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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/19

3:00 p.m., February 3, 1984

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	w. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	M. K. Bush
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	L. Leonard
A. Kafka	
G. Laske	
	C. P. Caranicas
	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
F. Sangare	
M. A. Senior	J. L. Feito
J. Tvedt	
	T. A. Clark
	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present

African Department: D. E. Syvrud. Asian Department: L. H. De Wulf. European Department: P. L. Hedfors. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; H. W. Gerhard. External Relations Department: D. M. Cheney. Legal Department: J. G. Evans, Jr., Deputy General Counsel; S. A. Silard. Middle Eastern Department: S. Thayanithy. Research Department: L. Alexander, K.-Y. Chu, N. M. Kaibni, E. C. Meldau-Womack, P. R. Menon, E. A. Milne, T. K. Morrison, A. Muttardy, A. Salehizadeh, D. Sapsford. Bureau of Statistics: A. K. M. Siddique. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, H. A. Arias, C. J. Batliwalla, S. E. Conrado, S. El-Khouri, S. M. Hassan, L. Ionescu, H.-S. Lee, W. Moerke, G. E. L. Nguyen. Y. Okubo, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, M. B. Chatah, G. Ercel, I. Fridriksson, V. Govindarajan, H. Kobayashi, A. Kone, M. J. Kooymans, G. W. K. Pickering, E. Portas, M. Rasyid, D. J. Robinson, S. Sornyanyontr.

1. COMPENSATORY FINANCING FACILITY - TREATMENT OF IMPORT CONTENT OF EXPORTS

The Executive Directors considered a staff paper on the treatment of the import content of exports under the compensatory financing facility (SM/83/262, 12/27/83).

The staff representative from the Research Department remarked that the first part of paragraph 2 on page 5 of the staff paper should be corrected to read: "For the remaining two products, diamonds and in-bond industries, shortfalls occurred on five occasions and excesses on four, with shortfalls exceeding excesses in each product." On page 10 of the paper, the introductory clause of the first paragraph should be changed to say: "For the six drawings by five countries where inclusion of the relevant product contributed significantly to the overall shortfall in respect to a particular request..."; the third sentence should begin with the words, "For those of the five countries that have made multiple drawings...." Finally, the meaning of the penultimate sentence on page 5 of the staff paper should be clarified. The statement was correct insofar as it applied to Israel; in the case of Romania, however, the product excess had had the effect of reducing the overall shortfall but not the drawings, which had already been constrained by the quota limits.

Mr. Laske observed that the staff paper, which had been prepared at his request, provided a comprehensive examination of an issue that he had raised in June 1983 in connection with a request by Panama for a purchase under the compensatory financing facility. He had taken note at the time of the high import content of Panamanian exports and had been led to the conclusion that, in such circumstances, an export shortfall should normally be accompanied by a parallel import decline. However, the staff had now convinced him that his conclusion--logical though it might be--could not be generalized, and that the particular circumstances of each individual case must be evaluated.

The staff had properly argued that an exclusion of the import content of exports from the shortfall calculation would be consistent with the purpose and spirit of the compensatory financing facility, Mr. Laske continued. At the same time, it had shown, first, that the extent to which member countries might have gained unwarranted compensation had been limited and, second, that the alternative approaches to resolving the problem would, if applied uniformly, entail certain drawbacks. Hence, he was for the time being prepared to accept the staff's recommendation to maintain the current practice of basing the shortfall calculations on the gross value of domestic exports, net of genuine re-exports. Nonetheless, it would be a welcome development if member countries were voluntarily to refrain from making requests under the compensatory financing facility when the calculated import content of their exports was significant and when the failure to take it into account might lead to an economically unjustifiable drawing. In that context, he attached particular importance to the statement at the bottom of page 10 that, "In dealing with future [compensatory financing] requests, where the import content is an important feature of the case, the staff will bring to the attention of the Executive Directors an analysis of the facts relevant to the issues discussed in this paper."

An alternative to voluntary abstention by members might be the application of special treatment in cases of obvious relevance and importance, Mr. Laske said. The cutoff point in such cases would certainly be a matter of judgment; however, special treatment for cases in which the import content of exports was larger than, say, 50 percent would not be unreasonable. Such an approach might be possible without changing the decision on the compensatory financing facility. Of course, the necessary determination of a "threshold" might make the approach inconsistent with the principle of uniform treatment; on the other hand, the same inconsistency would be evident if the Executive Board were to disregard cases in which the import content of exports was significant. It was unlikely that the sort of case that had prompted his request for a staff study would occur often in future, but if a similar situation were to present itself, careful consideration should be given to appropriate treatment. He wished to keep open the option for an ad hoc solution, which would of course have to conform to both the letter and the spirit of the compensatory financing facility decision.

Mr. Jaafar recalled that the compensatory financing facility had been established to help members suffering from temporary payments difficulties because of merchandise and services export shortfalls. The decision had been expanded in 1981 to include excesses in the cost of cereal imports. In principle, except for cereal imports, the import content of exports should be netted out from the shortfall, leaving the value-added component as part of the total shortfall. In practice, however, the matter was not a simple one. The value-added technique could be difficult to apply, and the net export approach could be applied only in those cases where the component of imports in exports was well defined, such as in the case of entrepôt commodities. Difficulties arose when, for example, a proportion of refined petroleum was used to meet domestic consumption. In the case of Panama, if the value of imported crude oil had been subtracted from the exports of refined petroleum, the result would have been negative, a development that underscored the difficulty of deciding what proportion of imports it was appropriate to deduct.

The matter became even more complicated when one looked at exports of merchandise and services exports with both direct and indirect import content, Mr. Jaafar continued. It was difficult, for example, to make calculations with respect to manufactured exports that had been produced wholly or partly with imported materials; the same was true when account was taken of services and income transfers, such as exports of foreign firms or multinational corporations operating with a blend of expatriates and local staff. He was forced to conclude that, in practice, it was extremely difficult to determine the import content of exports, except with respect to certain entrepôt commodities, and the staff should not be left too much discretion in other cases unless the Board could isolate and identify the various products for special treatment under the compensatory financing facility for which the import content was high, say, 50 percent of either the shortfall or of total exports. However, the isolation of such products would run counter to the principle of uniformity of treatment, and he could therefore not support such an approach. Since 1976, there had been only one case in which a country had benefited significantly from the inclusion of imports in the calculation of the shortfall; in other cases examined by the staff, the shortfall was even greater when the import content was included. On balance, therefore, he could support the staff recommendation to continue with present practice.

Mr. Kabbaj remarked that the issue under consideration could pose a problem as industrialization and international trade gradually spread, and as developing countries increasingly began to export finished products with a high import content. It was thus necessary to take steps gradually to incorporate in the current procedures for determining access to the compensatory financing facility a mechanism that would eventually separate the import content of exports without unduly complicating the smooth operation of the facility. It was encouraging to note from the statistics provided in the staff paper that the situation did not yet warrant the adoption of alternative procedures, such as the net export or domestic value-added approaches. In fact, in some instances, the application of those approaches could have the net effect of reducing the overall shortfall. The current approach was practical and simple; under the alternative approaches, it would be difficult accurately to assign a certain volume of processed exports to any particular import content.

Unfortunately, Mr. Kabbaj continued, the staff's argument for maintaining present practice had less to do with the virtues of that practice than with the difficulties associated with implementing the alternative approaches. The fact that current methods had worked well so far was comforting, but the Fund should aim at removing any remaining elements of bias--however insignificant they might appear--from its procedures, even at the cost of complicating the policy. The one virtue of the present method was that it accorded uniformity of treatment to all members; but that tended to beg the issue. Indeed, by according uniformity of treatment to diverse and inherently different problems, the procedure produced results that might be easy to achieve but were certainly far from uniform. In formulating a decision that would be the basis of Fund operations for a number of years, the Executive Board should do its utmost to ensure that the rules were comprehensive and free from ambiguities and that they incorporated provisions to ensure unbiased application.

All things considered, Mr. Kabbaj said, he tended to agree for the time being with the staff's recommendation that the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports, should be maintained. Moreover, he could endorse in particular the suggestion that, for future compensatory financing facility requests in which the import content of exports was a major feature of the case, the staff should bring to the attention of the Executive Directors an analysis of the facts relevant to the issues discussed in SM/83/262. At the same time, he urged the staff to continue its efforts to find a new procedure that could address the treatment of the import content of exports without undue complication.

Mr. Caranicas stated that he could support the staff's analysis and recommendations regarding the treatment of the import content of exports under the compensatory financing facility. The current practice of excluding from the shortfall calculations the extreme cases of import content was a reasonable second-best solution inasmuch as it ensured a uniform treatment of members eligible for drawings under the facility. To date, the practice had not created any particular problems, and the record of implementation had been good.

He agreed with the staff that the alternative methods surveyed in the paper did not represent an improvement over current practice, Mr. Caranicas continued. In fact, the drawbacks inherent in each approach far outweighed their attractive features. While supporting Mr. Laske's idea that members with a high import content to their exports should perhaps refrain from requesting drawings under the compensatory financing facility, he believed that it would be best to maintain the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports. At the same time, he could strongly support the idea that, when the import content of exports was large, a detailed analysis of the situation should be provided to the Executive Board.

Mr. Clark observed that, in principle, there seemed to be a strong argument for adjusting the calculation of an export shortfall to reflect any associated movement in imports; the manner in which such an adjustment could be made was clearly open to discussion. Something along the lines of the value-added approach outlined in the staff paper would seem to be acceptable; however, such an approach was difficult, if not impossible, to apply consistently in practice. Very few countries had full input-output tables, and even fewer countries produced them quickly enough for the information to be useful to the staff in calculating shortfalls. He agreed that any conspicuous links between export shortfalls and movements in imports should be identified by the staff; indeed, he hoped that the amount of any compensatory financing facility drawing would in broad terms reflect any such links. At present, however, he saw no satisfactory way of going beyond the staff's recommendations.

Mr. Schneider commented that the staff paper had clearly outlined the problems that would be involved in changing policies regarding the treatment of the import content of exports under the compensatory financing facility. Any effort to modify those policies could lead to complex procedures, difficulties in agreement on definitions, and arbitrary cutoff points. It could also lead to the introduction of changes in a general policy that, in practice, would apply usefully to only one country. In the circumstances, he could accept the staff recommendations outlined on page 10 of SM/83/262.

Mr. Delgadillo recalled that previous Board discussions on the treatment of the import content of exports had revealed that a departure from existing practices for calculating export shortfalls was not feasible. The rules and conditions for access to the compensatory financing facility were clear cut, and borderline cases should not be considered a justification for varying the rules or for giving too much discretion to the staff in applying them to different cases. In the staff's latest study of cases in which the shortfall calculation had included a relatively large import content, there was no strong evidence to suggest that the inclusion would lead to any significant difference in either the magnitude of the shortfalls or the size of drawings under the compensatory financing facility. In fact, since 1976, only Panama had benefited--in terms of the amount of drawings under the facility--from the inclusion of import content in the calculation of the shortfall.

It was clear from the staff paper that the alternative approaches to the treatment of the import content of exports were inadequate both on technical grounds and because their implementation might violate the principle of uniformity of treatment of members, Mr. Delgadillo remarked. In sum, therefore, he strongly supported the staff's recommendation that the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports, should be maintained.

Mr. Wang stated that his chair could also support the staff recommendations, including the idea that, in future, requests should be brought to the Board for discussion on a case-by-case basis whenever the import content of exports was considered a significant factor in the calculation of the shortfall.

Mr. Tvedt said that he could support the staff's proposal to maintain the current practice for the calculation of export shortfalls. Various practical and definitional problems would arise with the attempt to implement any of the alternative methods outlined in the staff paper. He attached great importance to the principle of uniformity of treatment in the calculation of export shortfalls, and that principle could best be upheld by the use of a method that was easily applicable in practice; the current procedure, as far as he could see, best met that requirement.

Mr. Prowse remarked that the staff paper showed clearly the practical difficulties of attempting to net out the import content of exports from the calculation of shortfalls for the purposes of the compensatory financing facility. While, in principle, such netting out was desirable, it was evidently too difficult to achieve with sufficient precision to enable the procedure to be adopted as a general rule without risking serious inconsistency. It was relevant to note that significant overcompensation had, over the years, been quite infrequent; hence, he could support the staff's recommendation to maintain current practice, especially as the recommendation was based on a thorough study. However, he believed that it would not be inconsistent with current practice if, in those few countries whose compensatory financing facility drawings were based largely on shortfalls in exports having a significant import content, the authorities and staff might consider limiting the amount of the drawing to some reasonable proportion of the calculated shortfall. Presumably, that would be somewhat higher than the calculation produced by netting out the best estimate of direct import content because of uncertainties of measurement. On the other hand, he could accept the staff's proposal to take account of those factors in their judgment and to bring to the attention of Executive Directors an analysis of situations in which the import content of exports was an important feature of the case at hand.

Mr. Suraisry remarked that the staff had argued convincingly that present procedures--even if they were not ideal--should be maintained, and he could endorse the conclusions in SM/83/262. The analysis of compensatory financing facility requests since 1976 indicated that the inclusion in the calculations of products with a high import content had not produced serious consequences; only in a very few cases had countries gained what might be termed an undue "advantage" from the inclusion of such products.

It would be difficult, from both a theoretical and a practical point of view, to develop satisfactory approaches to adjusting exports for their import content, Mr. Suraisry considered. The staff had examined two such approaches--the net export approach and the value-added approach--both of which evidently had serious conceptual and practical drawbacks. Even if satisfactory methods were to be devised for adjusting exports for their import content, the problem remained of where to draw the line between cases for which adjustments should and should not be made. The problem was particularly troubling since it touched on the principle of uniformity of treatment of member countries. He could support the staff's suggestion for including in future compensatory financing facility requests--where the import content of exports represented an important feature of the requests--a detailed analysis of all the relevant factors involved. Such an approach was not at variance with the principle of uniformity of treatment; indeed, it was already being applied to oil exporting countries requesting purchases under the facility. In sum, he had been convinced by the staff that the Fund had not thus far faced a serious problem in applying the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports. Attempts to deal with the problem of the high import content of exports by adopting specific new rules would result only in additional complications.

Mr. Kafka stated that, like others, he could support the staff's recommendations. Clearly, the only alternative to present practice that was conceptually defensible was the value-added approach; however, the practical difficulties entailed in implementing such an approach were insurmountable. It was also evident that the Fund could not determine cutoff points for taking account of the import content of exports, because such a determination would discriminate among members. For similar reasons, he could not agree that members should be asked voluntarily to refrain from making requests under the compensatory financing facility in cases in which they might appear to be benefiting from a high import content of exports; nor could he agree that the staff should make reductions in such cases compulsory. The present system had worked well and should be maintained.

Mr. Senior said that he could accept the analysis and recommendations in SM/83/262. Current procedures had worked effectively and were adequate for the purposes of the compensatory financing facility decision. There were serious drawbacks to the modifications explored by the staff, and he agreed that the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports, should be maintained. Nonetheless, he was disappointed that, in order to reach its conclusions, the staff had relied primarily on an indication of the practical--or definitional--difficulties of the alternative approaches, thus avoiding the need to make reference to the more fundamental conceptual problems that a modification of current practice would entail. While he agreed that practical difficulties would arise if an attempt were made to implement either of the alternative approaches outlined, he would have preferred to see the staff treat the problem of the import content of exports in a more fundamental way in order to reach even more definite conclusions regarding the adequacy of current practice and the inadequacy of the alternatives it had explored. He would, however, reserve his comments for occasions in future when the issue might again arise in connection with specific compensatory financing requests.

Mr. Sangare remarked that he had no difficulty with the analysis and conclusions in SM/83/262 and could therefore support the staff's call for maintaining the current practice of calculating export shortfalls. Perhaps the most important advantages of the compensatory financing facility over other commodity stabilization programs were the simplicity of its implementation and the timeliness of the assistance it provided. The present practice of calculating export shortfalls had helped to give the facility its unique character and had not given rise to any particular difficulties.

According to the staff, there was no evidence to show that the current procedures systematically resulted in inflated shortfalls, Mr. Sangare continued. On the contrary, the inclusion of products with high import content in the export shortfall calculations--even in the particular cases where the relevant products had contributed significantly to the overall shortfall--had mostly led to a substantial reduction in the overall shortfalls calculated for all the drawings made under the compensatory financing facility over the past eight years. Making the calculation procedures unduly complicated would gain nothing; what could be lost was the timeliness of the assistance that the compensatory financing facility provided.

The two alternative approaches outlined in the staff paper were not particularly satisfactory, Mr. Sangare considered. Neither was superior in any way to the present method for calculating the shortfall, and both suffered from serious conceptual and practical drawbacks and involved the establishment of arbitrary cutoff points that might be inconsistent with the principle of uniformity of treatment of members. Moreover, the two methods required more complex calculation procedures than present practice and would make implementation of the compensatory financing facility policy more cumbersome. In sum, he had found no convincing reasons for changing the current method for calculating export shortfalls under the compensatory financing facility.

Mr. de Vries stated that, like others, he would have preferred procedures for calculating the export shortfall that tended to eliminate some of the existing anomalies. However, he had been convinced by the staff that the practical difficulties of implementing either of the alternative approaches outlined in the paper far outweighed their advantages, and he could therefore support the staff's recommendation that the present practice should be maintained. The staff had also indicated that, in dealing with future compensatory financing facility requests where the import content was an important feature of the case, it would bring to the attention of Executive Directors an analysis of the facts relevant to the issues discussed in the paper. It was unclear, however, whether the provision of such an analysis would be consistent with the decision to maintain present practice. If current policies and practices were to be maintained, he saw little use in producing an analysis that might suggest that those policies and practices were inappropriate. A clarification of the purpose of the additional analysis would be useful.

Mr. Blandin remarked that he could go along with the staff's recommendation that the current practice for calculating export shortfalls should be maintained, and with the recommendation that particular cases relevant to the issues outlined in SM/83/262 should be brought to the attention of Executive Directors. It seemed to him that the major aim should not be to look for a new general method--which, as the staff had noted, would be difficult to implement--but to gain a better and more precise view of the agreed export concept.

Mr. Erb recalled that he had for some time held the view that the intent and spirit of the compensatory financing facility had been stretched too far in cases where fluctuations in export products with a high import content had been closely matched by similar fluctuations in associated imports. While agreeing that it made sense to exclude re-exports when the import content of re-exports was virtually 100 percent, he did not feel that it was reasonable to draw the line at that point and include without any adjustment exports whose import content was 99 percent or less. In such cases, the question might arise whether special treatment was being given, although the staff paper had been helpful in providing quantitative estimates to show that the problem of special treatment had not been significant in most of the cases in the past involving products that had been perceived to contain a relatively high import content.

The staff had usefully explored various methods for making adjustments when the import content of exports was high, Mr. Erb continued. He agreed that the methods designed to obtain precise estimates posed conceptual and empirical problems. Nonetheless, he was concerned that the staff's recommendations did not go far enough; while there were obvious problems in making precise estimates, there was certainly room for some adjustment based on analysis and judgment. In future cases, not only should the staff perhaps bring to the attention of Executive Directors an analysis of the facts relevant to the issue of the import content of exports, but it should also provide some indication of the magnitude of any adjustment in the calculations that might be appropriate.

When a final assessment was to be made on a request for purchase under the compensatory financing facility, it usually involved a series of judgments on various elements associated with the request, Mr. Erb noted. It would not seem unreasonable for the staff to include similar judgments with regard to the import content of exports, where appropriate; nor would it be unreasonable for those assessments to become part of the overall judgment by the Executive Board of whether or not the request should be supported. In that regard, he agreed with Mr. Laske's suggestion that countries whose exports had a high import content should refrain from requesting use of the compensatory financing facility.

Mr. Leonard considered that it was important, in examining possible changes in the operations of Fund facilities, to ensure that access to those facilities was in accordance with the criteria set down by the Executive Board for their use and also to ensure that an appropriate balance was struck between the benefits and costs associated with implementing the facilities. For that reason, he welcomed the objective study in the staff paper, which clearly delineated the considerations relating to the treatment of the import content of exports under the compensatory financing facility. His authorities were somewhat concerned that the current procedures allowed for the possibility that individual cases might not be fully consistent with the spirit of the facility; however, it was evident from the staff's analysis that no persistent or significant problems had arisen from the current practice of calculating shortfalls under the facility. Even if there had been a problem, the costs associated with making changes in the current practice would seem to outweigh any benefits that might be derived from those changes. Hence, he could accept the staff's recommendations that the Fund should continue with present practice.

It was of course important to ensure that the drawings under the compensatory financing facility were justified, Mr. Leonard remarked. Requests should therefore be examined with a view to determining that the export shortfall and the balance of payments need were sufficient to ensure the appropriate operation of the facility. If such an examination were carried out uniformly, Mr. de Vries's concerns should be met. It was important, in his view, that the staff should in future provide the Executive Board with an analysis of the relevant facts of a case when the import content of exports was significant.

Mr. Hirao remarked that, given the principles underlying the compensatory financing facility, it could be argued that the extent of the deterioration in a member's external position should be measured by the amount of the export shortfall, net of the offsetting import reduction. Still, for several reasons, he could go along with the staff recommendation that the current practice for calculating export shortfalls should be maintained. First, it was in practice difficult to subtract the import content of exports in all cases. Second, even under the current practice, the extreme cases of import content--namely, re-exported products--were excluded from the shortfall calculations. Third, according to the staff's analysis, there had been very few cases in which the inclusion of products with a high import content had resulted in an increase in drawings under the compensatory financing facility. Fourth, as he understood it, the staff would be providing the Executive Board with an analysis of the import content of exports in dealing with future requests for compensatory financing when the import content of exports was an important feature of the case.

He had noted with interest the suggestion for making provision for adjustments in cases of "obvious relevance and importance," for example, by setting certain criteria, Mr. Hirao continued. However, it would not be easy to establish appropriate criteria for triggering adjustments in the calculations. Furthermore, even for those cases in which drawings for the total amount of the export shortfall might not be fully consistent with the spirit of the compensatory financing facility, it would not be advisable to modify the present method of calculating the shortfall, although it would be desirable to ensure that final decisions on future requests were in keeping with the purposes of the facility. That goal could be fulfilled with the aid of the information on the import content of exports that would be provided by the staff.

Mr. Tshishimbi stated that, like others, he could support the recommendations on page 10 of SM/83/262. The staff had usefully explored ways of dealing with those cases in which the import content of exports was high and had presented two alternative techniques. The first was based on net export data; while it was useful for a limited number of products--such as petroleum--it was also complicated, especially for products for which imported inputs were involved in many processing stages or were put to more than one end use. There were also conceptual difficulties involved in the net export approach.

The domestic value-added approach would be even more difficult to implement, Mr. Tshishimbi commented, mainly because of the problems involved in gathering the necessary statistical information and putting together the input/output matrices required for computating the various value-added elements. On balance, therefore, he could support the maintenance of the current practice because of the ease with which it could be implemented and because of its consistency with the principle of uniformity of treatment of members.

Mr. Jayawardena recalled that, on an earlier occasion, his chair had expressed reservations about the proposal to take account of the import content of exports in making a case for drawings under the compensatory financing facility; he was happy to note that the latest staff paper confirmed his view that such a proposal was impracticable. Following an exhaustive analysis of 195 drawings under the compensatory financing facility since 1976, the staff had identified only one country--Panama--for which the import content of exports had had a positive effect on drawings under the facility. In two separate drawings, Panama had obtained a total of SDR 76.9 million, equivalent to less than 1 percent of the total drawings by member countries over the period. Furthermore, since the amount drawn by Panama was not entirely related to exports with a high import content, the amount at issue was an even smaller percentage of the total, and it was questionable whether Directors should be concerned about making complicated changes in policy to deal with such a relatively small matter.

There were innumerable difficulties involved in the effort to take account of the import content of exports, Mr. Jayawardena continued. Prices of the imported component and the exported product need not necessarily move in the same direction or in the same proportion; even if they did, exports and the associated imports might not take place during the same period. Hence, fluctuations in one would not necessarily be offset by fluctuations in the other. Furthermore, imports of one item might be associated with exports of more than one product, and any given item of export might have a number of imported inputs. In such cases, moreover, the prices of various products might well have moved differently. In view of those and other practical or conceptual problems raised by the staff, it would be difficult in practice to adjust the shortfall in exports of a commodity for the value of imported components. Besides, the current practice of basing the shortfall calculations on the gross value of domestic exports had worked well and had been consistent with the principle of uniformity of treatment of members.

Given the small amounts of "overcompensation" shown in the paper and the rarity of their occurrence, it would seem preferable to maintain the present rules and not to complicate them with alternative approaches--such as those examined by the staff--that entailed difficulties of implementation and militated against speedy and prompt financing, which was a valuable and fundamental feature of the compensatory financing facility, Mr. Jayawardena remarked. As Executive Directors were aware, timely and expeditious assistance to primary producing exporters to meet sudden sharp reversals in export earnings, as a means of preventing them from taking measures that ran counter to orderly world trade and finance, was the main purpose of the compensatory financing facility. To make assistance under that facility both timely and prompt, the early drawing procedure was available under current practice. However, if the Fund were to adopt a more complicated procedure for calculating the import content of exports--which would require input/output computations for all countries seeking assistance under the facility--it would probably be necessary to send missions to all countries to make the evaluation, thus effectively eliminating the early drawing procedure and heralding the end of speedy and prompt financing.

He could agree that, in dealing with future compensatory financing requests, where the import content was an important feature of the case, the staff should bring to the attention of the Executive Directors an analysis of the facts relevant to the issue, Mr. Jayawardena continued. However, such an approach should not lead to a change in the present method of calculating export shortfalls. Apart from the conceptual and practical problems involved in the changes considered, there could be difficulties of ensuring symmetry. If drawings were adjusted in those cases where products were contributing to a shortfall, they would also have to be adjusted in the other direction, where the products contributed to a reduction in the shortfall.

On a related matter, his chair felt that the present method of calculating the shortfalls tended generally to underestimate the financing requirements of members, Mr. Jayawardena said. Without wishing to complicate the issue at hand by detailing his views on that matter, he hoped that the point would be kept in mind by Directors. Finally, the staff's examination of the treatment of the import content of exports had been useful in setting to rest any doubts or concerns that undue advantage was accruing to some members because of a weakness in the present method of calculating export shortfalls. Hence, he could strongly support the staff proposal to maintain the current practice of calculating export shortfalls on the basis of the gross value of domestic exports, net of re-exports.

Mr. Alhaimus remarked that he too could go along with the maintenance of the current practice for calculating export shortfalls; the staff had demonstrated the practical difficulties of any alternative approach. Expanding upon a point raised by Mr. Jayawardena, he hoped that, in informing the Executive Board in future of those requests in which the import content of exports was an important feature of the case, the staff would also cover cases in which the current practice led to a significantly lower calculated shortfall.

The staff representative from the Research Department, referring to the staff's suggestion on page 10 of SM/83/262 regarding future compensatory financing requests, noted that a special effort would be made to collect all the available information on the import content of exports and, where feasible, to provide analysis relevant to the issue at hand; it was not envisaged that the special effort would involve the staff in protracted technical assistance missions to construct input/output matrices that could be used for the analysis. However, as demonstrated in the staff paper, the paucity of information might well limit the extent of the analysis that could be provided in such cases. For that reason, and also because the Board had not endorsed a method of adjustment, the staff did not intend to recommend any adjustment of the compensatory financing calculations, even if such adjustments were feasible. In the absence of Board endorsement of a specific method of adjustment, it would be presumptuous of the staff to undertake ad hoc adjustments. In addition, depending on the method used, the adjustment could work both ways; it could increase the entitlement in some cases and reduce it in others. He did not believe that Directors who favored an adjustment would wish to see a member's entitlement raised after adjusting for the import content of exports.

With regard to other issues, there was little he could say on the suggestion that members with a high import content to their exports should perhaps observe some restraint in requesting drawings under the compensatory financing facility, because there were legal issues involved. The staff could, of course, bring to the attention of the authorities of a requesting member the views and concerns of Directors about the issues under consideration. It would however be difficult for the Fund to suggest or recommend to a member that it request an amount less than that for which it might be eligible. The member could of course choose voluntarily to exercise restraint.

The Acting Chairman, summing up the discussion, observed that the Executive Directors had broadly endorsed the staff's recommendation that the current practice of basing the shortfall calculations on the gross value of domestic exports, net of re-exports, should be maintained. As for the staff's intention--in dealing with future compensatory financing requests where the import content was an important feature of the case--to bring to the attention of Executive Directors an analysis of the facts relevant to the issues discussed in SM/83/262, it would be important to clarify the procedure and its purposes. Without attempting to construct full scale input/output matrices or to send special missions to members, the staff could provide what relevant information on the case it could marshal. However, given that the application of the compensatory financing facility decision would remain unchanged, the calculation of the shortfall and the recommendations for drawings should continue to be based on current practice.

The possibility of voluntary restraint by members might not be ruled out, but the staff and management could not be placed under an instruction by the Board to force members in any way to reduce the amount of their requests, unless there were a decision by the Board to that effect, the Acting Chairman continued. There was a precedent for voluntary restraint in the experience of the compensatory financing facility itself. Industrial countries, for example, were not legally prevented from making requests under the facility; however, there had been from the beginning a "gentleman's understanding" that they would not do so. The question became complicated when the issue concerned the amount of reduction in a request that would voluntarily be accepted by the member rather than whether or not a drawing would be requested at all. Given the vast differences in data available in member countries, the difficulty of the calculations involved, and the problems of ensuring consistency with the principle of uniformity of treatment of members, it would seem preferable for the staff to go no further than to make the information available to the Executive Board without any recommendations. The Executive Board could of course ask for another general review of the matter if it felt in future that changes in the method of calculation and in the application of the decision were needed.

Mr. Laske agreed with the Acting Chairman that the Executive Directors seemed to be in unanimous agreement with the staff's recommendations. However, it would probably not be out of place for the staff, in negotiating possible drawings under the compensatory financing facility, to indicate to the requesting member the view of some Directors that any advantage that might accrue to members when the import content of their exports was particularly high would not be in conformity with the spirit of the decision on the compensatory financing facility.

Mr. Erb considered that the benefit a member might receive in cases where the import content of exports was particularly high was an element that should be taken into account in passing judgment on a compensatory financing facility request in the same way that other elements--such as balance of payments need, the test of cooperation, and the issue of whether the shortfall was beyond the control of the authorities--were taken into account. It was on the basis of each Executive Director's review of those elements that a determination was made of whether or not to support the request. He wondered, in that connection, whether the

Acting Chairman's preliminary summing up of the discussion would preclude an adjustment if the Executive Board were to decide, in looking at a particular case, that some adjustment was needed in the magnitude of the calculated shortfall, on the basis of an assessment of the underlying data.

The Acting Chairman said that he had no difficulty with Mr. Laske's proposal that the staff should bring relevant data on the import content of exports to the attention of the requesting member together with the Executive Board's concerns, because that proposal was not inconsistent with current practice. However, for management and staff to use those data in determining the amount of the proposed drawing or in deciding whether or not it should support a request for a drawing--in the absence of a Board decision authorizing such an approach--would be a departure from established procedures.

The Deputy General Counsel agreed with the Acting Chairman. The determination of balance of payments need, the test of cooperation, and the judgment of whether or not a shortfall was beyond the control of the authorities were all aspects of the decision that had to be assessed by staff and management in bringing to the Executive Board a proposal for a drawing under the compensatory financing facility. It would not be appropriate, after making the assessments required under the decision, to reject or reduce the amount of a request on the basis of a matter that was not explicitly to be taken into account as part of the assessments under the decision itself.

Mr. Clark said that he could support Mr. Laske's proposal and agreed that there might be difficulties in taking the approach suggested by Mr. Erb.

Mr. Erb recalled that there had appeared to be a consensus that the import content of exports was an element that should ideally be taken into account. Most Directors had indicated that, because of the difficulties of calculating the import content of exports precisely, they would prefer not to rely on a formula for making such a calculation. However, those difficulties should not prevent Directors from taking the matter into account as one of the various elements relied upon in assessing a proposed request for a purchase under the compensatory financing facility.

The Acting Chairman replied that it was one thing to draw the attention of a member to Directors' concerns on the question of the import content of exports in the hope that the member might voluntarily choose to request something less than the amount for which it was eligible under present practice. It was quite another matter to suggest that the import content of exports should be taken into account in some explicit way, without adding a codicil to that effect to the decision.

Mr. Erb said that he was not asking staff and management to take the analysis of the import content of exports into account in putting forward a proposed request; he was only noting that such information could be taken into account by members of the Executive Board in taking a decision on the proposed request.

Mr. Kafka agreed with the Acting Chairman. Some elements, even if they could not all be quantified, were part of the decision and were to be taken into account in judging whether, or to what extent, a member was eligible for a purchase under the compensatory financing facility. Other elements--which were not part of the decision--might well influence a Director's assessment of the case, but could not be alleged as a motive for that assessment. The import content of exports was one of those elements.

Mr. Suraisry said that, as he understood the staff's proposed procedure, relevant data would be made available to the Executive Directors for their information. While he sympathized with Mr. Erb's point of view, he felt that serious difficulties would arise if the Board were to use the data provided by the staff as a basis for engaging in a negotiation on the amounts that requesting members would be able to draw under the compensatory financing facility.

Mr. de Vries commented that the decision on the compensatory financing facility required the Executive Board--as well as staff and management--to make judgments on certain elements, including the existence of a balance of payments need, whether the test of cooperation had been met, and whether the shortfall was beyond the control of the authorities. There was nothing in the decision requiring a judgment on the import content of exports. In the circumstances, unless the Executive Board wished to change the decision, information on the import content of exports would have to be ignored as part of the assessment of a member's request.

Mr. Caranicas agreed that, so long as it was accepted that the current practice was to be maintained, the assessment of members' requests would have to be based only on the elements for judgment outlined in the compensatory financing facility decision.

Mr. Prowse recalled that, in a discussion in June 1983, the staff had confirmed that, in cases where there was a high correlation between imports and exports, a deduction for the import content of exports could be made without changing the decision on the compensatory financing facility. If that was true, he saw no reason why the less specific proposal of Mr. Laske could not operate as a "guideline" to the staff. Indeed, in the formulation of stand-by arrangements, there were many guidelines that were employed even though they were not necessarily specified as part of a decision.

The staff representative from the Research Department remarked that the staff had indeed indicated in June 1983 that, in principle, it would be possible in individual cases to deduct the import content of exports without changing the decision on the compensatory financing facility. There were many practices employed by the staff in making its calculations that were not specified in the decision itself, including adjustments on account of stock accumulation, adjustments to take account of double compensation, and so on. In fact, the decision itself did not even specify the precise definition of exports that should be used for the calculations; the definition that was used had arisen out of practice, which had, however, been endorsed by the Board. In the circumstances, a different practice or a change in practice could in principle be effected with the specific endorsement of the Executive Board without changing the language of the compensatory financing decision itself.

The Deputy General Counsel remarked that it was important to underline the words "with the endorsement of the Board," because all the calculations to which the staff representative from the Research Department had referred had been discussed at length and approved by the Executive Board.

Mr. Erb commented that, as an Executive Director, he clearly had the right to take into account the import content of exports as an element in any overall assessment of whether or not to support a request for a purchase under the compensatory financing facility. If there were no process by which some adjustment in the shortfall could be made to take account of his concerns, then he might have to vote against the request in certain cases because no flexiblity had been built into the decision-making process. While Mr. de Vries might well have been thinking in terms of whether it was appropriate for the Executive Board, as a corporate body, to take account of the import content of exports in assessing whether to support a compensatory financing request, it should be remembered that the Executive Board was made up of individual Directors who, in taking an individual position, could in their totality de facto affect the decision of the Executive Board as a whole.

The Deputy General Counsel observed that Mr. Erb's latest remarks raised a troublesome issue. It would not be proper for the Executive Board to tell a member that was making application for a purchase under an existing policy decision that, because of collateral information made available at the time of the request, the decision would be applied in a new and different manner. If Directors wished to change the method for the calculation of shortfalls under the decision on the compensatory financing facility to incorporate data on the import content of exports, they could do so; but they would have to do so with the express endorsement of the Board. However, until there was an express decision of the Executive Board to change the elements in the calculation of the shortfall, the application of the decision would remain as at present. Even if a majority of Executive Directors felt on the occasion of a request that information external to the previously agreed method of applying the decision warranted a change in the method of calculation, it would not be proper to make that change after a request was put forward on the basis of information that it had not been agreed would be a factor in the calculation.

Mr. Erb considered that there was no question of applying certain factors ex post to a country's request and catching that country by surprise. The concerns of Executive Directors about import content in individual cases had been expressed on a number of occasions and were a matter of record. The issue at hand was whether or not to accept a formula for dealing with cases in which the import content of exports was high or whether to leave the matter to judgment. There was no implication of discrimination involved, because the Executive Board had discussed extensively the problems of principle that some Directors had with current practice and why those Directors felt that the matter could not be ignored.

The Acting Chairman observed that it was clear that the issue to which Mr. Erb and others had referred was not likely to arise very frequently. Some Directors had expressed concern about the question; however, until there was some agreement by the Board that the import content of exports was to be taken into account in the calculations and the manner by which it would be taken into account was agreed, it would not be proper for the Board to reject or reduce a request based on the present method of calculations. In summing up the discussion, he noted that Executive Directors in general accepted the staff recommendations on page 10 of SM/83/262 and that the staff would informally bring the concerns of Executive Directors to the attention of member countries when the issue of the import content of exports was pertinent to their requests for purchases under the compensatory financing facility.

The Executive Board accepted the Acting Chairman's summing up of the discussion and adjourned at 4:35 p.m.

APPROVED: July 17, 1984

JOSEPH W. LANG, JR.
Acting Secretary