Fund

Recent developments have strengthened the liquidity position of the IMF and will enable it to continue to support the economic and financial adjustment efforts of its members. This is in contrast to the situation prevailing in 1983 when delays on the part of many members in assenting to the increase in quotas following the Eighth General Review of Quotas[2] placed pressure on the IMFs liquidity position. The subsequent improvement has resulted from payments for the quota increase, the enlargement of the General Arrangements to Borrow (GAB)[3], and the conclusion of four new borrowing agreements totalling SDR 6 billion.

The four new borrowing agreements were with the Bank for International Settlements (BIS), Japan, Belguim and Saudi Arabia. The BIS agreement was reached in late 1983. It provides for a stand-by credit facility amounting to SDR2,505 million in which the Fund is able to draw on the facility over a one year period from 30 April 1984. Each drawing is to be for a minimum period of two and a half years. The central banks of 17 industrialised countries (including New Zealand) act as a guarantor in the scheme. The monetary authorities of Japan and Belgium agreed to provide SDR375 million and SDR120 million respectively under bilateral loan agreements concluded in early 1984. The terms were similar to those of the BIS facility. Similarly the Fund concluded an agreement with Saudi Arabia in early 1984 for SDR3 billion.

Details of the IMFs new loan commitments and other uses of its resources are given in table 2.

TABLE 2
NEW LOAN COMMITMENTS
AND OTHER USES OF IMF RESOURCES
(billions of SDRs)

	1979	*1980*	*1981*	*1982*	*1983*	*Jan. - Aug. 1984*
New Loan Commitments:	-0.8	6.6	12.1	2.4	10.6	-0.1
Industrial Countries	—	—	—	—	—	—
Developing Countries	-0.8	6.6	12.1	2.4	10.6	-0.1
Purchases under low conditionality facilities:	0.6	1.0	1.5	3.0	3.4	0.8
Industrial countries	—	—	—	0.1	—	—
Developing countries	0.6	1.0	1.5	3.0	3.4	0.8
Trust fund loans disbursed (developing countries only)	0.5	1.3	0.5	—	—	—
Total	0.3	8.9	14.0	5.5	14.0	0.7

1 The World Bank consists of the International Bank for Reconstruction and Development (IBRD) and its two affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC).

2 For details, refer page 286 of the July 1983 Reserve Bank Bulletin and page 9 of the January/February 1984 Bulletin.

3 For details, refer page 287 of the July 1983 Reserve Bank Bulletin and page 10 of the January/February 1984 Bulletin.

Commonwealth Finance Ministers Meeting

Commonwealth Finance Ministers met in Toronto, Canada in September 1984 where the Commonwealth Consultative Group on International Economic Issues reported on its investigation of the international monetary and trade and payments systems. The only specific recommendation of the Group's report was that Finance Ministers propose a special two-three day meeting of the IMF/World Bank Development Committee to discuss the full range of trade and payments issues.

At the subsequent IMF/World Bank joint annual meeting and the associated meetings of the Interim and Development Committees, the United States put forward a proposal which extended that contained in the communique of the Commonwealth Finance Ministers, namely that both the Interim and Development Committees would be an appropriate forum for a discussion of the issues of external debt and international monetary reform. As a result, it was decided that the next meetings of the Committees (scheduled for April 1985) would be devoted to the problems of the developing countries including external indebtedness, international trade and protection and the role of the IMF and World Bank.

JOINT PRESS STATEMENT

The following press statement was issued jointly by the Hon. R.O. Douglas, Minister of Finance and the Hon. David Caygill, Minister of Trade and Industry:

Abolition of Compulsory Ratios

"Eight sets of regulations and a directive under the Reserve Bank Act, which together comprise the compulsory ratios system, will be revoked on 11 February 1985, abolishing the ratios system."

The Minister of Finance, Roger Douglas, and the Minister of Trade and Industry, David Caygill, announced this in a joint press statement on 7 February 1985.

These regulations had required certain financial institutions to invest various specified proportions of their total funds in Government stock or other public securities.

"The ratio system represents a maze of regulations which result from disconnected decisions taken at different times for a variety of reasons.

This complicated array of controls is not serving any useful economic purpose. It is a serious obstacle to financial efficiency. It penalises both the public and the institutions alike.

Indeed, it is likely that the lower income savers and borrowers have been the group most heavily penalised by the ratio system, and there is no way that can be justified", they said.

Messrs Douglas and Caygill said abolition of the system should not be expected over-night to remedy damage and inefficiency which had been inflicted on the financial system over many years.

"What we're doing will, however, free the institutions to readjust over a period and, in the medium term, to achieve a new efficiency which responds better to the needs of their customers.

The ratios system had been highly discriminatory, requiring markedly different proportions of funds to be invested in public securities by the different institutions.

Those requirements have varied a great deal over the years, but most recently, their levels have been:

— private savings banks, 54 per cent, plus requirements to hold minimum amounts of certain liquid assets;
— trustee banks, 38 per cent, plus requirements to hold minimum amounts of certain liquid assets;
— finance companies, 30 per cent;
— life insurance companies, 20 per cent in government securities, 11 per cent optionally in government or local authority securities, and 20 per cent in housing or farming;
— private superannuation funds, 20 per cent, 11 per cent optionally in government or local authority securities, and 10 per cent optionally in government securities, housing or farming;
— building societies, 19 per cent;
— trading banks, as required by directive issued under the Reserve Bank of New Zealand Act 1964, and as at February 1985, 27 per cent.

Since past governments paid cut-rate interest on the money they thus compulsorily acquired, the system has amounted to an arbitrarily discriminatory tax on these institutions.

On the other hand, various 'fringe' institutions, including solicitors' mortgages, have always been completely outside the system, and were exempt from any of those penalties.

The burden of the penalty has been borne ultimately by the customers of those institutions, which were forced to widen their margins between deposit and lending rates to hold profitability.

The necessity had made ratioed institutions less competitive than uncontrolled sectors, and high-ratioed institutions like savings banks less competitive than low-ratioed institutions.

The system has therefore been directly responsible for redirecting funds away from the ratioed institutions, and into the uncontrolled or less controlled 'fringe' financial markets.

Such markets are generally higher-cost and lower-quality sources of finance for borrowers. Their interest charges are greater and the term of their loans tends to be shorter.

The ratioed institutions, left with less funds than they would have had otherwise, were forced to ration customers by limiting loan levels, turning people away, or making them wait unnecessarily.

The unfortunate consequences are demonstrated clearly in the rates of growth for the various institutions, which have been greatest in uncontrolled sectors and least for the high ratioed institutions.

In the decade to 1984, for example, the high-ratioed private savings banks grew at an annual rate of only 6 per cent, and trustee savings banks at 16 per cent.

By comparison, the lower-ratioed finance companies grew at an average annual rate of 31 per cent. Unratioed solicitors' mortgages have accounted for over 30 per cent of the value of reported mortgages registered.

It is probable that housing finance has been the area most adversely affected by this ill-conceived and illogical system''.

Messrs Douglas and Caygill said past governments had considered fiddling with the system, for example by controlling solicitors' mortgages as well.

''This Government conceives that to be pointless. The root problem is the system itself, which deserves to be scrapped.

Past Governments have also seen the system as an economic management tool. By varying the ratios, they believed they could influence levels of liquidity to the benefit of the economy.

In fact, however, funds leaked so fast into the uncontrolled sector that the level of control was always less than satisfactory and the financial distortions were counter-productive.

It had been a further objective of the system to ensure that institutions placed sufficient of their funds in areas of high overall security, as a guarantee of their financial stability.

In fact, however, the law required the specified level to be held at all times. So those holdings were totally illiquid, even in the case of a crisis.

Moreover, the low return received on the investment made substantial losses almost inevitable for the institution, if it did find itself forced to sell for security reasons.

In future, the stability aspect of policy will be managed by strengthening the Reserve Bank's prudential surveillance of financial institutions.

The Reserve Bank will initiate further discussions about this with the institutions groups in the near future.

New Zealand's need is for a finance market structured to transfer money from the saver to the borrower in the most efficient and economical manner.

Ratios have become an impediment, not an aid, to that objective'', Messrs Douglas and Caygill said.

Note: Compulsory ratios were first introduced for trading banks almost 50 years ago. They were extended to cover trustee banks in 1948, then in the late 1960's and early 1970's were further extended to cover additional kinds of institutions.

TREASURY BILL TENDERS

On 5 February 1985 the Reserve Bank rejected all bids in both its weekly tender of new issue 42 day treasury bills and an offer of short-dated (21–23 day) Treasury bills from the Bank's own portfolio.

Rates bid for the short bills ranged from 17.24 per cent to 19.5 per cent and rates bid for the 42 day bills ranged from 17.8 per cent to 19.83 per cent. These rates were well up on the average rate of 17.02 per cent accepted in the first Treasury bill tender held on 29 January 1985.

In announcing the rejection, the Deputy Governor of the Reserve Bank, Dr R.S. Deane, said that the Bank in offering bills by both tender and out of its own portfolio, was of the view that short term liquidity, which had been tight, would ease over the week ahead. The rates bid by the market imply that the market did not share this view. Following the tender it became evident that liquidity had eased as the Bank expected and call rates came back quite sharply.

The Bank noted that a distinction needs to be drawn between the government stock tenders which have been operated for some time, and the new treasury bill tenders. Government stock tenders have medium-term objectives and are a key element of monetary policy. Treasury bill tenders have a much shorter focus and are part of a recently introduced system for short term liquidity management which was to offset some of the seasonal and other short term flows in order to moderate the instability of short term interest rates. Accepting the rates bid on 5 February 1985 would not have helped achieve this latter objective the Bank believed.

Dr Deane concluded that the Treasury bill tendering system and the Bank's open market operations, which is the other main element of liquidity management, are still in a settling down phase.