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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/79

10:00 a.m., June 2, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
J. de Groote	H. G. Schneider
B. de Maulde	
A. Donoso	
R. D. Erb	C. H. Dallara
M. Finaish	T. Alhaimus
A. H. Habib	Jaafar A.
T. Hirao	T. Yamashita
R. K. Joyce	
A. Kafka	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
	A. Lindø
	C. Taylor
Zhang Z.	Wang E.

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

African Department: O. B. Makalou, Deputy Director; S. E. Cronquist. Asian Department: K. A. Al-Eyd, J. T. Boorman, R. J. Niebuhr. European Department: P. Gotur. Exchange and Trade Relations Department: C. D. Finch, Director; S. Mookerjee, Deputy Director; M. Allen, H. W. Gerhard. External Relations Department: R. Russell. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel. Middle Eastern Department: A. S. Shaalan, Director; A. K. El Selehdar, Deputy Director; B. A. Karamali. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; K.-Y. Chu, L. U. Ecevit, N. M. Kaibni, E. C. Meldau-Womack, P. R. Menon, S. S. Morrison, A. Muttardy, A. Salehizadeh. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Berthet, D. Gupta, O. Roncesvalles. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Statistics: D. K. Kar. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, C. J. Batliwalla, S. E. Conrado, S. El-Khouri, S. M. Hassan, L. Ionescu, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, L. Barbone, R. Bernardo, M. B. Chatah, T. A. Connors, G. Ercel, C. Flamant, A. Halevi, M. Hull, J. M. Jones, P. Leeahtam, Y. Okubo, J. G. Pedersen, M. Z. M. Qureshi, J. Reddy, D. I. S. Shaw, H. Suzuki, P. S. Tjokronegoro, J. C. Williams, A. Yasseri.

1. COMPENSATORY FINANCING FACILITY - REQUESTS FOR DRAWINGS BY OIL EXPORTERS

The Executive Directors considered a staff paper on certain issues arising in relation to requests for compensatory financing drawings by oil exporters (SM/83/87, 5/16/83).

Mr. Nimatallah made the following statement:

The sharp decline in the demand for oil over the past two years has led to a large shortfall in the oil export earnings of many oil exporting countries. At the same time, some of these countries have been experiencing severe balance of payments difficulties. Under normal circumstances, one would expect these countries to come to the Fund with requests for drawings under the compensatory financing facility. Yet they have been discouraged from doing so, either directly or indirectly, under the assumption that their requests would be considered controversial. The oil exporting countries, whether members of the Organization of Petroleum Exporting Countries (OPEC) or not, have become concerned about this development, and they view it as being at variance with the principle of uniform treatment of Fund members.

This controversy was triggered by some of my Board colleagues when they raised the question whether the shortfall in oil export earnings was caused by circumstances beyond the control of the oil exporting countries. I fail to understand why they should raise such a query in the first place. The decline in the demand for oil is obviously outside the control of the oil exporting countries. As far as prices are concerned, there is no product in the real world whose price is fully determined by market forces, without some kind of intervention in the market.

The basic factor influencing market behavior, of course is the principle of maximizing profits and returns. Oil producers and exporters, whether firms or governments, want to maximize their earnings. However, oil, unlike renewable products, belongs to the family of exhaustible resources where additional criteria are required for production and pricing decisions. Some of these criteria are related to individual national considerations. These considerations could be political, economic, or social. Certain countries may want, for example, to extract their limited reserves of oil over a longer period of time, irrespective of the level of demand for oil.

Other criteria are related to market considerations. The decision by a country on how much oil to produce beyond what is necessary to meet its requirements for consumer goods and services would depend on a host of factors, including the rate of inflation, the rate of return on competing assets, and expectations regarding the future value of the price of oil. The country would aim at obtaining a price for its oil that enables it to maintain the real value of other assets over time.

The price of oil, like that of other commodities, would rise or fall so as to equate the supply and demand for oil. If demand exceeds supply at any given point in time, the price should rise to the extent that it brings in additional supplies while curbing excessive demand. If, on the other hand, demand declines, the price should also decline to the extent that supply is discouraged and demand is encouraged, to again reach an equilibrium point at which the price will settle.

The supply and demand sides of the oil market tend to be characterized by high inelasticity in the short run. That at least partly explains why the behavior of consumers of oil in the late 1970s pushed the price in the spot market to about $40 a barrel. Consumers were building up unnecessarily large inventories of oil. The price was led by the market behavior to perform its function of eventually equating supply with demand. On the other hand, when the United Kingdom, Nigeria, and other oil exporters reduced the price of their oil, it was simply a reaction to the behavior of the spot market.

Some, of course, might ask whether the OPEC price should have risen in 1981 to $34 a barrel, and whether in March 1983 it should have declined to below $29 a barrel. The answer to the first question, in my judgment, is in the affirmative. The spot market price actually hit $40 a barrel at that time. Saudi Arabia and others were convinced that the spot market price did not truly reflect basic market conditions, due to the unnecessary accumulation of inventories. Saudia Arabia, therefore, was of the opinion that a price in the low $30s would be more reflective of true market conditions. The price had to go up to that level to induce an increase in the supply of oil from high production cost areas, and to encourage the development of alternative energy resources. The price also had to reach that level to discourage wasteful consumption of oil.

When it comes to the lower price of $29 a barrel, the decision of the oil exporters must have been influenced by a complex of criteria that included, inter alia, (1) the recession and consumer demand, (2) the quest for price stability for everyone, consumers as well as producers, (3) avoidance of a possible future energy crisis, (4) possible bank failures and an international financial crisis, (5) severe payments difficulties of some oil exporting countries, and (6) possible halt of investment in alternative energy resources. All of these factors could not have been only in the interest of OPEC, and therefore OPEC could not "dictate a floor price." The price is now $29 a barrel because world oil market conditions dictate such a level. The proof is that the spot market price did not fall below $29 a barrel in February 1983 at a time of high uncertainty in the oil market, and well before the London announcement in March.

The share of OPEC in world oil production is such that it could not control the price of oil even if it wanted to. Table 2 of the staff paper shows that the share of OPEC in total world production averaged about 45 percent during 1974-82. This is not a situation where OPEC can dictate its wishes on the market. In fact, Table 3 of the Annex to the staff paper shows beyond doubt that OPEC was never able to lead the market but only to follow. It was only when spot prices exceeded the official OPEC prices, and sometimes by substantial margins, that OPEC prices increased. And when spot prices started to decline a few months ago, OPEC prices declined. OPEC was only ratifying what the market had already dictated. 1/

I agree with the observations made in the staff paper that the actions of OPEC did not determine oil earnings in the relevant period of analysis for export shortfalls. It is true that OPEC did not always have a price policy; and when it did, it was characterized to a large extent by establishing price ceilings rather than price floors. Furthermore, I endorse the staff's conclusion that "there is diversity among members of OPEC in respect of the volumes of their production and exports and in relation to the changes in the unit values of their exports." Therefore, requests by oil exporters for compensatory financing drawings should be treated on a case-by-case basis.

In conclusion, I want to emphasize the following point. The Fund is a cooperative institution that bases its relationship with its members on the principle of uniform treatment. Any impression that the Fund might give that it is discriminating against some of its members would jeopardize the cooperation of members with the Fund. I think we all agree that the principle of uniform treatment plays an important role in holding this institution together. To single out oil exporters as having control over their export earnings is discriminatory in my judgment, and would be detrimental to the Fund.

1/ Let me remind Directors that South Africa's share in world gold production is 55 percent, while OPEC's share in world oil production is now about 35 percent. Yet at the time South Africa requested a purchase under the compensatory financing facility last year, the question whether the shortfall in South Africa's gold export earnings was largely due to circumstances beyond its control was not raised. Furthermore, the shortfall in gold exports was included in the calculations made in the staff paper, despite the fact that South Africa had been deliberately and consistently reducing its gold production over time. One would have expected those who are now raising doubts about the eligibility of oil exporters to use the compensatory financing facility to have also expressed doubts about South Africa's use of the compensatory financing facility.

Mr. Kafka said that he was in full agreement with the staff's conclusions, which seemed to have been well argued on the basis of the facts. In sum, if and when oil exporters in general and OPEC members in particular sought compensatory financing from the Fund, their requests must be treated without prejudice, each case being examined on its merits, as all other such requests were. He agreed with Mr. Nimatallah that any other course would be discriminatory. The Fund could not afford to run the risk of allowing even the suspicion of discrimination in the way in which it treated its members.

Mr. Finaish said that he had found the staff's analysis to be clear and concise and its approach to the issues addressed in its paper quite objective. As he had noted during the previous discussion in the Executive Board on the Fund's liquidity position (EBM/83/60, 4/8/83), it was not clear to him why it was deemed necessary to consider the question of eligibility of exporters of a particular commodity as a group for drawings under the compensatory financing facility when the standing practice in dealing with members' requests under that facility was to consider them on an individual basis, country by country or case by case. The criteria or tests applied in evaluating compensatory financing requests had been discussed and clarified during several general policy discussions in the Executive Board in the past, including specifically the discussion in April 1982 of the meaning of a shortfall largely attributable to circumstances beyond the control of the member (EBM/82/41 and EBM/82/42, 4/5/82). The eligibility of members under that common set of criteria had always been determined on a case-by-case basis. To single out exporters of oil for different treatment, for which no provision had been made in the governing Decision on the Compensatory Financing of Export Fluctuations, could therefore give the impression of being inconsistent with the principle of uniform treatment, a principle to which the smaller members of the institution attached special importance.

But he had been comforted, Mr. Finaish added, by the conclusion of the staff paper that compensatory financing requests from oil exporting countries, like those from exporters of other commodities, should be treated on a case-by-case basis. Some oil exporting countries--including both OPEC and non-OPEC exporters--had been permitted to draw under the compensatory financing facility in the past.

Uniformity of treatment, however, was not the only argument for following a case-by-case approach in respect of possible compensatory financing requests from the oil exporting countries, Mr. Finaish stated. Even on technical grounds, as shown by the staff paper, there was little justification for doing otherwise.

The main question addressed by the staff, Mr. Finaish continued, was whether membership in OPEC would in and of itself create a presumption that a shortfall in the export earnings of an OPEC member arose from factors within that member's control. For such a presumption to be valid, two independent conditions would have to be satisfied simultaneously. First, OPEC actions would have to be the determining factor in shaping the profile of the group's export earnings and a shortfall in those earnings would have to be largely attributable to its own actions and policies. Second, what was true for OPEC as a whole would also have to be true for its individual members. As shown in the staff paper, neither condition was supported by the evidence, either for the period relating to a current shortfall or for any preceding period.

He broadly agreed with the staff's brief but fairly clear analysis, and with the evidence presented, that there was no support for a presumption to the effect that OPEC's actions had played a determining role in influencing the behavior of its markets' export earnings, Mr. Finaish remarked.

The pricing and the control of oil output raised some interesting and complex theoretical issues, especially because of oil's special attribute of being an exhaustible resource, Mr. Finaish noted. Whether or not a shortfall in export earnings was largely attributable to factors beyond the control of an exporter was, and should be, determined with reference to the five-year period centered on the shortfall year. However, the staff had, in his opinion, provided some useful background information by also reviewing briefly the events of the early 1970s. It was clear from the description provided in the staff paper that the major developments that had converged to generate the increase in oil prices in 1973-74 had not been brought about by OPEC. The exceptionally rapid rate of increase in the demand for oil due to the world economic boom (in addition to the continuing impetus to demand provided by the artificially depressed price of oil), the progressive loss of monopoly control over the oil market by international oil companies, and the political events of 1973, had been largely unrelated to OPEC as such. It was well known that throughout the postwar period decisions about oil prices and production levels had been made almost exclusively by major international oil companies, as a result of which the price of oil had been kept at levels well below its real replacement cost or relative scarcity value. It would be grossly erroneous to argue that the oil price increases of 1973-74 had been the result of a shift from a competitive oil market to a monopolistic one.

In assessing the role of OPEC policies in influencing the time profile of its export earnings over the period relating to any current shortfall, Mr. Finaish added, the evidence and the staff's analysis supported rather strongly the argument that that profile had been largely shaped by market conditions and not by policy actions on the part of OPEC. The demand pressures in 1979 and 1980 had stemmed to a large extent from a substantial jump in inventory demand on the part of some buyers, partly caused by market apprehensions about the political situation in the Gulf area. While production had been maintained near capacity levels by most OPEC members, and a sizable increase in production by some non-OPEC sellers had also taken place, the market had remained tight due to the upsurge in demand. During that period, the average OPEC price had lagged behind, increasing less than either the spot market price or the average price charged by non-OPEC sellers. The downward pressure on oil prices and on the volume of oil sales between 1981 and 1983 was again largely attributable to market developments, in that case influenced by falling demand brought about by the worldwide recession, conservation in the use of oil, and a large drawdown of inventories from the high level built up over the previous two years. The fall in the demand for OPEC oil had become even greater as production by non-OPEC sellers continued to increase. The swings in the demand for OPEC oil were amply reflected in the profile of its export earnings, as shown in Chart 1 of SM/83/87. Annex Table 3 provided clear evidence that OPEC price actions had consistently followed market price movements, which had been led by the spot market and non-OPEC sellers.

A point to note about the developments in the oil market since 1978 was that fluctuations in inventory demand had emerged as a major source of instability in the market, Mr. Finaish said. A rapid buildup of inventories in 1979-80 had been followed by an accelerated drawdown starting about mid-1981. The estimated rate of inventory drawdown by early 1983 amounted to some 5-6 million barrels a day, or about one third of total OPEC oil exports and one fourth of total world oil exports at that time. According to many analysts, in addition to motives such as security of supplies and pure speculation, an increasingly significant consideration bearing on inventory management by the oil importers appeared to have been the deliberate use of stockpiles to influence the oil market, or, in the words of a recent study by the Group of Thirty, The Future of the International Oil Market, "to fight OPEC pricing decisions."

However, Mr. Finaish went on, OPEC had for the most part exercised no control over the level of production of its members. There had been no market-sharing arrangements. OPEC had clearly not been in a position to control the total supply of oil in the international oil market, if only because of the large and increasing share of non-OPEC sellers. It had also not been in a position to erect any barriers to entry into that market. Furthermore, even with respect to the pricing of oil, OPEC had not, for the most part, had a uniform price policy; quite often it had hardly had any price policy at all. As noted in the staff paper, "uniformity of prices among OPEC members has been conspicuous by its absence." Where some pricing policy could be identified, it consisted chiefly of setting price ceilings rather than price floors. Clearly, those were not the attributes of a cartel--as the term was understood in microeconomic theory--much less of one that could dictate any terms to the market.

In short, Mr. Finaish stated, it should be quite clear that the profile of OPEC's export earnings had been determined mainly by market-related developments rather than by OPEC actions. A shortfall in OPEC's export earnings as indicated by that profile could not, therefore, be regarded as being attributable largely to factors within OPEC's control. Indeed, to the extent that OPEC's or its members' actions could be considered to have had some role in the movements in the group's export earnings, the effect--as noted in the staff paper--appeared to have been a stabilizing one and to have thereby helped to reduce rather than to increase the size of the shortfall estimated for 1983.

The staff had reached similar conclusions about the dominance of market conditions in determining movements in oil prices and the volume of sales in its analyses of oil market developments prepared as part of the World Economic Outlook exercise, Mr. Finaish went on. For instance, in the draft of the published report on the world economic outlook, the staff had stated, with respect to the oil price increases that had taken place between 1979 and 1981, that:

> As the members of OPEC were divided on the pricing issue during 1979-81, the large increases in oil prices through early 1981 resulted mainly from actions taken by individual oil exporters (inside and outside OPEC) in response to the sharp rise in spot market prices and other market developments. The decisions on oil prices taken at various OPEC meetings during this period represented in most cases compromises providing for price ceilings and tending to ratify pricing decisions already taken or about to be taken by individual members.

With respect to the decline in export earnings of OPEC since 1981, the staff had noted in the same report that "changes in total production and export volumes of the oil exporting group have been determined mainly by developments in oil consumption and production in the rest of the world and by movements in world oil inventories." Those, it would be noted, were all developments largely outside OPEC's control.

It had been observed in another Fund study, "The 'Energy Crisis' and Payments Imbalances - A Twin Challenge: The Role of Oil Exporting Developing Countries," which had been discussed by the Executive Board in October 1982, that "it has taken almost a decade for the world public at large to realize that the oil price rise since 1973 has been an inevitable result of demand's collision with the inherently exhaustible limits of oil reserves." Interestingly, that statement had subsequently been deleted from the published version of the study. Many other studies undertaken outside the Fund had come to broadly similar conclusions.

The second condition that would have to be satisfied if membership in OPEC was to be regarded as providing sufficient basis for the presumption that a shortfall in the export earnings of an OPEC member arose from factors within that member's control, Mr. Finaish repeated, was that what was true for OPEC as a whole must also be true for each of its members. The evidence, however, clearly did not support any such assumption of intragroup homogeneity. The staff paper provided a well-documented account of the considerable diversity that had characterized OPEC members in respect of both the volume of their oil production and exports and the changes in the unit values of their exports, which together determined the profile of their export earnings and, hence, also the timing, extent, and character of any shortfalls indicated by that profile. In view of that diversity, it would evidently be untenable to generalize that what might be true for OPEC as a whole also applied to OPEC members. Indeed, the existence of diversity among OPEC members provided sufficient justification for following a case-by-case approach in respect of possible compensatory financing requests from them, regardless of what might or might not be true with respect to the profile of the export earnings of OPEC as a whole. As the staff had noted in its paper, "it is the specific policies pursued by each country rather than the role of OPEC itself that is relevant."

It should thus be clear that there was little basis for the presumption that membership in OPEC alone provided a sufficient reason for regarding a shortfall in the export earnings of an OPEC member as arising from factors within that member's control, Mr. Finaish stated. Neither of the conditions that needed to be satisfied for such a presumption to be met was supported by the evidence. Therefore, requests for compensatory financing from the oil exporting countries, be they members of OPEC or not, should be treated, in line with the normal practice, on a case-by-case basis.

Finally, Mr. Finaish remarked briefly on the view expressed by some that, in considering possible compensatory financing requests from the oil exporting countries, account should also be taken of their impact on the Fund's liquidity position. It should be clearly understood that the Fund's liquidity position had no bearing whatsoever on the central issue under discussion--the eligibility of oil exporters to draw under the compensatory financing facility. Eligibility had to be decided, as in other cases, solely on the basis of whether or not the country requesting a compensatory drawing met all the existing criteria of the Decision governing the facility that were common to the membership, including the criterion of balance of payments need. It was true that the Fund's liquidity position had come under increasing strain in recent months, but solutions to the liquidity problem could not be sought through limiting access to the Fund's resources for a part of the membership, for that would clearly be discriminatory.

Mr. Erb said that he agreed with the staff's conclusion that there was great diversity among oil exporters and that any requests from them for compensatory financing must be dealt with on a case-by-case basis. As his chair had indicated during numerous discussions in the past, all such requests must be considered and judged against the Fund's Articles and all the criteria set forth in the Decision on the Compensatory Financing of Export Fluctuations. Membership in OPEC per se should not involve a presumption that any of the relevant criteria had not been met, just as membership in OPEC per se should not involve a presumption that any of the criteria had been met. As pointed out in the staff paper, each case was unique: the circumstances, the policies, the role in the joint decision-making process, the mix of commodity exports, and so on, were all different. Some countries had a diversified commodity base for export earnings, and some had export earnings heavily concentrated in oil. Some requests might pose serious difficulties, some might pose less serious problems. The present discussion should not, therefore, lead to any conclusion or presumption that requests for use of the Fund's resources by members of OPEC would be viewed favorably or unfavorably.

In short, Mr. Erb continued, the Executive Board must look at each case involving oil vigorously and thoroughly, just as it should at all compensatory financing cases. He continued to expect, of course, that in accordance with standing policy, no request for use of Fund resources under any facility, including the compensatory financing facility, would be brought forward to the Board unless staff and management concluded that it clearly met all relevant criteria, including, first, balance of payments need; second, the test of cooperation, and the safeguard provisions of the Articles applying to the use of all Fund resources; and, third, the test of circumstances being beyond the control of the member.

Before discussing how he had applied those criteria to previous compensatory financing requests and how he would thus apply those criteria to requests involving oil, Mr. Erb referred to the staff paper which was interesting, although authorities had differences of view or of emphasis in a number of areas covered. First, the staff examined the impact of world economic developments on the oil markets but failed to give adequate weight to the impact of oil market developments on the world economy. For example, inflation and recession during 1974-75 and 1979-81 had certainly been exacerbated by the large oil price jumps that had occurred at the start of those periods.

Second, Mr. Erb added, the analysis of oil market developments in 1981 and 1982 was set within too short a time period. He would argue, for instance, that a part of the supply and demand adjustments taking place during that period outside OPEC had been induced by the 1973-74 oil price increases implemented by OPEC members and reinforced by production limitations by several key OPEC producers. The rationale was that many energy developments on both the supply and the demand sides had long response periods. For instance, it took from seven to ten years to develop new oil fields; oil substitutes, such as nuclear power, also had long development periods.

A third gap in the staff paper, Mr. Erb remarked, was that not enough attention was paid to the impact on the oil markets of developments within OPEC, including the positions taken by various major OPEC producers regarding the desirability of production or export quotas and the appropriate price level for oil. To cite an example, he recalled times when inventory building outside of OPEC had occurred because the markets feared that the OPEC members who sought large price increases through explicit quotas would achieve that objective within OPEC. He agreed with the staff's view, however, that the short-run production responses of some other OPEC producers--Saudi Arabia had been cited as an example in the paper--had worked to stabilize oil prices during a number of the subperiods when world supply and demand shifts had been occurring.

Finally, while the staff paper had spelled out the evidence suggesting that OPEC did not behave as a tightly-knit cartel consistently through the period (in the sense of having agreed production quotas to support an agreed price level), and that other developments also had an influence on oil market developments, Mr. Erb considered that economic theory as well as economic evidence suggested that producer organizations could have an important influence on a market through their impact on the behavior of individual members within the organization.

He realized that those were controversial issues that had been debated among professional analysts who had closely followed the oil markets over the past decade, Mr. Erb said. He had pressed the view during Executive Board discussions of requests for compensatory financing relating to other commodities that the staff must closely examine the pricing and production policies of the member requesting a compensatory financing drawing, taking account of the behavior of that member within a producer or producer/consumer organization to which it might belong.

Regarding the balance of payments test, Mr. Erb continued, he agreed with the statement by the staff on page 2 of SM/83/87 that "the Fund should be satisfied that a member seeking to use the Fund's resources has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves." There could, of course, be differences among oil exporters in respect to their balance of payments need, and at any given time some exporters could be ruled ineligible for a compensatory drawing because of a lack of need.

As for the requirement for cooperation for a drawing above 50 per cent of quota, Mr. Erb added, he strongly supported the practice of requiring that a comprehensive adjustment effort be in place; in most cases, that meant a Fund program. Where a country's export shortfall was embedded in a larger balance of payments problem, it had been the U.S. view that the safeguard provisions of the Articles required the Fund to assure itself--for any request for compensatory financing, even in amounts of less than 50 per cent of quota--that the country would be able to repurchase without being forced to take destructive economic actions. Although a temporary shortfall in export earnings might be technically isolated from broader economic developments and policy directions for the limited purposes of determining eligibility to draw under the compensatory financing facility, in reality, export developments could not be viewed in isolation from the broader economic and balance of payments considerations. Where there was a clear need for adjustment policies, use of compensatory financing without such adjustment might contribute to further delays in tackling the underlying problems--delays which in the end might not benefit anyone.

In a number of compensatory financing cases during the past year or so, Mr. Erb recalled, his chair had expressed serious reservations and concerns on two related counts: cooperation with the Fund, and the ability of the country to meet its repurchase obligations. To quote from one statement made in the context of a specific request for compensatory financing by a member, "both of these areas of concern stem from the same source, the inadequacy, in our view, of past and current policies" in the requesting country. That statement by his chair had gone on to mention that "the test of cooperation is, of course, important in part because of the need to safeguard the Fund's resources. Given the current stance of policies, the record of repurchase during the past year and the situation in the external accounts, we must have some doubts about whether there is an adequate basis for concluding that the member will correct its payments problems and be in a position to meet its obligations to the Fund."

In future compensatory financing cases, including any involving oil, Mr. Erb stated, he would continue to apply those same principles to the criteria for the test of cooperation and for the need to safeguard Fund resources.

In the more general context of the Executive Board's discussion in April 1982 of the criteria for determining whether or not an export shortfall was due to circumstances beyond the control of the member, Mr. Erb said, his chair had raised a number of issues and argued for a strict interpretation of that requirement. He would continue to press for a strict interpretation in all compensatory financing requests, including any that involved oil.

As far as commodity stabilization policies were concerned, Mr. Erb reiterated what he had said in the April 1982 discussion: the staff should continue to subject each stabilization arrangement to a careful analysis, and it should not automatically treat a volume shortfall resulting from the operation of export quotas as being outside the control of the member. Adjustments in the shortfall should be made when appropriate, for example, when an export quota arrangement did in fact exacerbate the shortfalls of an individual member. He had also stated that it was important not only to look at the impact of the export quota system in the shortfall year, but also at the performance in the preceding and following years. More fundamentally, he had argued that export quota arrangements should more properly be handled through the buffer stock financing facility rather than through the compensatory financing facility. Arguments that export quota agreements ultimately reduced disbursements under the compensatory financing facility over time were irrelevant in his view when making judgments under the existing terms of the compensatory financing facility.

In that discussion in April 1982, Mr. Erb went on, he had also differentiated between price takers and dominant market producers. Insofar as dominant exporting countries were concerned, he had asked the staff how it judged whether or not a country's attempt to maximize export revenue was appropriate; over what period of time did it evaluate a country's efforts to maximize earnings?

Many of those issues, Mr. Erb remarked, were once relating to the compensatory financing facility that he had raised on numerous occasions in the past and would continue to raise in future discussions of specific cases--whether or not they involved oil--and in more general discussions of the compensatory financing facility as well. His chair had also raised questions during the Board's consideration of specific compensatory financing requests when it had doubts that the shortfall could be judged to be largely beyond the control of the government because of anticompetitive behavior in pricing or marketing.

Citing a few important examples from the previous interventions by his chair, Mr. Erb recalled the concern he had expressed, in November 1982, that South Africa's production policies might have led to the export shortfall for gold. His concern had been allayed to a large extent because the calculated shortfall could be accounted for by exports other than gold. In the same discussion, he had wondered whether there had not been stockpiling of diamonds and had suggested that a general policy should be considered for making adjustments to shortfalls if stockpiling was thought to have taken place but stockpiling data were unavailable.

In March 1982, Mr. Erb recalled, his chair had argued that Zaïre, as a dominant producer of cobalt, had followed marketing and pricing policies that had exacerbated the shortfall. The argument had been that because the shortfall could not be considered outside the control of the authorities, an adjustment should be made to the shortfall calculation. Similarly, in September 1981, he had expressed the view that the Malaysian authorities had restrained the export of saw logs and oil, and he had wondered whether it was appropriate for the Fund to compensate member countries that withheld exports or set a high price relative to the market price, thus resulting in a larger reduction in exports.

Those were just a few examples of past compensatory financing cases in which his chair had closely examined the member's price and production policies and had determined that a part of the export shortfall did not meet the "beyond the control" criteria, Mr. Erb stated. He would continue to scrutinize all requests for compensatory financing; including any involving oil, with the same attention to that criterion, "beyond their control." In sum, his chair would examine oil-related compensatory financing requests on a case-by-case basis; it would apply the criteria of the Articles and the compensatory financing decision in the same way in which those criteria had been applied to past requests for compensatory drawings and as outlined in his statement; and it would expect the staff to provide the data and analysis necessary for assessing whether or not the criteria of the Articles and the Decision on the Compensatory Financing of Export Fluctuations were being met.

Mr. Polak recalled that from its start, the compensatory financing facility had been subject to one rule of self-denial: the industrial countries, as those countries had been defined at the time, would not use the facility. For the past ten years, the Fund had been operating on the working assumption that oil exporters would also not make use of the compensatory financing facility, and for a number of reasons. At least since 1953, the oil exporting countries as a group, as defined in International Financial Statistics, had never incurred a significant decline in aggregate export value until 1981, except for a minor dip in 1975. There had therefore been every reason to expect that oil exports would not show the sharp cyclical fluctuations characteristic of the exports of most other producers of primary products. Over the past ten years, and with varying degrees of success, which as the staff paper showed had been less than perfect, OPEC had aimed at controlling the price of oil. In the latter part of the 1970s in particular, there had been much talk of the desirability of keeping that price on a slowly rising trend in real terms, associated with the increase in productivity in the industrial world. If price stabilization had been successfully achieved, oil exporters collectively would have been spared the price swings that the compensatory financing facility had been designed to compensate with respect to exports of primary commodities.

The two large oil price increases of the 1970s had also brought, at least in the short run, Mr. Polak commented, a large financial bonanza to oil exporting countries. One manifestation of that was the leading role played by a number of OPEC members in financing the oil facility and later the supplementary financing facility, by means of which oil surpluses had been mobilized to help finance the oil deficits of other Fund members. The service rendered to the Fund by the lending countries at that time should not be forgotten, and it should be stressed that those lenders had included some countries with low per capita incomes, such as Nigeria and Iran. For the lenders, that service had in some sense been a kind of reverse compensatory financing facility to deal with the occurrence of export excesses before possible shortfalls. If such shortfalls were to materialize later, which had not seemed likely at the time, the lenders would have had the option of immediate reimbursement by the Fund.

It had now become clear, however, that the expectations underlying the assumption that oil exporters would not use the compensatory financing facility were no longer valid, Mr. Polak continued. OPEC had not been able to keep the value of its exports on a smooth trend; both OPEC and the market--and no useful purpose would be served in trying to allocate their respective responsibilities--had seriously underestimated the medium-term elasticity of supply and demand with respect to energy. The high oil prices of 1980 could not be maintained. As Table 2 in the Annex to SM/83/87 showed, the volume of oil exports by OPEC members other than Saudi Arabia, which had been in the neighborhood of 20 million barrels a day in 1977-79, had sunk to about 10 million barrels a day by 1982. Moreover, some exporters had lost the ample foreign exchange reserves built up in the 1970s and were incurring severe payments deficits after spending booms that had led to large indebtedness.

It was obvious in those circumstances, Mr. Polak went on, that the assumption of nonuse of the compensatory financing facility by oil exporters needed to be reconsidered. The Fund based its relationship with its members on the principle of uniform treatment, and no member could be expected to refrain from any use of Fund resources unless such nonuse was compatible with that principle. Mr. Nimatallah had stressed that principle, and there could be no disagreement on that point. It did not mean, however, that the Fund should, in future, process requests for compensatory drawings on the part of oil producers on top of the multitude of such requests by other members. The oil trade was too important and too special for the Fund to adopt such a "business as usual" attitude. In the present new circumstances, the Fund would have to reconsider the general policies and practices under the decision on compensatory financing. A number of major aspects of the facility would be involved and the potential impact on many members called for the reconsideration to be undertaken as a general policy matter. That would be all the more appropriate inasmuch as important aspects of the compensatory financing policy were to be reviewed shortly in any event, and the Fund was currently making a thorough appraisal of the liquidity aspects of many of its other policies.

Oil constituted by far the largest export of developing countries, Mr. Polak observed. The value of the oil trade in 1980 had been about half the value of world trade in primary products, or about ten times as large as the value of the next largest item, coffee. As long as compensatory financing for oil exporters could be discounted, liquidity considerations had permitted more generous use of the compensatory financing facility by other members; that had been of major significance when the Fund had decided--in two steps, in 1975 and 1979--to raise access under the facility from 50 per cent to 100 per cent of quota. For similar reasons, the use by oil exporters of the compensatory financing facility would have major implications for the costs of that facility. The quotas of oil exporting countries--those for which oil accounted for 50 per cent or more of total exports but excluding the surplus countries in the Gulf--were in aggregate SDR 5.3 billion, or more than one third of the quotas of all other developing countries, which aggregated some SDR 15.5 billion.

It followed, Mr. Polak noted, that if the compensatory financing facility was to accommodate all member countries, at a time when the liquidity of the Fund was in any event under considerable pressure, the quota limits on use of the facility would need to be reconsidered. On a related point by Mr. Finaish, he would agree that there should be no question of setting separate degrees of access in terms of quota limits for oil exporters and other countries.

As for the special characteristics of the role of oil, Mr. Polak continued, the working assumption that oil exports need not be taken into account for purposes of the compensatory financing facility had made it possible in the past to operate that facility on a formula reflecting the basic assumption that any export shortfalls were determined primarily by market forces. If that assumption did not hold for some minor commodities--such as cobalt, to which Mr. Erb had referred--the consequences for the facility were not important. But if the current formula was applied to oil exports, it would be seen to have severe weaknesses, as indicated most notably by Annex Table 2. It was evident from that table that application of the formula currently in use would mean that the bulge in oil export earnings from 1979 to 1982 would be factored into the export norm from which the shortfall for 1983 would then be derived. The question then was how far the shortfall measured in that way should be considered as largely beyond the control of the member concerned.

Difficulties of application stemming from use of the compensatory financing facility relating to oil pointed to a clear and urgent need for reviewing the present formula, Mr. Polak considered. There were moreover other good reasons for a review of the formula, which was still based on a market analysis for individual primary commodities, even though a large proportion of compensatory drawings were currently accounted for by shortfalls in the exports of industrial commodities by newly industrializing countries. While he considered the case for a review to be urgent, he recognized that the problems facing some oil countries might call for solutions in the coming weeks, rather than in the coming months. Therefore, he suggested that the staff be asked as a matter of urgency, meaning within the next few weeks, to prepare a practical interim solution to be applied to the oil component of members' exports, pending agreement on a revised formula applicable to all exporters.

Such an interim solution could consist of two components, Mr. Polak suggested. First, an appropriate reduction would be made to the figures for the two preshortfall years so that they better reflected the trend value. Second, a standard method would be applied to resolve in individual cases the extreme uncertainty indicated in the staff paper for estimated values for the two postshortfall years which, according to Chart 2, led to widely different estimates of the shortfall. Again, the Fund could be guided in the interim by the way in which calculations had been made recently with respect to gold at a time when there had been great uncertainty about the future world market price. Those calculations had been made on the basis of an assumed relatively low price rather than on the basis of an estimated price, which the staff in a sense had not been able to predict. If those two steps were adopted for the interim approach, they would in his mind solve, in an agreed quantitative way, any questions arising from attempts to apply the criterion of "beyond the control of the member" so that the Fund would be spared the difficult task of attempting to resolve that issue on a case-by-case basis.

His interim proposal, Mr. Polak concluded, would apply to a member's oil exports only. The Fund should be prepared to process in the normal way requests for compensatory financing from oil exporting members that were based on such members' non-oil exports wherever a plausible case could be presented that the member would in any event not have access to the facility on account of oil, but without prejudice to a subsequent request that would cover exports on both counts. In addition, after the termination of the interim period, which should not last more than a few months, a member could present a request--in accordance with standard compensatory financing rules--for the correction of any undercompensated interim shortfall.

Mr. Prowse commented that it would take time to give a considered reaction to Mr. Polak's thoughtful and informative statement. His own authorities would regard any proposal to change the way in which the compensatory financing facility operated as a matter of importance. The particular issue under discussion was also important in the broader sense because it raised the question of uniformity of treatment. Nevertheless, he deplored the tendency to canvass all the policy issues almost every time a specific proposal was raised relating to the compensatory financing facility. Those Executive Directors who wished to confine their remarks to the more immediate issues were thereby placed at a disadvantage.

Referring to the matter raised in the staff paper under discussion, Mr. Prowse mentioned that, like others, he would start by emphasizing the great significance of the principle of uniformity for the ongoing success of the Fund. The only constraint in terms of categories of eligibility that attached to the use of the compensatory financing facility derived from its origin as a facility intended to meet the needs of countries whose exports were heavily dependent on a few primary commodities. An associated objective of the facility was the stabilization of the prices of the commodities involved. It was evident, throughout the history of the compensatory financing facility, that commodities subject to agreements aimed at influencing the behavior of prices had been accepted as being eligible for compensatory financing. Unlike Mr. Polak, he had found in his own reading of the history of the facility no evidence to suggest that the Executive Board had had in mind a principle that oil should be excluded as a commodity eligible for compensatory financing. Indeed, he believed that there had been numerous instances, going back as far as 1967, of use of the compensatory financing facility by members to finance a loss of oil export earnings. Projections had been made from time to time in the past about the likely demand for assistance under the compensatory financing facility, without making any explicit provision for financing oil exports; he supposed that was simply because the price of oil had been expected to rise. He had found only practical grounds, and no issue of principle, for not factoring into the estimates any provision for temporary compensatory financing for loss of oil income.

Perhaps the core issue that arose in discussing the staff paper on compensatory drawings by oil exporters was the meaning of a shortfall largely beyond the control of the member, which had been examined closely in an earlier staff paper that had been discussed at length in April 1982, Mr. Prowse continued. It had not been evident to him that oil had been an issue at that time, or in more recent months when the question of a shortfall beyond a member's control had been discussed. The sense of the April 1982 meeting, as summed up by the Acting Chairman, had been in favor of accepting the recommendation in the staff paper, namely, that existing procedures should continue to be followed in a flexible way and that Executive Directors could discuss all matters they considered relevant to individual cases. As he recalled, the only modification to present procedures had had to do with the adjustment for stock holdings. The position of his chair, following what had been a thorough review, remained unchanged: consideration of requests for assistance under the compensatory financing facility would be based on the facts, case by case.

In that connection, Mr. Prowse went on, the effects of OPEC activities on the price of oil had been examined by the staff in SM/83/87 in a very succinct manner. Although, like some other Directors, he did not endorse all of the staff comments on what were to some extent broad issues of judgment, he did not disassociate himself from its general conclusions. Moreover, other commodity agreements with differing objectives had affected the price and the demand for other commodities without raising the issue of eligibility to use the compensatory financing facility. He would only observe that OPEC activities had affected the demand for and the price of oil but had not determined prices over the past decade, or indeed during the more recent years that would affect the shortfall period. He would submit that the outstanding factor in a consideration of the oil market was the eventual irresistibility of market forces. It was interesting to note that in the past few years, after the institutional and technical lags had been given an opportunity to operate, market forces had emerged.

As both Mr. Finaish and Mr. Erb had recognized, there was not only great diversity in the experience and situation of OPEC members, but the majority of oil exporters were not members of OPEC, Mr. Prowse observed. Therefore, it would be extremely difficult to argue that oil exporters should be classified differently on the basis of membership or nonmembership of OPEC. If anything distinguished oil from other commodities, it might be not only the importance of oil in international trade over the period, which Mr. Polak had emphasized, but the relative difficulty and uncertainty of forecasting oil prices and therefore export values for postshortfall years. As he understood it, that problem underlined to some extent Mr. Polak's proposal to review the formula for assessing a shortfall.

It should perhaps be kept in mind that access to the compensatory financing facility was constrained not merely by the need for a shortfall to be largely beyond the control of the member and to be temporary, but by the requirement of balance of payments need, which included examination of the trend and level of a country's reserves, Mr. Prowse remarked. There could not of course be any constraint based on the relative level of income of the requesting country; that would be an intolerable breach of uniformity.

As had already been pointed out by other Directors, Mr. Prowse added, the Executive Board had begun to review in depth the Fund's policy on access to its resources. That policy had to take account of the total demand for and total availability of Fund resources, and it was in that context that the matter of access limits on the use of the compensatory financing facilty should be examined if they were to be examined at all. Furthermore, it seemed misleading to discuss the issue of compensatory financing in relation to the Fund's liquidity position by referring specifically to the potential net increment to the demand on the Fund's resources resulting from possible compensatory drawings in an amount of SDR 3-5 billion. Members' balance of payments needs would have to be financed either entirely through the compensatory financing facility or partly by other means. The issue was perhaps a proxy for another issue--to what extent deficits due to the loss of oil income should be financed by Fund resources made available with low or high conditionality.

In sum, Mr. Prowse remarked, that there was no convincing basis for not endorsing the staff's recommendation that the procedures established for applying the Decision on the Compensatory Financing of Export

Fluctuations should not be modified until the Executive Board had fully reconsidered any aspects that it decided might need to be reviewed. It would be unacceptable to change established practices on the basis of an examination of a very narrow aspect of the matter.

No doubt the staff would have been looking at the problem of how to project oil exports in the postshortfall years, which was probably more difficult for oil than for most other products, Mr. Prowse noted, although Mr. Polak had referred in that respect to gold and to diamonds. It had seemed to him that a reasonable and sound position had been adopted in projecting the gold value conservatively. He would have difficulty in envisaging any change in the formula as a result of examining any particular request for compensatory financing, unless the staff wished simply to take account of reality if it had tremendous problems in deciding the future price of oil, as it had had with respect to gold.

Mr. Grosche noted, first, that he considered members of OPEC to have the same rights and obligations as other members of the Fund. Second, he considered oil exporters to have the same rights to request drawings under the compensatory financing facilty as any other exporter, provided that the drawing complied with the guidelines and rules governing the facility. Third, he had serious doubts whether decisions approving past compensatory drawings, while fully complying with existing rules, had always faithfully translated the Executive Board's original intention in establishing the facility. That intention had been to make Fund resources available to cover export shortfalls due to bad harvests or cyclical price movements for goods produced by relatively small suppliers that were price-takers in the world market. The real world had become considerably more complex. His chair was rather skeptical whether it was still useful--and whether the Fund could afford--to compensate countries for shortfalls in export revenues that were mainly due to temporary depressed export growth rates or that arose in markets where prices were administered by cartels or by other price controlling arrangements. His authorities had often felt uneasy when approving compensatory drawings for shortfalls in receipts from exports of diamonds, cobalt, coffee, and similar products.

In the coming weeks, Mr. Grosche considered, the Executive Board should try to answer the fundamental question whether drawings under the compensatory financing facility could be made as extensively in the future as they had been in the past. He attached great importance to the forthcoming discussion on policy aspects of the facility. It would be necessary to have projections reflecting all potential demands for compensatory financing and the resources available to the Fund in order to permit an assessment of future limits under the policy of enlarged access. The more financial resources that had to be reserved to meet requests for compensatory financing, the less available for drawings under the enlarged access policy. He welcomed the staff's intention to provide projections in its forthcoming memorandum on policy aspects of the compensatory financing facility. The amounts involved in potential drawings by oil exporters would be very large; he had been quite concerned to read in The Washington Post of May 31, 1983 that Venezuela alone was counting on drawing $1.4 billion from the compensatory financing facility.

The present discussion would be useful in clarifying some important issues that arose in relation to requests for compensatory financing by oil exporters, Mr. Grosche commented. However, given the complexity of the problems, the answers could only be preliminary until the whole issue had been taken up in the framework of future policy relating to compensatory financing by the Fund.

Referring more specifically to the staff paper, Mr. Grosche mentioned his agreement with the staff's conclusion that the mere fact that a country was a member of OPEC did not create a presumption that a shortfall in its export earnings arose from factors within the country's control. He also agreed that it would be better to deal with requests from oil exporters on a case-by-case basis, as was the practice for exporters of other commodities. But he thought that the staff had gone too far in the second paragraph on page 17 of SM/83/87, in supposing that if there were doubts about the influence of OPEC actions, membership in OPEC could not be held to create a presumption that an export shortfall arose from factors within a member's control. Rather, the fact of OPEC membership should be ignored--if a request from an oil exporter was received--and attention should be concentrated on whether or not the shortfall was largely beyond the control of that particular country.

Admittedly, Mr. Grosche went on, the oil market was a complicated one; the factors influencing it were manifold and changed quickly. Mr. Nimatallah's statement was very informative in that respect, and the staff had given a detailed description of market developments and pricing policies over time in its paper. But not all questions about the possible impact of pricing policies of oil exporting countries on current shortfalls had been answered. There seemed to be little doubt that, in 1973, production cuts and embargoes had been major factors leading to higher prices for oil. The impact on prices of a shortage of oil supplies also seemed to have been established for the late 1970s when production had declined in the wake of the Iranian revolution, making the situation in the oil market tighter. But there seemed to be no evidence that oil exporting countries had tried hard to keep the value of their oil exports on a smooth trend, say, rising slowly in real terms over time, which would have benefited all countries concerned. The view could be held that a number of oil exporting countries were interested in raising prices as quickly as possible to levels prevailing on spot markets, which usually overshot the mark. Other oil exporters, however, had foreseen the adverse effects of the jump in oil prices for oil importing countries, industrial and developing alike. They had not underestimated the medium-term elasticity of supply and demand with respect to oil imports and had made provision for later export shortfalls. From that point of view, Saudi Arabia's prudent role in trying to smooth price movements should be emphasized.

On the question of whether or not an export shortfall was largely attributable to circumstances beyond the control of a member, Mr. Grosche observed, it could be argued that if in certain periods a particular country had cooperated with others to establish a price level that turned out not to be sustainable, it could be considered as having created shortfalls. He would have welcomed discussion by the staff of whether or not such shortfalls should be classified as being largely beyond the control of the authorities.

Another issue not discussed at length in the staff paper, Mr. Grosche remarked, related to the matter of how much of the shortfall would be of a long-term nature and should therefore not be compensated. All oil importing countries had undertaken great efforts to reduce the consumption of imported oil. Especially after the second oil price increase, the major industrial countries had decided not to adopt an expansionary policy, as they had in response to the first price increase. Instead, they had followed an anti-inflationary stance so as to be able to accept the shift in the relative price of oil. Consequently, there had been a significant substitution of other sources of energy for oil, and energy conservation. That longer-term trend was reflected in the substantial decline in the consumption of energy in relation to GDP, thereby raising some questions at least about the extent of the short-term nature of the oil export shortfall. In the view of his chair, that part of the oil export shortfall due to higher oil production in the importing countries, energy saving, and oil substitution should not be deemed eligible for compensation.

Finally, Mr. Grosche concluded, since part of the decline in the demand for oil was due to structural factors, it appeared appropriate for the relevant oil exporting countries to implement measures of adjustment to solve their balance of payments problems. Those adjustment measures could be supported by the Fund in the framework of an extended or stand-by program. He would prefer that approach to seeing countries request drawings subject to low conditionality under other Fund facilities.

Mr. Joyce said that his point of reference in taking up a difficult subject was that any request under the compensatory financing facility was subject to consideration on a case-by-case basis. It was the responsibility of the Executive Board to assure itself that the request met necessary conditions with respect to balance of payments need, cooperation with the Fund, and existence of a genuine shortfall. If the matter was left simply at that, he would have no trouble with the present discussion; his difficulty arose in dealing with an attempt to see not whether individual countries in particular circumstances met those tests, but whether a group of countries--that happened either to be all oil exporters or members of a particular organization--met those requirements. It was not a particularly useful exercise; indeed, the concept of treating countries as a group struck at the fundamental root of the institution, namely, the principle that members should be treated in a nondiscriminatory fashion.

He thoroughly supported the staff view that it was probably not possible to make meaningful generalizations in respect of oil exporters or of some particular set of oil exporters, Mr. Joyce continued. Even if it were possible, it would not necessarily be appropriate to do so. His first conclusion, therefore, was the same as that of Mr. Erb and Mr. Grosche: there should be no presumption that oil producers were or were not to be excluded from access to the compensatory financing facility. However, having carefully read the staff paper and discussed it with a number of other Directors, he had realized that the analysis raised a number of important issues bearing on the future of the operations of the facility. Some of those issues might be relevant in considering the situation of oil exporting countries, but they were certainly of relevance to the Fund's membership at large because they touched on the overall character of the compensatory financing facility and its operation. Many of the considerations discussed in the staff paper in terms of oil were, he suspected, equally applicable to other commodities or raw materials. Thus, although those considerations might not be couched in the right terms in SM/83/87, he agreed with Mr. Erb that they were sufficiently important to merit discussion in a broader context.

One of those considerations, Mr. Joyce noted, was the issue of what constituted undue influence on price or quantity, or to put it differently, when a shortfall was beyond a member's control. Again, the staff considered the matter in relation to oil, but as an earlier discussion in the Executive Board had shown, it extended to other commodities and raised questions about the relationship between operations under the compensatory financing facility and the workings of international commodity agreements, especially when such agreements included provisions on prices or output. He was not saying that membership in an international commodity agreement should automatically lead to denial of access to the compensatory financing facility. But when production limits were set well below capacity--for whatever reason--there was at least some presumption that the shortfall might not have been beyond the control of the member. Similarly, questions arose about how to apply the concept of "beyond the member's control" in case of hostilities--military or economic--between two countries. Could a country subjected to aggression claim that its fall in production was beyond its control? For that matter, could the aggressor make a similar claim, especially if its fall in production resulted from rigorous countermeasures taken by its opponent? It was not the time to discuss those issues but they needed to be addressed in the review of the compensatory financing facility.

A second topic for consideration was to ascertain whether or not the present formula for calculating the shortfall was appropriate or equitable in all cases, Mr. Joyce observed. The shortfall was calculated as a departure from the trend line; and the trend was derived by considering the course of export earnings over the previous two years and an estimate of earnings for the two subsequent years. Were two years on either side always enough to give a true reading of the magnitude of the shortfall or of the trend? What would happen if the current year's earnings were broadly in line with normal levels--as measured, say, over the past four or five years--and were down only with respect to the most recent one or two years in which for one reason or another earnings might have been abnormally high? Again, those were issues to be taken up in a broader context, and he agreed with Mr. Polak that the question of the formula needed to be addressed promptly.

Third, there was the question of liquidity, Mr. Joyce said. The likely extent of potential requests from oil exporters for compensatory drawings had been raised in the staff paper. Appropriately, the staff had said that the matter would be taken up in the forthcoming memorandum on the policy aspects of the compensatory and buffer stock financing facilities. He would naturally worry if there was a prospect of a spate of requests that could draw down the Fund's resources so rapidly that its liquidity position might be endangered, or that the institution might be forced to consider using borrowed resources to finance compensatory drawings. He recognized that if a number of major producers of oil sought to draw on the compensatory financing facility at one time, and if the requests were all to be accepted, there would be pressure on the Fund's resources. But the same might also be true of other countries and of other commodities, as it was in fact with respect to prospective calls on the Fund for use of other facilities or of the reserve tranche. The issue was thus broader than that of the use of the compensatory financing facility by oil producers. The Executive Board's discussion should therefore also be conducted in a broader context.

To summarize his position, Mr. Joyce noted first that oil producers, like producers of any other commodity, had a right to apply for financing under the compensatory financing facility and a right to receive assistance if indeed they met the tests; but at the present time, there should be no presumption that they would or would not qualify as individual countries. Second, a number of the points that had surfaced in the staff paper and in the course of the discussion were sufficiently important to need consideration in a broader context. Third, those issues should be taken up as a matter of urgency in the context of the forthcoming review of the compensatory and buffer stock financing facilities. Fourth, he was not sure that Mr. Polak's suggestion for an interim solution--interesting as it might be--was necessarily the best way to proceed, given the implications as he saw them for the principles on which the institution was based. Of course, he would be prepared to look at that or any other proposal that might be put forward with respect to the operations of the compensatory financing facility.

Mr. Lindø stated that the principle of uniformity of treatment implied that the compensatory financing facility should be open to all members, whether oil exporting or not, as long as they met the basic conditions set out in the Articles of Agreement and the Decision on Compensatory Financing of Export Fluctuations. The Nordic countries had on several occasions stressed that principle. Although compensatory drawings by oil producers together with increased use of Fund resources by other countries were bound to further strain the liquidity position of the Fund, his authorities were of the view that the fundamental principles of the institution's operations must be upheld.

According to the conclusion in SM/83/87, the staff appeared to doubt seriously that OPEC countries could be excluded from using the compensatory financing facility on the basis of the criterion that the export shortfall must be largely beyond the control of the member, Mr. Lindø noted. It seemed that the staff might be giving too much emphasis to official OPEC decisions and too little to the practical implications of the cartel. In that context, it might also be added that there was a certain interrelationship between the trend in oil prices and the world economic situation.

In the circumstances, Mr. Lindø commented, he found it difficult to come to a general conclusion on drawings by oil exporting countries under the compensatory financing facility. Therefore, as the staff had proposed, requests for such drawings should be treated on a case-by-case basis in the same way as requests from producers of other primary products, if those countries too were perhaps able to influence world market prices. However, the Fund should examine very carefully whether or not a balance of payments need actually existed and whether or not the shortfall was due to circumstances beyond the country's control. Finally, it would be interesting to have some clarification of how the criterion relating to reserve developments would be applied in the case of countries with large foreign assets.

Mr. Senior noted that, for obvious reasons, mutilateral financial institutions and cooperative international organizations had devoted considerable attention to the problems arising from the instability of export earnings. Those problems afflicted especially developing countries that were heavily dependent on exports of a few primary products subject to marked and recurring variations in international prices. As mentioned in Fund Pamphlet No. 34 on the compensatory financing facility, three complementary approaches had usually been followed in order to reduce fluctuations in the export earnings of developing countries, or at least to mitigate their adverse impact on economic activity: export diversification; stabilization of prices through international commodity agreement; and provision of compensatory financing assistance to countries experiencing export shortfalls. The Fund had implicitly and explicitly recognized the legitimacy of all three approaches, albeit with different emphasis on each.

Thus, in its advice to countries that were too dependent on one or a few export commodities, the Fund had advocated the need for and advantages of export diversification, even though it had also recognized that the process would be a slow one at best, Mr. Senior continued. On the other hand, the very establishment of the buffer stock financing facility was explicit recognition of the legitimacy of mechanisms of price stabilization through international commodity agreements. And the establishment of the compensatory financing facility in 1963 had made it blatantly clear that, within its jurisdiction, the Fund considered that mechanism most appropriate to provide resources to its members that produced primary commodities for export if they confronted balance of payments problems as a consequence of export shortfalls. In the Decision on Compensatory Financing of Export Fluctuations, it had been explicitly recognized that the financing of deficits arising from export shortfalls had always been regarded as a legitimate reason for using Fund resources.

In general, Mr. Senior observed, the Fund had made the provision of compensatory financing conditional on four basic requirements: first, that the requesting member had a balance of payments need; second, that an export shortfall, as defined by the Fund, existed; third, that the shortfall was of a short-term character and largely attributable to circumstances beyond the control of the member; and fourth, that the member cooperated with the Fund in an effort to find, wherever required, appropriate solutions for its balance of payments difficulties. The first and the fourth of those conditions or requirements were also more or less applicable to other drawings on the Fund's resources while the second was logically an extension of the nature of the facility itself. In reality, it was only the third requirement, namely, "that the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member," that could be said to be unique to the compensatory financing facility. Thus, it was logical that the discussion should center around that point.

Generally speaking, Mr. Senior observed, the Fund had, as much as possible, tried to apply the principle of uniformity of treatment and had sought to handle requests from members on an individual basis, judging each request on its merits. Thus, he was concerned that in the recent past a particular group of member countries seemed to have been directly or indirectly discouraged from requesting the use of Fund resources under the compensatory financing facility, on the basis only that their requests might be considered controversial. That was a clear deviation from the principle of uniformity of treatment, and also from the usual practice of judging each request on its merits. Indeed, like Mr. Nimatallah, he failed to see why such requests would be controversial or why they should be treated as a group, although the very fact that the present discussion was taking place clearly indicated that other Directors held a different opinion. Nevertheless, a return to the Fund's usual practice was essential to safeguard the institution's cooperative character. The Fund should not even give the impression that it had deviated in any way from the basic principle of uniformity of treatment.

Commenting upon the basic issue under discussion, namely, whether or not a shortfall in exports could be said to be beyond the control of a member of the Fund that was also a member of OPEC, Mr. Senior stated that if there was anything to be learned from the Board's discussion of the economies of member countries, it was that prices could not be controlled or fixed by decree, in defiance of market forces. The staff had indeed made a convincing case in its paper for the proposition that, while some actions taken by OPEC from time to time might have had a certain influence on prices because of their effect on market expectations, they had not on the whole consistently determined OPEC export earnings. Clearly, only basic market forces had determined such earnings and prices; OPEC action had mainly accommodated such forces.

There was abundant evidence in Table 3 of SM/83/87, Mr. Senior remarked, that OPEC price decisions had consistently followed market price movements. In the same manner, average prices of OPEC members had followed, also with a lag, downward movements in those same markets from 1982 to the present. In addition, while substantial price increases in the first part of the years from 1978 to 1982 had given the appearance of being the result of OPEC decisions, in reality they had basically been expressions of market price movements led by the spot market, by non-OPEC sellers, or by some individual members of OPEC. OPEC members would hardly reduce their prices and earnings after 1982 if they were able effectively to control or determine prices. Only market forces could have led to such reductions, in the same way that only market forces could have led to price increases.

To further emphasize the point that OPEC actions could not have consistently determined prices and export earnings, Mr. Senior added, until March 1983, OPEC had exercised no controls on production, with the exception of a brief period in the first half of 1982. At the same time, he would concur with the staff view that a diversity of circumstances affected the export earnings of oil exporters, and that there was a diversity among non-OPEC oil exporters with respect to changes in their production and export volumes and in the unit value of exports. Indeed, the oil production of OPEC members represented a steadily declining proportion of total oil production, and in 1982 represented less than 35 percent of that total.

In conclusion, Mr. Senior said, there were no valid arguments for determining that OPEC had consistently determined oil prices and export earnings, or that shortfalls in exports of OPEC members were not largely beyond the control of the authorities. In any event, it would be a gross inequity to declare a Fund member ineligible for use of resources under the compensatory financing facility simply on the basis of OPEC membership. Commodity prices were not entirely determined by market forces without any other kind of intervention. Examples of such intervention were the many international agreements, such as those relating to coffee, sugar, tin, and rubber, as well as the concerted efforts that oil importing industrial nations had made to reduce their dependency on the product. Membership in such agreements was not sufficient to disqualify any member from the use of Fund resources under the compensatory financing facility. The Fund would have to maintain its practice of judging each request on its own merits, on a case-by-case basis.

The Executive Directors agreed to resume their discussion at 2:30 p.m. and adjourned at 11:50 a.m.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/78 (6/1/83) and EBM/83/79 (6/2/83).

2. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS - SUBMISSION OF REPORT TO BOARD OF GOVERNORS

1. Section 14(e)(ii) of the By-Laws states that Reports of the standing Joint Committee on the Remuneration of Executive Directors and their Alternates shall be submitted to the Board of Governors for a vote on any recommendations contained therein without meeting, in accordance with Section 13 of the By-Laws.

2. The Board of Governors is therefore requested to vote upon the recommendations of this Committee without meeting, pursuant to Section 13 of the By-Laws of the Fund.

3. The Secretary is authorized and directed to send on Thursday, June 2, 1983, to each member of the Fund by airmail or other rapid means of communication the following letter of transmittal, together with the Report of the standing Joint Committee to the Board of Governors:

> The standing Joint Committee on the Remuneration of Executive Directors and their Alternates has adopted a Report and recommendations to be submitted to the Board of Governors. At the request of the Joint Committee, I am transmitting its Report and recommendations herewith. The Joint Committee neither discussed with nor disclosed to Executive Directors its Report and recommendations prior to their transmittal to the Governors.
>
> The Board of Governors has been requested to vote without meeting, pursuant to Section 13 of the By-Laws of the Fund, on the Resolutions attached to the Report. The Executive Board has decided, pursuant to Section 13(d) of the By-Laws, that no Governor shall vote on the Resolutions until June 9, 1983.
>
> To be valid, votes on the Resolutions must be cast by Governors or Alternate Governors and must be received at the seat of the Fund on or after Thursday, June 9, 1983, but not later than Wednesday, July 6, 1983. Votes received before June 9, 1983 or after 6 p.m., Washington time on July 6, 1983, will not be counted.

It will be appreciated if you will transmit the Report to the Governor of the Fund representing your country with the request that he vote on the Resolutions attached to the Report. No particular form of vote is required, so long as the Fund receives a clear indication as to whether the Governor approves or disapproves the proposed Resolutions; such communication should be signed by the Governor or

Alternate Governor or there should be a clear indication that it is sent on his behalf.

4. All votes cast pursuant to this decision on the proposed Resolutions shall be held in the custody of the Secretary until counted. As soon as practicable after the poll is concluded, the Secretary shall canvass the votes on the proposed Resolutions and report thereon to the Executive Board. Any Executive Director may challenge the Report or the status of any vote counted or disqualified, in which case the Executive Board determines the result of the vote.

5. The effective date of the Resolutions of the Board of Governors shall be the last day allowed for voting.

6. The Secretary is authorized to take such further action as he shall deem necessary or appropriate in order to carry out the purposes of this decision. (EBAP/83/145, 5/31/83)

Adopted June 1, 1983

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 82/167 and 82/168 are approved. (EBD/83/152, 5/25/83)

Adopted June 1, 1983

APPROVED: October 20, 1983

LEO VAN HOUTVEN
Secretary