NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/119

3:00 p.m., August 1, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. Koné, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
	M. Teijeiro
	D. C. Templeman, Temporary
	M. Lundsager, Temporary
M. Finaish	T. Alhaimus
	T. Yamashita
	I. R. Panday, Temporary
R. K. Joyce	L. Leonard
	H. A. Arias, Temporary
	G. Grosche
G. Lovato	N. Coumbis
R. N. Malhotra	
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
	E. I. M. Mtei
	M. Camara, Temporary
M. A. Senior	J. L. Feito
J. Tvedt	A. Lindå
	T. A. Clark
	J. Bulloch, Temporary
	Wang E.

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

Also Present

Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; J. A. Clement. External Relations Department: A. F. Mohammed, Director; H. P. G. Handy. Fiscal Affairs Department: A. L. Antonaya. Legal Department: A. O. Liuksila, J. K. Oh. Middle Eastern Department: S. von Post. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; J. Artus, C. P. Blackwell, M. C. Deppler, M. D. Knight. Secretary's Department: J. C. Corr. Treasurer's Department: M. A. Tareen. Western Hemisphere Department: J.-P. Amselle, R. A. Elson, M. R. Figuerola, H. E. Khor, T. F. Lehwing, J. Martelino, S. J. Stephens, J. E. Sundgren. Bureau of Statistics: W. Dannemann, Director; A. C. Bouter, D. K. McAlister, P. Sukachevin. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. El-Khouri, L. Ionescu, H.-S. Lee, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, R. L. Bernardo, V. Govindarajan, D. Hammann, N. U. Haque, H. Kobayashi, E. Olsen, G. W. K. Pickering, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, A. J. Tregilgas.

1. COSTA RICA - 1984 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting (EBM/84/118, 8/1/84) their consideration of the staff report for the 1984 Article IV consultation with Costa Rica (SM/84/156, 7/2/84; and Sup. 1, 7/25/84). They also had before them a report on recent economic developments in Costa Rica (SM/84/146, 6/29/84; and Cor. 1, 7/25/84).

The staff representative from the Western Hemisphere Department, responding to Executive Directors' questions, said that the authorities were continuing to implement measures that would bring them close to achieving the objectives that they had set earlier in 1984, particularly with regard to expenditures. The Government had put a proposal to the legislature to cut expenditures by about ₡ 400 million, approximately 0.3 percent of GDP, which would be in addition to the substantial reduction of about ₡ 1 billion that had been made earlier in the year. The cuts would presumably cover various expenditure items, including current and capital spending and transfer payments. It was also expected that there would be further action by the legislature on the Government's proposals to bring about higher revenue yields. A related measure was the change in the official rate of exchange from ₡ 20 to ₡ 40 per U.S. dollar, which would have a significant effect on the calculation of certain specific import duties and would increase the yields from those taxes in the second part of 1984. Another pending legislative proposal was intended to reduce the exemptions available under certain fiscal incentive legislation. It was hoped that those measures together would yield additional revenue of about ₡ 1 billion, thereby almost closing the fiscal gap that had emerged since the beginning of the year. The staff would shortly be reviewing fiscal policy in general with the authorities.

With regard to the question of fiscal reform, the staff representative continued, a commission of former ministers of finance had concluded their deliberations in the middle of 1984 on a number of proposals relating to external debt management, the establishment of priorities in the public investment field, and the like. There had been a strong consensus in the commission that the Government should move forcefully and promptly toward the creation of a unified cash budget. The commission's report was with the executive branch of Government at present and it was hoped that specific legislative proposals would be presented to the legislative assembly later in 1984. In addition, the Assembly had established its own commission to look into the question of fiscal reform and was considering issues similar to those taken up by the commission of former finance ministers. That commission was required by law to report to the full assembly by mid-November.

Some Directors had commented on the behavior of inflation in the past year and wondered why the rate of inflation had turned out to be so much lower than expected under the program, the staff representative recalled. Three factors deserved emphasis. First, there was the interaction between the behavior of domestic prices and the exchange rate.

While it was difficult to establish the causal relationships in a country--such as Costa Rica--with an open economy and in which the prices of foreign goods bore heavily on domestic production costs, there tended to be a close association between large movements of the exchange rate in either direction and the behavior of domestic prices. In 1984, as a result of the authorities' forceful implementation of an adjustment program, there had apparently been a strong recovery of private sector confidence, which had been reflected in a large reflow of private savings that had been expatriated in earlier years. That reflow of savings had had a stabilizing effect on the free market exchange rate, which in turn had affected prices; as prices had decelerated sharply, while the level of nominal interest rates had remained unchanged, there had been a further strengthening of the reflow of private capital.

A second factor was that the compression of public sector activity in the economy in 1983 had been larger than anticipated under the program, which undoubtedly could have had an effect on aggregate demand and on prices, the staff representative added. Third, the authorities had suggested that as a result of the rapid inflation in 1981 and 1982, many entrepreneurs had been satisfied with the prices that they were charging in 1983. A further factor in the decline of inflation might have been the management of public sector tariffs. There had been a rollback of some important tariff adjustments that had been built into the program in early 1983, which could have affected expectations and price behavior in some sectors of the economy during that year. The staff believed that the recovery of confidence and its effects on inflationary expectations had probably been the most important factor in influencing price behavior in the past year.

Although the data in the staff report suggested that there would be little change in money velocity in 1984, the staff representative remarked, the numbers were somewhat misleading as a result of rounding down and rounding up the figures for 1983 and 1984, respectively. The staff expected that there would be a further reduction in velocity, which, in fact, appeared to be taking place. However, it was not easy to say what would be the effect of interest rate behavior on developments in the real sector of the economy. In 1983, there had been a transition from a regime of intense credit rationing to a situation in which credit had become amply available because of the effect of higher real interest rates on financial savings. Credit had, therefore, been readily extended to the sectors where it was needed. One puzzling aspect was that there had been a substantial expansion of credit in real terms--about 30-35 percent--while GDP had grown by less than 1 percent. The most straightforward explanation appeared to be that the expansion in credit had satisfied demand for working capital and for inventory accumulation, which had been severely constrained in the previous years.

A number of Directors had commented on the need for cooperation between the Fund and the World Bank in Costa Rica, the staff representative observed. There had thus far been close collaboration between the staff of the two institutions. A World Bank mission was in Costa Rica at that moment to discuss what could be the first in a series of structural adjustment loans. The Bank staff had suggested to the authorities that they should have in place a stand-by arrangement with the Fund to ensure that short-run stabilization objectives were being addressed. At the working level, the staff of the Fund would focus primarily on short-term financial management and exchange rate policies, while the Bank staff would concentrate on four longer-term areas: institutional reform of the public sector, tariff and trade reform in the Central American region, reform of the financial sector, and priorities in public sector investment projects.

The question of tariff reform was important to the prospects for export diversification in Costa Rica, the staff representative from the Western Hemisphere Department noted. The country was heavily dependent on traditional exports, which would continue to be important. Recently, Costa Rica had been able to re-establish its trade position with the rest of Central America mainly because of the elimination of the distortions in the exchange system and through the liberalization of trade with neighboring countries. For the medium term, both the Costa Rican authorities and the World Bank believed that there was a need to work toward significant trade reform within the Central American Common Market so as to bring about a reduction in the common external tariff and to redirect the export drive that had been part of the Common Market system for the past 20 years away from emphasis on increased intraregional trade toward exports outside the region. The Fund staff had endorsed that approach because it offered the best prospect for the development of Costa Rica's exports.

Mr. Senior noted that Executive Directors had generally agreed that the performance of the Costa Rican economy under the stand-by arrangement in 1983 had been highly satisfactory. There had been a substantial deceleration in inflation, a marked turnaround in the balance of payments, and a significant improvement in public finances. In all those areas, results had been better than anticipated. The reduction in the rate of inflation, from 90 percent in 1982 to about 32 percent in 1983, had been particularly outstanding. Indeed, in the final months of 1983, the annualized inflation rate had been only about 11 percent. There were few countries in the world that had experienced such success in arresting inflationary pressures in so short a period of time. That performance underlined the appropriateness of the authorities' monetary and exchange rate policies and the credibility of their general approach. A reduction in inflation of such a magnitude necessarily involved concerted progress toward abating inflationary expectations. The commitment of the authorities to economic adjustment had, therefore, permitted the correction of imbalances at a faster rate and at a lower cost in terms of lost output than had been originally envisaged. The authorities had also moved promptly to arrest temporary deviations from the program in the first half of 1984. Significant measures had been taken with regard to monetary, fiscal, and exchange rate policy to build on the successful adjustment achieved in 1983. Furthermore, the authorities were considering additional measures in the fiscal area that could permit them to reach their original objectives.

The Chairman made the following summing up:

Executive Directors were in general agreement with the thrust of the appraisal in the staff report for the 1984 Article IV consultation with Costa Rica.

Directors commended the authorities for the substantial adjustment effort implemented during 1983 in the context of the Fund arrangement. Directors observed that all the quantitative performance criteria of the arrangement had been met and that significant progress had been made toward the reduction of inflation, the achievement of overall fiscal balance, exchange rate unification, and the elimination of external debt arrears.

Directors noted the intention of the authorities to consolidate the gains achieved in 1983 with a new financial program aimed at compressing the public sector deficit further and curtailing the growth of bank credit consistent with the objectives of low inflation and an overall payments surplus. However, Directors expressed concern over the delays experienced in the implementation of the program and drew attention to the slippages in economic performance in the first half of 1984. Directors welcomed the recently announced fiscal and monetary measures which were designed to bring the economy back toward the original adjustment path set by the authorities. They emphasized the importance of completing action on the policy measures needed to meet the country's stabilization objectives. Directors expressed the hope that Costa Rica would soon be in a position to have its request for further Fund assistance submitted to the Executive Board.

Directors referred to the critical role of fiscal policy in the Government's stabilization program, and reiterated the importance of achieving tighter control over government expenditures. In this connection, the need to moderate public sector wage increases, which was a problem area in the previous year's program, was underscored. Several Directors also pointed to the importance of institutional reforms in the public sector, such as the dismantling of the present complex system of revenue earmarking and compulsory spending as a means of strengthening expenditure control.

In the area of monetary policy, Directors expressed support for the authorities' flexible interest rate policy and the recent measures that were instituted to moderate the pace of credit expansion in the economy. It was noted in particular that Costa Rica had continued to maintain interest rates at levels that were significantly positive in real terms.

Directors noted the authorities' intention to pursue a flexible exchange rate policy, and they stressed the need to ensure that in practice exchange rate policy was sufficiently flexible, particularly in view of the recent deterioration in the external sector and the accumulation of external arrears. In this connection, Directors pointed to the intensification of restrictions in recent months, in the form of payments arrears and also of a deposit requirement for import prepayments, and they urged the authorities to eliminate these restrictions as promptly as possible.

Directors pointed to the heavy external debt situation that Costa Rica is facing and will face for a number of years. These conditions and the need to restore balance of payments viability require further continuous adjustment efforts over the medium term. The contribution that concessional assistance, and in particular close cooperation between the Fund and the World Bank, could make was also underlined.

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

2. ST. VINCENT AND THE GRENADINES - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with St. Vincent and the Grenadines (SM/84/163, 7/9/84). They also had before them a report on recent economic developments in St. Vincent and the Grenadines (SM/84/168, 7/18/84).

Mr. Leonard made the following statement:

The generally good performance that characterized the economy of the islands in the years following the natural disasters of 1979 and 1980 has continued since the last review by the Executive Board.

- GDP growth was over 4 percent in 1983 and an increase of the same order is expected in 1984.

- Agriculture, despite a further setback caused by drought in 1982, grew by over 6 percent in the following year and has more than recovered its prehurricane levels of output.

- The expansion of manufacturing has eased but is expected to pick up again in the period ahead as a result of increased provision of factory shells and better energy supply.

- Construction and tourism, after a lean period, should also benefit from higher investment and more buoyant trading conditions, especially in North America.

- Sustained flows of grants and concessional finance from abroad together with private direct investment funds have kept the overall external account close to zero; there is a prospect of a small surplus in 1984. Within the account, the current position has improved, with the deficit falling from a high point of 22 percent of GDP in 1980 to a more manageable 7.75 percent in 1983 and a somewhat lower estimated figure in 1984.

- The rate of rise in consumer prices continued its steady fall from about 17 percent in 1980 and is now about 4 percent.

While the economy in general is in a satisfactory state, a number of weaknesses, some of which were noted by Directors in the course of discussion for the 1983 Article IV consultation, require attention. First, narrow profit margins in the preferential U.K. market for banana producers and heavy inroads into markets for arrowroot by cheaper substitutes suggest an uncertain commercial future for the two main agricultural crops. Action has already been initiated to reduce dependence on them and to encourage diversification into other areas of production but will take time to yield full results. At the same time, strong efforts are being made to increase returns from the secure market for bananas by improving the efficiency of island production, packing, and transport of the fruit. Also affecting the outlook for agriculture is the high cost of sugar manufacture from domestically grown cane. For activity in this area to be viable, means have to be found of offsetting the losses being incurred by the state-owned Sugar Industry, Ltd.

Second, good management of the public finances overall is prejudiced by losses on the part of public enterprises. Thus, while current budget deficits of the Central Government averaging nearly 2 percent of GDP in fiscal years 1981 and 1982 were converted into savings in the fiscal years 1983 and 1984 and savings of the rest of General Government were maintained at about 2 percent of GDP over the period as a whole, the gains were largely offset by the losses of the arrowroot and sugar industries. Furthermore, in financing these losses, the state-owned National Commercial Bank has seriously constrained its own liquidity and remedial action is now desirable.

As regards the government finances in the present fiscal year, close attention to both taxation and expenditure, especially public sector pay, will be necessary to avoid loss of balance in fiscal management. Finally, issues of the banks' interest rates and of exchange rate policy as discussed in the staff report arise for decision.

The staff analysis of and views on current requirements in the management of the economy have been put before the incoming Prime Minister for the attention of his Government. 1/

On behalf of the authorities of St. Vincent and the Grenadines, I should like to express appreciation of the extensive work done by the Fund mission in the course of the Article IV consultations and the helpful nature of their comments.

Extending his remarks, Mr. Leonard remarked that the recent change in government to which he had referred precluded his indicating the approach of the new authorities to the various issues raised in the staff paper, of a budgetary and financial nature and relative to the parastatal enterprises. However, the new Prime Minister had requested him to inform the Executive Board that his party--the New Democratic Party--was of the political center, and that the policies and priorities of his Government might not necessarily coincide with those of the previous Government. He understood that budgetary matters had been discussed at a cabinet meeting on the previous day, but he had not been advised of the outcome; it would be reasonable to expect that it would take the new Government some time to reach any firm conclusions. It would be useful for the Executive Board to express its views, which the authorities could take into account in setting the direction for the economy during the initial period of their administration.

Miss Bulloch said that the economy of St. Vincent and the Grenadines was recovering reasonably well from the effects of the various natural disasters of 1979 and 1980. Since then, real GDP growth had averaged about 5 percent a year, and the prospects for continued growth seemed good. It was also encouraging that the rate of inflation was declining and that the external balance had strengthened considerably. Perhaps the major contribution that the new authorities could make to the process of development in the coming year would be to strengthen further the public sector finances. To date, the balance on the current operations of the Central Government had been satisfactory, with revenue rising over the past five years to match increased expenditures. The recent projection by the staff of an emerging unfinanced gap of 3 percent of GDP on the Government's operational account during the current financial year had been made on the basis of assumptions that might no longer hold. But the exercise had nevertheless been valuable because it had demonstrated the importance of restraining the Central Government's current expenditures, including civil service wages, in order to enhance public sector savings.

1/ The recent general election in St. Vincent and the Grenadines resulted in a change of government. The incoming Prime Minister was sworn in on July 30 and nominated his Cabinet on the same day. The first cabinet meeting was held on July 31, 1984.

It was clear from the staff reports that public sector enterprises were a serious drain on government finances, Miss Bulloch continued. The weakening of the financial position of the Central Water Authority attested to the need for the authorities to consider increasing water charges to a level that would cover costs. The position of the sugar and arrowroot industries was less straightforward because of the weakness of market conditions. Selling off arrowroot stocks seemed to be the most sensible course of action under the circumstances, alongside the pursuit of a policy of agricultural diversification. She had noted the staff's suggestion that the domestic price of sugar should be raised, although according to the report on recent economic developments, the production cost per pound of refined sugar in St. Vincent was double the domestic price, which in turn was more than three times the international price. She would therefore be interested to hear the staff's view on the long-term viability of the domestic sugar industry.

The combined deficits of the sugar and arrowroot enterprises had been the equivalent of more than 3 percent of GDP in 1982/83, Miss Bulloch noted. The question was whether a quick reduction in the deficits, although desirable, could be regarded as likely. The liquidity position of the National Commercial Bank was a closely related cause for concern that might take some time to redress. Like the staff, she could support raising the lending rate ceilings and eliminating the tax on deposits, which should encourage domestic savings.

The recent evolution of St. Vincent's external position revealed, in U.S. dollar terms, a widening trade deficit together with a gradually increasing surplus on services, Miss Bulloch continued. Efforts to develop agriculture and fisheries sectors were appropriate to reduce dependence on exports of traditional products. The tourism sector seemed reasonably strong, and she would be interested in learning more about the prospects for its expansion. St. Vincent and the Grenadines seemed to have achieved some success in attracting private direct investment, and again she would be interested to learn more about the prospects for the future.

More generally, Miss Bulloch said, St. Vincent and the Grenadines must maintain its international competitive position. A restrained civil service wage policy would be helpful, given that the state enterprises and the public sector had traditionally followed the Central Government in granting wage increases.

She looked forward with interest to the completion of the joint study being made, under the auspices of the Eastern Caribbean Central Bank (ECCB), on the implications of the appreciation of the Eastern Caribbean dollar, a matter of great importance, Miss Bulloch commented.

Finally, Miss Bulloch remarked, she would have been interested in a fuller discussion in the staff report of relations between St. Vincent and the Grenadines and the World Bank group. For instance, was the public investment program likely to be assessed by the World Bank?

Ms. Lundsager noted that St. Vincent and the Grenadines had made progress in several areas since the natural disasters of 1979 and 1980. During 1983, real GDP growth, led by agriculture and construction, had picked up from the previous year, and inflation had continued to fall from its high level in 1980. The significant decrease in the current account deficit in 1983 was encouraging. While no further change was projected for 1984, private and official capital inflows would more than offset that deficit, allowing for a slight buildup in reserves. Also, because most of the debt was concessional, debt service remained manageable, at about 2.5 percent of exports of goods and services.

In spite of the progress made, she urged the authorities to follow the staff's recommendations in several key areas, Ms. Lundsager continued. The public sector investment program deserved support, inasmuch as it would provide the infrastructure for a continued expansion of the private sector. Concessional loans and grants from abroad would finance much of that development spending, but local financing of about EC$9 million would be required. Owing to the present low rate of savings, there would have to be significant policy changes in 1984 if the required domestic savings were to be generated. In particular, she urged the authorities to improve the savings performance of the Central Government through the containment of current expenditures, including civil service wages. The deficits of the sugar and arrowroot enterprises would also have to be reduced, in the latter case by scaling down operations. She agreed with the authorities that already high taxes left no room for further tax increases, and she encouraged them to reduce those taxes that were currently a disincentive to production and savings.

Referring to monetary policy, Ms. Lundsager mentioned the urgency of a speedy completion of the ECCB study on the structure of interest rates in its member countries. St. Vincent and the Grenadines needed to increase interest rates to positive real levels, thereby stimulating higher private savings. Finally, the effect of the overvaluation of the Eastern Caribbean dollar on member countries of the ECCB needed examination. Her authorities maintained their belief that an appropriate exchange rate could be the best incentive to producers to expand and to diversify exports.

The staff representative from the Western Hemisphere Department explained that the sugar industry had been set up by the previous Government as an employment-creating project and as part of an attempt to revitalize a region that had once been prosperous but that had become depressed. The authorities were aware that the industry was not viable in the long term, with production costs close to six times the world sugar price. Apart from the obviously short-term solution of raising the domestic price of sugar, measures had been taken to reduce costs; for instance, the burning of bagasse instead of fuel oils had led to substantial savings. The distillery to be set up was expected to generate profits that could also be used to subsidize some of the losses of the refinery, with which it would be connected although it would be a separate operation. The short-term solution to the deficit of the arrowroot industry was to sell stocks over a two-year period. The long-term solution was to phase out the production of both sugar and arrowroot, and to encourage farmers to grow other cash crops. Various vegetables could be produced for export and as a substitute for the many food items that were imported, in part to support tourism.

The market for tourism in the Caribbean was not a homogeneous one, the staff representative noted. The island of St. Vincent had limited facilities; both beaches and hotels were small. The islands of the Grenadines were a tax haven and also catered more to visiting yachts. However, with additional infrastructure, both St. Vincent and the Grenadines could make greater use of their natural resources to expand tourism, both in the short and in the medium term.

The World Bank had had a limited direct role in investment in the country, the staff representative commented. Most of the Eastern Caribbean islands received loans from the World Bank through the Caribbean Development Bank, which was at present channeling only IDA funds to St. Vincent. The first direct loan by IDA to St. Vincent would be a contribution of US$5 million toward the total cost, amounting to US$34 million, of a large power project. Because of its limited direct lending to St. Vincent and the Grenadines, the World Bank had not made an overall assessment of St. Vincent's investment program. However, the World Bank believed that investment supportive of infrastructure would offer opportunities for the private sector to develop tourism and other activities.

The Eastern Caribbean Central Bank had not yet completed its study of interest rates, the staff representative said. The ECCB objective for the time being was to focus on recommending that a minimum rate of interest be set on deposits rather than on establishing ceilings on lending rates. The policy in itself was sound, but a mechanism would have to be found to overcome the problem posed by differences in the cost of attracting financial savings in the member countries. St. Vincent, unlike most of the other members, imposed a 2 percent tax on deposits, whereas the tax in Dominica, for instance, was 1 percent.

The St. Vincentian authorities recognized that the exchange rate had appreciated, and were therefore willing to take part in the ECCB exchange rate study, although they were not convinced that it would be to their advantage to change the rate of the Eastern Caribbean dollar. The collapse of arrowroot exports had been less a function of the exchange rate than of the disappearance of the market.

The prospects for direct investment were good, the staff representative said. The Government's investment program would provide the necessary infrastructure, including factory shells, which were rented to foreign enterprises. However, there had been a recent lull in the establishment of such enterprises because of the lack of factory shells. Further investment along those lines could be expected as soon as forthcoming loans from the Caribbean Development Bank became available. There were also possibilities for direct investment in tourism and other productive areas, including perhaps agriculture.

Mr. Leonard remarked that the problems of small tropical island economies were of broad interest because they were manifestations, in concrete and immediate rather than abstract form, of general economic problems.

Like others, Mr. Leonard remarked, he would await with interest the findings of the exchange rate study by the Eastern Caribbean Central Bank. The appropriateness of the exchange rate of the Eastern Caribbean dollar for all members of the ECCB was a complex matter. Moreover, as had frequently been mentioned by members of the Executive Board, it was proper for a small economy to maintain the most stable environment possible if it wished to attract external investment. One way of doing so was, of course, to maintain exchange rate stability. Once the rate began to change, potential investors would always be uncertain about the direction of movements in the rate in the future. In addition, a stable relationship with a particular currency often enforced useful disciplines because the authorities had to pay attention to the fundamental economic conditions, none of which could be changed simply by constant adjustment of the exchange rate.

The Chairman made the following summing up:

> Directors expressed general agreement with the appraisal in the staff report for the 1984 Article IV consultation with St. Vincent and the Grenadines. They noted that the economy had recovered rapidly from the natural disasters of 1979-80. They also observed that since 1980 the current account of the balance of payments had strengthened, and that the rate of inflation had been reduced significantly.
>
> Directors drew attention to the substantial progress made in reducing the imbalance in the public sector through fiscal year 1983/84, but expressed concern about the increase in expenditures which had been projected for the current fiscal year. Directors remarked that in order to provide the necessary domestic resources to finance the stepped-up domestic program in fiscal 1984/85 and beyond, it was essential that the savings performance of the Central Government be improved and that the operating deficits of the state-owned sugar and arrowroot enterprises be reduced significantly. Directors underlined the importance of containing central government expenditures, particularly civil servant wages, and welcomed the intention of the authorities to take steps to improve the financial situation of the enterprises, especially in view of the deleterious effects that their operating deficits had on the liquidity position of the national commercial bank. Particular concern was expressed about the heavy costs of production of refined sugar, and the need to move toward more profitable and diversified agricultural production was underscored.

The authorities were urged to make interest rate policy more flexible, particularly as regards lending rates, and to re-examine the policy of taxing bank deposits, given the need to encourage saving and improve resource allocation.

Directors underlined the currency appreciation indicated by the rise in the real effective exchange rate in the past three years, and stressed the importance of staying competitive. They thus welcomed the authorities' support for the Eastern Caribbean Central Bank's study on the implications of such an appreciation for its member countries. In this connection, Directors underlined the importance of a restrained wage policy to maintain the competitive position of the economy.

It is expected that the next Article IV consultation with St. Vincent and the Grenadines will be held before February 1986.

3. GLOBAL CURRENT ACCOUNT BALANCES - STATISTICAL DISCREPANCY

The Executive Directors considered a staff paper on the discrepancy in global current account balances (SM/84/157, 7/3/84).

Mr. Nimatallah observed that the discrepancy in world current account balances had grown rapidly during past years, when high inflation had been followed by recession. The most recent information in the draft Annual Report, which incidentally had not been included in SM/84/157, indicated that the discrepancy had declined from approximately $95 billion in 1982 to approximately $65 billion in 1983. The magnitude of the discrepancy was likely to diminish even further with a gradual return to normal conditions in the world economy. In large part, therefore, the problem seemed to him not to be of a lasting character, at least in magnitude.

A great part of the discrepancy arose, in his judgment, from the methods used by certain countries to compile statistics, Mr. Nimatallah added. The disaggregation of the discrepancy by different items on current account in Table 1, which pointed to investment income flows as being responsible for much of the discrepancy, was not necessarily the best way of approaching the problem. Attention should be focused on the availability and compilation of data by groups of countries, particularly developing countries. It was interesting to note that the decline of about $30 billion in the current account deficit of developing countries as a group in 1983 had coincided with an almost equal decline in the discrepancy. He would welcome the staff's comment on his belief that there was a link between those two declines.

Moreover, Mr. Nimatallah continued, the staff paper did not mention the proportion of the discrepancy in world current account balances that could be attributed to the current account position of nonmember countries. In the World Economic Outlook survey, nonmember countries were thought to have a small aggregate current account deficit, but the staff had admitted that its estimates were based on sketchy information, which was furthermore available only until 1981. It was common knowledge that, over the past several years, certain Fund members had spent billions of dollars on arms, military equipment, and other goods from nonmembers, whose current account position might well be much better than the staff thought. Whether or not such expenditures explained part of the overall discrepancy, more attention should be paid to nonmember countries' current account positions.

From a practical point of view, the discrepancy did not appear to be harmful to the formulation of member countries' policies, which were based on a number of domestic and external considerations. As far as the balance of payments was concerned, it was in the end the reserve level that counted. Therefore, he failed to understand why so much attention should be paid to the discrepancy; the Executive Board should consider it as an issue that should not be ignored but that should be tackled over time and in the normal way, namely, by providing technical assistance to members. Any attempt to initiate an extensive project, along the lines described by the staff, was likely to achieve less than Fund technical assistance, and it might even be wasteful.

As the staff had rightly stated, even if the sources of the discrepancy were identified, its reduction or elimination would require a large measure of international cooperation, Mr. Nimatallah went on. If previous similar efforts, both bilateral and multilateral, had failed to reduce the discrepancy, because of the lack of necessary cooperation among major trading partners, how did the Fund expect to secure the necessary intensive international cooperation, even if the proposed project was endorsed by the Interim Committee?

In sum, Mr. Nimatallah concluded, the discrepancy had resulted partly from the unsettled era through which the world economy had passed, partly from inadequate technical reporting by some members, and partly from the unclear impact of nonmember transactions. The problem should not be given exaggerated attention, especially as the discrepancy was declining, but it should not be ignored. The Fund should first try to identify more accurately the impact of transactions between members and nonmembers on the overall discrepancy. Second, the Fund should concentrate on helping national authorities to improve the quality of their balance of payments statistics. He could not support any large-scale scheme that might turn out to be costly and unnecessary, and might perhaps have doubtful results.

Mr. Yamashita considered that the global current account discrepancy, which had tended to increase significantly in recent years, would not only intensify the uncertainty of the external environment in which macroeconomic policy was formulated, but would also tend to encourage protectionist pressures based on mistaken perceptions of external payments positions. His authorities were prepared to cooperate fully with international initiatives to improve the understanding of factors underlying the global discrepancy.

The two-tier procedure suggested in the staff paper--namely, a steering group and several working groups--had the general support of his authorities, Mr. Yamashita remarked. The steering group would be of use in ensuring the effective implementation of the program of work. The group should consist of official representatives of sufficiently senior rank to take the relevant decisions. Highest priority should be given to considering strategies for solving the issues that would have the greatest impact on macroeconomic policymaking, leaving technical considerations to the working groups, which should nevertheless be given guidance as needed. He would also have no major difficulty with the staff's suggestion that the steering group should reflect the constituencies of the Executive Board. The Chairman should preferably be either a senior official, at a decision-making level, with adequate knowledge and experience in balance of payments statistics, or a senior Fund staff member or suitable consultant.

The working groups should be composed of competent specialists in the compilation and analysis of statistics, Mr. Yamashita observed. Each group should seek the participation of experts in the area to which it would devote its efforts. The size of each group should be kept small so that the work could be carried out efficiently and effectively. At the same time, the actual number and composition of the members of each group should be determined flexibly, taking into account specific needs. In that context, it might be desirable for some groups to seek the active participation of members from developing as well as developed countries.

He would have no difficulty with either asking the Interim Committee to endorse the program of work or reporting to the Committee on the progress made, Mr. Yamashita commented. When the time came to implement any recommendations, it might be useful if either the Executive Board or the steering committee were to maintain a monitoring role.

He could support the general thrust of the suggestions outlined in Part V of SM/84/157, Mr. Yamashita continued. Among the five topics suggested for study, particular emphasis could be placed on investment income flows, which had become the largest source of the rising discrepancy in recent years.

Finally, he had taken note of the cost of the program of work, and of the estimate that about ten temporary staff members would be needed, Mr. Yamashita said. While the estimates seemed reasonable, the temporary increase in staff should not lead to a permanent increase in the staff ceiling, and the actual costs incurred should be assessed from time to time against the expected benefits so that the exercise could be conducted in the most effective and efficient manner.

Mr. Templeman noted that the staff paper provided additional information on the most likely sources of the statistical discrepancy in world current account balances, especially the missing surpluses of recent years, and the staff had proposed specific procedures for making further progress in identifying the sources of the discrepancy and, he hoped, in reducing them. More important than simply compiling more accurate statistics was the prospect of improving policymakers' perspective of the evolution of world current account balances. For example, everyone was aware of the large and growing deficit on the current account of the U.S. balance of payments. The existence of the discrepancy could mean that countries with the corresponding current account surpluses might be unaware of the true extent of those surpluses; alternatively, to the extent that the U.S. deficit included some unrecorded receipts, the size of the deficit might be overstated.

It would be regrettable if governments were to make economic assessments based on misperceptions arising from the statistical discrepancy, Mr. Templeman went on. The proposed work program might not necessarily result in a reduction in the discrepancy; in fact it might uncover a new discrepancy. However, a better understanding of the sources of the discrepancy could be helpful in avoiding erroneous responses. His authorities were interested in pursuing the matter further and they were willing to cooperate with the Fund staff. The resources that they could devote to the work were limited. Any eventual commitments to change U.S. data, impose new reporting burdens on U.S. businesses and banks, and the issue of confidentiality of data were considerations that were subject to a few caveats, but that should not however impede the active participation of the U.S. authorities in the proposed exercise.

The Fund also should limit the extent to which it committed new resources to the project, Mr. Templeman considered. He had been surprised at the suggestion that as many as ten additional staff members might be required, even if they were hired only as consultants or for a limited term, and that the cost to the Fund would be on the order of $1.3 million, or $1.8 million if the Fund paid for the associated costs of the proposed working groups and steering committee. Both the number of staff and the cost could be reduced. One way might be to study priority areas first and review the results before proceeding to explore other areas. Cooperating goverments might also be expected to absorb a considerable part of the cost. He asked the staff to provide a more adequate justification of its estimates. Certainly, the project should not result in the hiring of permanent new staff members.

The main areas of study had been accurately identified in the staff paper, Mr. Templeman remarked. Clearly, the investment income item deserved priority because of its relative importance in explaining the discrepancy. He also agreed with the staff's suggestion that both compilers and users of statistics should be involved in the exercise; he saw the usefulness of questionnaires; he supported working groups, and would be agreeable to having either consultants or Fund staff chair them; he would prefer the creation of an overall steering committee of limited size to the direct referral of initial reports to the Executive Board; and he presumed that a timetable of about one or two years for the completion of the study would be reasonable. He did not believe in the necessity of seeking endorsement by the Interim Committee to obtain the required political support for the exercise. Agreement by the Executive Board, with the backing of national authorities, should be sufficient.

Mr. Prowse said that he had been surprised by the size of the proposed work program and the resources that would be required to carry it out. It had already been generally decided that the discrepancy mattered and that it should be reduced. However, he would favor limiting any studies at the present stage, and would wish to give priority to studying investment and financial flows, including the recording practices of member countries. There would be scope for an active working group of experts, which should consist of fewer than the ten people proposed, and yet still be able to work on other urgent issues. The study should be focused on countries where the deficiencies were most evident and on areas where the problem was greatest. For instance, there was no need for a uniform sweep throughout the membership to reduce a discrepancy relating to investment and financial flows in the aggregate balance of payments.

Depending on the progress made by the initial working group on that and on a few other issues, the work program might be extended later, Mr. Prowse noted. It would be confusing to the authorities who would have to provide the raw materials for the study if an attempt were made to identify all sources of the discrepancy at one time.

A more limited initial program of study conducted by one working group would not need to be coordinated by another body, such as a steering group, unless enough progress was made within a reasonable time to justify the expansion of the field of study of the working group, Mr. Prowse commented.

Appropriate experts, both users and suppliers of statistics, should be represented in the working group, Mr. Prowse said. It might also be useful to include a representative from international organizations with an interest in the subject. For instance, a suitably qualified person could be seconded on a full-time or part-time basis from the OECD. Presumably, although the proposals in the staff paper did not seem to make specific provision for it, the Fund would have a full-time staff member participating in the work of the group. If eventually it did become necessary to establish a steering group, it too should have among its members a senior Fund staff member or management representative, and perhaps even members of the Executive Board; the steering group should not necessarily be limited to outsiders.

As long as the work program was relatively circumscribed, as he had suggested it should be in the first instance, it might be sufficient if its studies or reports were brought to the Executive Board with a covering memorandum from the Research Department. One possible way to bring the Interim Committee into the picture might be for the Managing Director to mention briefly the nature and status of the work of the group when he reported to the Interim Committee, thereby obtaining the Committee's endorsement.

Finally, Mr. Prowse said, it would be helpful if the travel and other costs of the working group could be shared by Fund members, since they would be direct beneficiaries of the outcome.

Mr. Polak stated that the error in the world balance of payments was an important problem that would not solve itself. The discrepancy for 1983 had been put at $74 billion in the World Economic Outlook survey and in the draft Annual Report, a lower figure than in 1982, when the discrepancy had reached $96 billion. However, the forecast in the World Economic Outlook survey was that the discrepancy would increase again in 1984.

The five fields which the staff wanted to concentrate its attention and the procedures it had specified in those fields represented a reasonable choice, Mr. Polak remarked. He was not enthusiastic about enlarging the bilateral payments matrix for the members of the European Community. Bilateral matching had its own problems, even in the United States and Canada, as had been mentioned during the Executive Board's previous discussion of the global discrepancy. A tentative beginning could be made to include a few other countries; in a limited-scale exercise, work could be stopped if it was not productive. It also seemed reasonable to find adjustment coefficients, rather than to change the statistics for all countries, in order to deal with timing and valuation asymmetries.

Reference had been made in the staff paper to the fact that international organizations did not prepare balance of payments figures, Mr. Polak noted. The Fund and the World Bank could contribute to an improvement in the data by producing their own balance sheets, which they could do without much difficulty.

Working groups were a good idea and it was essential to include in them the compilers of statistics, for all of the good reasons stated in the staff paper, Mr. Polak said. The groups might well have to include more than five or six people. He had not been convinced of the need for a steering group, although he would not object to one. However, he saw no need for every seat on the Executive Board to be represented in a steering group. The appointed members of the Executive Board, along with about one third of the elected members, should provide a sufficiently balanced representation and a more manageable body than the Executive Board sometimes was. If it was a question of participation by individual member countries, a conference might have to be envisaged at the end of the project, and the results would then have to be convincing to far more than 22 member countries.

The proposed use of staff resources was not unreasonable, Mr. Polak considered, although he would urge that greater use be made of in-house staff and less use of consultants. There were many staff members with considerable experience in the field, partly in the Research Department and Bureau of Statistics, and probably in other departments of the Fund as well. Some of those staff members might be less heavily involved in immediate country work, but might have made a noteworthy contribution to the Fund's balance of payments work at one stage or another of their career.

The endorsement of the project by the Interim Committee seemed to him to be a secondary issue, Mr. Polak concluded. He suggested waiting until the results of the study were available; at that time, the Interim Committee could evaluate and endorse the results.

Mr. Grosche recalled that, during the Board's first discussion of the discrepancy in world current account balances, he had supported an effort to uncover at least its main sources, mainly because the discrepancy might be detrimental to the formation of economic policies and give wrong signals to financial markets. He continued to believe that the discrepancy would remain a disturbing factor over time unless tackled appropriately.

He was in broad agreement with the staff paper, Mr. Grosche continued. On the particular issues on which the staff had requested guidance, he would agree first that the number of studies should be limited. The staff had put forward compelling reasons for such an approach. National compilers of statistics should not be overburdened because later on they would have to implement any necessary changes in existing procedures. Nevertheless, one issue should be added to the list in Part III of SM/84/157. His authorities suspected that large discrepancies might arise from the recording of nonfinancial activities in offshore centers, including merchant trade, insurance, and other invisibles. A study in that particular area could begin with the bilateral payments flows between industrial countries and offshore centers.

Small ad hoc working groups should be appointed by the Managing Director, as suggested, Mr. Grosche continued. The groups should be composed not only of experts from within the Fund and the OECD staff, but also of high-ranking experts from industrial and developing countries, including offshore centers. In no case should there be more than ten people in the working groups. It was difficult to evaluate the estimates of staff resources needed for the project, but the staff's estimates seemed appropriate and to be aimed generally at minimizing costs.

The steering group to which the working groups would report might shield the Executive Board from involvement in technical detail, Mr. Grosche commented. At the same time, a steering group might present the Executive Board with a set of predetermined views. Therefore, an in-between solution might be advisable; the Fund staff, assisted by a few high ranking experts, could compile the findings of the steering committee and write a final report, that it would submit directly to the Executive Board for consideration.

Mr. Tvedt remarked that due regard had been paid by the staff in its paper to the views expressed in April 1984 when the Executive Board had first discussed how to deal with the statistical discrepancy in global current account balances.

In choosing substantive fields of inquiry, a higher benefit/cost ratio was likely to be found in the five areas outlined in Part III, Mr. Tvedt observed. In two of the fields proposed for study, future inquiries could build on work already undertaken by the OECD and the EC, thus limiting the use of additional Fund resources.

The establishment of small ad hoc working groups, including representatives from member countries, could be helpful in providing guidance and support for the study, Mr. Tvedt added. He understood from the staff paper that the number of such groups was to be limited. Furthermore, he was in favor of establishing a steering committee to coordinate the work of the groups and to report to the Executive Board, but he had no firm views on its size or composition. As a number of Executive Directors had already mentioned in April, and repeated during the present discussion, the Interim Committee's political endorsement of the exercise should be sought at the forthcoming meeting of the Committee. Such an endorsement might ease relations between the people involved in the work and national authorities.

Finally, on the allocation of staff resources to the project, he regarded the costs involved to be relatively modest compared with the benefits that could be achieved, Mr. Tvedt concluded.

Mr. Joyce said that he maintained his position that the discrepancy was a serious problem, the very complexity of which dictated, however, that care be taken in attempting to determine its origin. Proposals for specific studies should be examined carefully before any commitments were made. His authorities considered that a step-by-step approach seemed appropriate in the circumstances. They certainly agreed that the proposed program of work should be endorsed by the Interim Committee before it was started.

A wide range of research efforts, involving four or five working groups supervised by a steering group, had been proposed in the staff paper, Mr. Joyce continued. The proposal seemed to his authorities to be unduly ambitious and likely to prove costly; indeed, they questioned the feasibility of a project of the scope proposed by the staff. An additional issue was whether national statistical agencies, even in the larger countries, had the resources available to tackle such a multifaceted project. His authorities had a preference for exploring two avenues of further research at the present stage. The first course would be to make a pilot study to review and assess the success of previous attempts at statistical reconciliation of the discrepancy. Some countries had undertaken such efforts, yet their authorities had apparently not found it necessary to change their statistical practices. Those undertaking the pilot study might well consult with national statistical agencies and gain from their experience. A second possibility would be to focus on the most cost-effective and useful area for further research, namely, investment income and related flows. It seemed from the staff paper that those flows were worthy of special attention, because of both the relative importance of their contribution to the discrepancy and the widely felt dissatisfaction with available statistics. Depending on the results of those preliminary investigations, the exploration of other areas could await a later decision.

The proposal for a pilot study should fall well within the competence of the Research Department and the Bureau of Statistics, Mr. Joyce noted. The second project, on investment income and related flows, could be conducted by a single working group. In appointing the members of that group, consideration might be given to an appropriate balance between large and small countries, thereby offering a safeguard against an unduly burdensome exercise and resulting in less friction between authorities.

The working group should be kept small, Mr. Joyce added. To the extent that additional staff resources were required, they should be obtained on a contractual or seconded basis and not, as far as possible, by permanent additions to the Fund staff. If it was decided that one or two studies should be made to begin with, it might well be adequate to submit the reports directly to the Executive Directors rather than to pass them to a steering group, thereby ensuring that the Board accepted its responsibility to maintain the momentum of the work.

Mr. Nguyen stated that the staff should be encouraged to pursue its studies further, based nevertheless on a clear and realistic understanding of the balance between the costs and benefits. It would thus be most useful to focus on the topics with the most promising return.

It seemed somewhat contradictory for the staff to state in paragraph 3 of Part II that "there are few if any solid grounds for supposing that particular countries account for a disproportionate share of the global discrepancy," suggesting that the level of error was the same in all countries, and to state later in the second paragraph of Part III that the quality of recording practices was not the same among member countries, indicating that some countries were more responsible than others for the discrepancy.

An assessment of investment income flows and financial services would certainly be interesting, Mr. Nguyen continued, although attempts to build a parent balance sheet for each country vis-à-vis the rest of the world seemed ambitious. Even if the study were limited to the banking sector, it was not clear whether much progress could be made. Some countries--and a non-Fund member in particular came to mind--would be reluctant to provide data on the geographic origin of banking deposits; other countries with strong asset positions might be similarly reluctant to reveal the size and the distribution of their deposits. The proposed study on the statistical impact of offshore centers seemed a more fruitful area for research.

He could endorse the implicit suggestion in the staff paper to make use of OECD expertise on official transfers, Mr. Nguyen remarked. It would be judicious, in taking into account work already done in Europe on the bilateral payments matrix, to undertake any study in that field in close consultation with the EC statistical services. The problem of timing and valuation asymmetries should be treated as part of a global statistical project. The relative stability, in absolute terms, of the discrepancy relating to shipping did not mean that it was not a problem, although it was probably not a priority subject. Furthermore, it would be difficult to explore the "flag of convenience" shipping fleets.

National representatives should be closely associated with the studies made, Mr. Nguyen observed. Otherwise, the staff conclusions might not be followed up by concrete measures. At the present stage, it seemed premature to seek the endorsement of the Interim Committee, even though it might be sought after the experts had completed their work so as to encourage national authorities to implement the recommendations of the Executive Board.

Mr. Clark recalled that his chair had made three points during the Executive Board's discussion in April. First, his authorities supported the proposed initiative in principle but were concerned not to initiate too elaborate a study. Their preference was for starting in one or two areas, say, investment income and timing and valuation asymmetries. If the first results justified it, other areas could be explored. Second, it followed from that general position that his authorities were not in favor of establishing a large bureaucratic structure. One, or possibly two, working groups, with a membership covering a range of countries, might perhaps be supported by a small permanent staff. Third, against that background, he would question the need for a large steering committee; the committee might consist of three or four rather than the twenty-two people implied in the staff paper. In passing, he noted that it would perhaps be more normal to establish the steering group at an earlier stage, and not some time after the working groups had been set up. It would not be appropriate for the Interim Committee to endorse a detailed program of work.

It was not clear to him that the same administrative structure would necessarily be best suited to cope with the two phases of the study, namely, the diagnosis of the problem and its treatment, Mr. Clark added. He had also been interested in the staff's comment that "there is no question of putting together a project which requires, in either the short or medium term, collecting and processing new, basic information." In one sense, such restraint was laudable; but was it realistic to expect substantial progress without assembling new information?

Although it was mentioned in the staff paper that the study was conceived of as being a collaborative effort with the OECD, Mr. Clark noted, he would be grateful for an explanation by the staff of the precise nature of that intended collaboration.

Mr. Lovato observed that his authorities were interested in any effort to overcome the problem of the global current account discrepancy. The description of the discrepancy and the different approaches suggested for reducing it were useful. In the beginning, his authorities would prefer a study of a single priority item, more particularly, of investment income flows. The working group should be a small one. Finally, although the cooperation of national institutions would be very important, an undue burden should not be allowed to fall on them.

Mr. Panday reiterated his chair's support for the proposed study, which was worth making even though the cost seemed large; a more selective choice of topics might reduce the cost well below the estimates in the staff paper. He recalled that during the Executive Board's discussion in April, his chair had favored a selective approach by the Fund that would concentrate the analysis on areas contributing to the largest proportion of the asymmetry. Thus, if it would not jeopardize the objective of the study, he would prefer some of the topics mentioned in Part III to be excluded; for instance, other international agencies might already have done work on a bilateral payments matrix and on asymmetries in payments for shipping services.

The staff had mentioned that it would take one or two years to complete the study, Mr. Panday noted. The total estimated cost, if the Fund had to bear it all, would be $1.8 million. The proposal was to hire staff for 18 months; if, as he inferred, the total estimated cost was for only 18 months, any extension of the study would increase the cost.

Mr. Schneider said that in principle he could support the proposal to look into the problem of the discrepancy in world current account balances. At the very least, the outcome would be a better understanding of the issues involved, which in turn might contribute to a better assessment of current account developments by policymakers. However, he was hesitant to support an exercise of the size envisioned by the staff, and was leaning more toward a modest beginning. The establishment of small ad hoc working groups, composed of national experts, should concentrate first on priority areas, and the scope of the project should be limited to major countries with large discrepancies on current account. Like other Directors, he considered that the work should focus on investment income flows and financial services. Depending on the findings in that respect, the project could be extended later.

Like others, he was not convinced of the need for a steering committee at the beginning of the exercise, Mr. Schneider remarked. He also doubted whether the endorsement of the Interim Committee should be sought until the Executive Board had a better view of how the project was progressing.

Mr. Malhotra said that it was necessary to reduce, to the extent feasible, the overall discrepancy in the world current account balances. However, he was not sure whether the staff proposals would bring about the foreseen benefits. A very selective approach in undertaking the proposed studies would be advisable. He could not support a project of the size and cost envisaged. Nor should it be necessary to recruit new staff; existing staff could carry out the work.

Furthermore, he was not convinced about the feasibility of some of the topics proposed for consideration, Mr. Malhotra continued. For instance, the suggestion to examine timing and valuation asymmetries, based on careful examination of trade statistics, the development of statistical algorithms, and an adjustment procedure to achieve a measure of uniformity would involve a great deal of work and probably not lead to much of a reduction in the discrepancy on merchandise trade balances. In any event, the trade discrepancy had declined significantly, in nominal terms, over the past three or four years. As mentioned by the staff, the discrepancy in official transfers had been reasonably stable, offset in part due to income transfers by governments to foreign residents and the manner in which they were recorded at the paying and receiving ends. It was not clear to him how any changes in procedure would reduce the overall discrepancy, since the flows were in any case recorded in the balance of payments. It might be easier to deal with the problem of the different valuation placed on contributions by donors and by recipients; however, further thought must be given as to whether it was worthwhile studying that problem, if it was not causing major difficulties.

The expansion of the bilateral payments matrix of the EC might also not be very useful, Mr. Malhotra remarked. He had doubts about how many more countries could be added to the matrix. Asymmetries in shipping payments certainly were of low priority and could be omitted from the project.

He was also not certain that it would be beneficial to undertake a large project, covering all countries, on the major source of the discrepancy on current account, namely, investment income flows, Mr. Malhotra continued. It might be better to direct the study toward the offshore centers, and above all, to the rules applied by the countries that had allowed those centers to develop--the countries of domicile as well as the countries whose banks operated in those centers--in an effort to determine whether or not those rules were self-negating. In addition, some way should be found to establish the geographical origin of the major discrepancies, since a global project would pose major difficulties.

It would be consistent with a more selective, step-by-step approach for the staff to begin by organizing the information that was already available to the Fund or to the World Bank, Mr. Malhotra noted. A report could then be made to the Executive Board, along the lines suggested by Mr. Joyce. The results of previous attempts to improve statistics should also be made known to the Executive Board, which could then approach the matter more realistically.

At the present stage, Mr. Malhotra remarked, he had serious doubts about proceeding to appoint working groups. It would certainly be premature to think in terms of a steering group. He questioned the wisdom of submitting the matter to the Interim Committee without adequate preparation. He was apprehensive about the resulting publicity at a time when the financial system was still in difficulties. To draw the attention of a political body to what could be seen as a serious discrepancy in the world current account balances could lead to questions about the Fund's information systems. Such an approach would not merely be premature but could also be counterproductive. It would therefore be advisable to avoid premature mention of the problems in the communiqué of the Interim Committee.

Mr. Finaish said that in view of the importance of accurate and reliable data to sound country policies, the need for the study and a possible correction of the discrepancy in global current account balances could not be denied. However, as had been pointed out during the Executive Board's previous discussion on the subject, and as some Directors had reiterated at the present meeting, the complex and global nature of the exercise that was being proposed would necessitate careful preparation, if the study was to be well focused and clearly defined. Preparatory research efforts could throw light on the best manner in which to approach the problem. While the staff paper went some way in providing some further clarifications, it might still be worthwhile considering whether the necessary in-house preparatory effort had been made. For instance, the extent to which existing balance of payments estimation procedures were not being applied uniformly could be ascertained, within the Fund's normal consultation and technical assistance procedures. In addition, the completion of the balance of payments matrix for industrial countries, for which much of the work had been done by the EC, would not call for a global consensus and yet it might produce ideas for resolving the problem quickly and more economically.

Finally, Mr. Finaish remarked, his authorities had so far confined themselves largely to raising questions and seeking clarification about the nature and details of the project. Therefore, he was not in a position to endorse the staff proposal at the present meeting.

The Deputy Director of the Research Department stated that careful consideration would be given to the comments and suggestions made by Executive Directors.

Responding to specific questions, the Deputy Director mentioned that it was indeed possible, as Mr. Nimatallah had suggested, that the increase in the asymmetry would prove to be temporary and come down subsequently, as it seemed to have done in 1983 compared with 1982. The staff interpretation, however, was that the asymmetry was on an upward trend, which had been sharpened in 1982 by the weakness of world trade in that year. Aggregating the trends in the trade and service components of the asymmetry could obscure underlying trends; usually, a negative and growing asymmetry on services was partly offset by a positive asymmetry on trade. However, as world trade shrank in 1982, that positive asymmetry also shrank so that the negative asymmetry on services had been offset by a smaller amount than usual. The staff's interpretation, which was of course only a hypothesis, was nevertheless supported by the projections for 1984-85 showing a resumption of the upward trend in the asymmetry.

Shifts in the balance of payments between the industrial and developing countries had led Mr. Nimatallah to ask whether there might be a link between the discrepancy and global balance of payments trends, the Deputy Director continued. Again, such a link was possible, although if the staff projections for 1984 and 1985 turned out to be at all well based, the discrepancy would have been rising in two different situations: in 1980-82 when the industrial countries' balances had been moving in one direction, and in 1984-85 when they would move in the other direction.

Another important question raised by Mr. Nimatallah, although one that the staff was not in a good position to investigate directly, was the accuracy of the current account statistics for nonmember countries, the Deputy Director remarked. The staff suspected, as did apparently a number of Executive Directors, that offshore centers might be responsible for a significant portion of the asymmetry, although he would be reluctant to say just how large it was. In a sense, those centers could be regarded as nonmembers insofar as their balance of payments statistics were not included in the staff's calculations. The staff would be less inclined to believe that the Eastern European nonmember countries accounted for much of the asymmetry. It was unlikely that those countries would run a surplus without spending it, and their spending would show up in the Fund's bilateral payments statistics.

The problem with the suggestion that the staff should select for further study the countries or transactions in which the discrepancy seemed to be most serious was a lack of available information, apart from some figures on errors and omissions, the Deputy Director explained. As had been pointed out in the staff's previous paper on the statistical discrepancy (EBS/84/49, 3/9/84), some transactions could give rise to both errors and omissions in national accounts and to an increase in the overall discrepancy, but many transactions would not have that joint effect. It should also not be forgotten that the Bureau of Statistics made a comprehensive statistical effort, by providing technical assistance to member countries, that at least in principle kept recording practices across countries on as consistent a basis as possible. It was only when the problem was raised at the international level that the discrepancies became obvious.

On the discrepancy in official transfers, the Deputy Director agreed with Mr. Malhotra that it was difficult to know what proportion of such transfers was misclassified under private transfers and did not thus appear in the total figure for official transfers. The intention had been to get some idea of the extent to which official transfers were misrecorded because of the systematic tendency of donors to record aid in their books at a higher value than that recorded in the books of the receiving countries. It would not be possible to obtain that sort of information unless transactions recorded as private transfers were eliminated from those recorded as official transfers.

The ability of the staff to manage without new, basic information had been questioned by Mr. Clark, the Deputy Director recalled. The need for new information might become apparent at a later stage, but as Mr. Clark himself had pointed out, the purpose of the project at present was to discover the sources of the discrepancy before proposing precise ways for dealing with it.

The question of the proposed role of the OECD had also been raised by Mr. Clark, the Deputy Director noted. Like the Fund, the OECD prepared global statistics, and was both interested in the project and keen to participate with the Fund. The OECD, because it had a more limited membership, had thought that it should defer to an organization having a worldwide membership. The particular expertise of the OECD in development assistance, through the Development Assistance Committee, and in the evaluation of official transfers had suggested that those might be areas in which the OECD and the Fund could envisage collaborating with each other.

In response to a question by Mr. Camara, the Deputy Director added that the EC had generated balance of payments matrices, both for aggregate trade within the Community and for categories of transactions, broken down in the same way that the staff had drawn up Table 1 in SM/84/157. By applying statistical procedures, the EC could find a pattern of discrepancies related to the identification of geographical sources of the asymmetry. For example, two countries might attempt to reconcile their bilateral trade flows, but there would be no easy way of discovering the source of a statistical discrepancy without identifying all the individual transactions. However, in a matrix of trade flows certain countries might be shown to have systematically larger discrepancies in their bilateral trade flows with the other nine members of the Community. Such a matrix had thus seemed to be a potentially fruitful statistical tool that could be extended, on the basis of existing figures, to the United States, Japan, and possibly to Canada and one or two other countries so that, within the share of world trade accounted for by those countries, it would be possible to have an idea of the extent of any discrepancies. Intra-EC trade accounted for approximately 20 percent of world trade; the share would probably be twice as large if Japan, the United States, and Canada were added to the group. It should then be possible to reach a judgment about the share of the discrepancy that could be attributed to transactions among that group of countries, and the share accounted for in the trade of other countries and in trade between that group and the rest of the world. If no discrepancies were found within the group of countries, it would not of course be possible to claim that those countries were necessarily recording their trade with the outside world correctly, but it could be determined that one part of their trade was not responsible for the discrepancy.

In response to Mr. Templeman's question on how the cost of the study had been calculated, the Deputy Director of the Research Department noted that the estimate in the staff paper could not by its nature be precise. The staff had attempted, based on its own experience with similar exercises and in consultation with the authorities of members and the staff of other international organizations, such as the EC, to calculate approximately the staff resources required to make a minimal but adequate study in each of the suggested areas. It would be possible to mount a more limited exercise under a more limited budget.

Mr. Templeman inquired to which area of study the staff would give preference if its resources were truly limited. It seemed to him that investment income was probably the most important topic, even though the staff had suggested approaching it in segments.

The Deputy Director of the Research Department responded that it was a matter of the greatest yield in terms of reducing the discrepancy, as well as of the cost in terms of resources. The staff would agree with most Executive Directors that if only one study could be made, it should cover investment flows and financial services, encompassing the offshore centers where most of the discrepancy was to be found. However, two of the more research-related topics suggested in the staff paper--the matrix of bilateral trade flows and the development of an algorithm for adjusting asymmetries--were less likely to be resource intensive. The EC had already developed a matrix and would be prepared to extend it if the Fund provided the data and some assistance. The algorithm would also not involve the collection of data or a major research effort but would be largely a matter of examination; in a recent World Economic Outlook survey a similar attempt had been made to estimate the causes of the timing and valuation asymmetries, relating them to trade flows.

The Chairman made the following summing up:

On the whole, the Executive Board considered--although some doubts were expressed--that the discrepancy in world current account balances was a serious problem that was not likely to resolve itself. The discrepancy could lead to misperceptions by governments of balance of payments developments in their own countries and in the world, and thus to wrong policy reactions. Hence, the Board was interested in Fund efforts directed at identifying and reducing or eliminating the sources of the discrepancy. But at the same time, the Board warned against undertaking too ambitious a project. The general feeling was that the Fund should proceed cautiously, on a step-by-step, and selective basis.

The guidance offered by Executive Directors could perhaps be summed up in the following way:

As far as the fields of inquiry are concerned, it was clear that Directors felt that the staff should concentrate on the most productive area for research, in terms of the magnitude of the imbalances and of the likely results of the work. Investment income flows, and the financial services of offshore centers, should probably be at the core of the study, within which however a number of lines of work would have to be identified and coordinated.

The shipping study was seen to have low priority. The bilateral payments matrix was viewed as falling somewhat outside the ambit of the Fund's work, even though at some stage the Fund might wish to participate in an expansion of the EC matrix of bilateral payments flows. The more modest project of exploring timing and valuation asymmetries, which would not appear to require a large allocation of Fund resources, could perhaps be fitted in with the projects of the Research Department and other interested departments.

On the procedures for carrying out the research, which would begin with the project on investment flows, the working group to be set up would be small, consisting of people who were directly involved in compiling statistics, from countries judiciously selected to take into account the magnitude of the flows and their geographical distribution, together with the permanent presence of relevant staff members of the Fund and international organizations working on the same problem.

There was not at the present stage much support for the establishment of a steering committee, all the more so as there would be no different groups to coordinate if the project began on a small scale, and if the one working group was able to handle the work itself, as it probably would be.

As for the role of the Interim Committee, I understood from the discussion that I should inform the Interim Committee, as part of my general presentation of the work being accomplished by the Fund, of what was contemplated in the field, without bringing any specific decision-making pressure to bear on the Interim Committee. When more substantive results began to stem from the work of the group, and specific policy questions arose that had to be posed to the membership, the Interim Committee might be asked to back up the outcome of the group's efforts and recommendations.

The Executive Board had expressed its preference for avoiding the cost of taking on more than a limited number of consultants, who should moreover be employed on a temporary basis. Account would also be taken of the wish of the Board to make as much use as possible of in-house staff; department heads would be asked to look within their own offices for qualified staff who might be made available on a temporary basis for such work. For a less broad study, the allocation of Fund resources could be significantly less than had been envisaged; the number of positions could be reduced by, say, half from the ten originally envisaged. Further proposals would be made in that respect.

APPROVED: May 21, 1985

JOSEPH W. LANG, JR.
Acting Secretary