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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/138

10:00 a.m., October 29, 1982

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

Executive Directors	Alternate Executive Directors
M. Abdollahi	O. Kabbaj
J. Anson	C. Taylor
A. Buira	M. A. Senior
J. de Groote	
B. de Maulde	A. Le Lorier
R. D. Erb	C. Dallara
	J. C. Williams, Temporary
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. C. Iarezza	R. T. Salazar
R. K. Joyce	M. Casey
A. Kafka	J. R. Gabriel-Peña
	V. Supinit
S. Kiingi	F. Sangare
G. Laske	G. Grosche
	P. Kohnert, Temporary
G. Lovato	C. P. Caranicas
S. Nana-Sinkam	A. Alfidja
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	B. Legarda
	L. Vidvei
	Tai Q.

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; F. d'A. Collings, S. E. Cronquist, J. N. Fonderson, J. Harnack, M. Sidibé. Asian Department: R. J. Niebuhr. European Department: B. Rose, Deputy Director; D. N. Lachman. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; A. Abisourour, S. Kanesa-Thasan. External Relations Department: H. O. Hartmann. IMF Institute: A. Mullor-Sebastian; J. Mapakou, A. Nkodia, Participants. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy Director; W. E. Holder, Ph. Lachman. Middle Eastern Department: A. S. Shaalan, Director; A. K. El-Selehdar, Deputy Director; A. D. Crockett, S. H. Hitti, H. E. Jakubiak. Research Department: C. F. Schwartz, Associate Director and Director of Adjustment Studies; R. R. Rhomberg, Deputy Director; N. M. Kaibni, B. R. H. S. Rajcoomar. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: R. J. Familton, Deputy Treasurer; D. Williams, Deputy Treasurer; D. S. Cutler, C. M. de Rosa, H. Flinch, D. Gupta, Q. M. Hafiz, G. Wittich, P. K. Woolley. Bureau of Statistics: W. Dannemann, Director; J. B. McLenaghan. Finance & Development: B. Nowzad, Editor. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, S. E. Conrado, A. B. Diao, S. El-Khouri, L. Ionescu, H.-S. Lee, P.-C. Maganga-Moussavou, P. D. Péroz, F. Sarraf. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, L. Barbone, L. E. J. Coene, T. A. Connors, R. J. J. Costa, M. K. Diallo, C. Flamant, A. Halevi, M. Hull, J. M. Jones, M. J. Kooymans, J. A. K. Munthali, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, C. N. Pinfield, E. Portas, D. V. Pritchett, M. Z. M. Qureshi, J. Reddy, J. Schuijer, D. I. S. Shaw, H. Suzuki, A. Yasseri, A. A. Yousef.

1. PEOPLE'S REPUBLIC OF THE CONGO - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with the Congo (SM/82/182, 8/31/82), together with a proposed decision concluding the 1982 Article XIV consultation. They also had before them a report on recent economic developments in the Congo (SM/82/197, 9/30/82).

Mr. Nana-Sinkam made the following statement:

> On behalf of my Congolese authorities, I wish to thank the staff for the excellent set of documents it has prepared in connection with the 1982 Article IV consultation with the Congo. These comprehensive papers portray very well the evolution of the economic and financial situation in the People's Republic of the Congo since the 1978 Article IV consultation discussion in the Board.
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> Following the recovery in oil output and favorable world prices for the country's export products, which led to an improvement of the country's external position, the Congo's economy has expanded rapidly since 1978. The real GDP growth rate averaged about 13 per cent during the period 1979-81, and external and budgetary receipts increased significantly. Crude oil export value rose by 57 per cent in 1976, doubled in 1980, and rose again by 44 per cent in 1981 to SDR 807 million.
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> Consequently, in the external sector, the overall balance of payments turned from a deficit of SDR 24 million in 1978, reflecting mainly the rapid increase of external debt interest payments, to a surplus of SDR 8 million in 1979 and SDR 59 million in 1981; it is forecast to reach SDR 57 million in 1982.
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> In 1981, total budgetary revenue rose to CFAF 210 billion compared with CFAF 117 billion in 1980, reflecting the increase in resources from the oil sector, and the improvement in the non-oil sector. The overall budgetary balance registered a surplus of CFAF 18.9 billion in 1981, compared with a deficit of CFAF 12.6 billion the previous year. The domestic arrears were reduced by 10 per cent. Furthermore, because of the continued improvement in oil and non-oil revenues, total budgetary revenue is projected to increase by 17 per cent in 1982. Thus, the 1982 budgetary outcome is likely to remain favorable, despite an estimated 23 per cent increase in government spending.
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> However, the authorities are well aware that the recent improvement in the budgetary situation reflects the upsurge in oil revenue rather than a fundamental readjustment of budgetary policy. They are also aware that the availability of domestic resources for development financing remains critically dependent not only on oil resource prospects but also on the fiscal policy

stance. Therefore, the objective of budgetary policy in the medium term is to raise the ratio of non-oil receipts to current expenditure from 57 per cent to 75 per cent in the 1983 budget (excluding debt service). The Government also intends to review the tax system to adapt it to the new economic conditions and objectives.

At the end of 1981, the authorities adopted the first Five-Year Economic and Social Development Plan covering the period 1982-86 with three primary objectives: the improvement of the basic physical infrastructure, the rehabilitation of state enterprises, and the improvement of the standard of living of the population. But the prospects for the oil sector, on which the financing of the plan depends, is somewhat uncertain due to the conditions in the world market, exchange rate movements, and the peculiar characteristics of Congolese oil (high production costs). Being aware of these uncertainties, the authorities have adopted a flexible approach to development planning. The bulk of investment from the public sector (44 per cent for infrastructure, 37 per cent for agriculture, forestry, and industry) is to be adjusted annually in light of experience and changing circumstances, particularly with respect to the oil sector's revenue prospects. Investment priorities are to focus on projects having a large impact on production and on the living conditions of the people.

For the state enterprises rehabilitation programs, emphasis is to be placed on existing enterprises; the creation of new enterprises will be limited to indispensable ones and with proved profitability.

In the monetary field, the authorities' main objective remains the promotion of economic growth with price stability. The recent rapid expansion of credit to the economy should be viewed in the light of the revival of economic activity in the non-oil sector. However, the Government is concerned about the sharp expansion (159 per cent) of nonrediscountable credit by commercial banks during the two years ended March 1982. Domestic credit expanded by 26 per cent in 1981, compared with an average of 14 per cent in the two preceeding years. This expansion of credit together with the depreciation of the CFA franc boosted the inflation rate to 17 per cent in 1981 from an average of 7.5 per cent in 1979-80.

After a persistent deficit during the 1970s, the Congo's overall balance of payments remained in surplus in 1981 for the third consecutive year in terms of SDRs, although it declined by 16 per cent to SDR 54 million in 1981, reflecting the depreciation of the CFA franc (through the French franc).

> Although the current account deficit is expected to decline from 23 per cent of GDP to 18 per cent in the same year, the Congolese authorities are seriously concerned by the weight of their external indebtedness, and by the heavy and unsustainable reliance on external financing for their development efforts. Therefore, they have undertaken profound structural reforms and introduced measures to correct the imbalances in the economy. However, they are fully aware that recovery is going to be a long-term process, for which sustained Fund support will be required.
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> It is in this context that today's discussions and comments by the Executive Directors will provide a useful guideline to the Congolese authorities.

Miss Le Lorier commented that the staff report made it clear that the economic situation of the Congo had improved markedly since the Article IV consultation three years previously (EBM/79/63). On balance, the staff report perhaps gave an unduly bleak estimate of the situation. The Congo was an oil producing and oil exporting country and, as such, needed to lay the foundations for sustainable growth in the period when the oil resources began to decline. Leaving aside the difficult question of the optimum rate of exploitation of oil reserves, which might not always be entirely within the control of the authorities, it would be rather surprising if during the years of rapidly increasing oil production, such an economy was not--as the staff had noted--increasingly dependent on the oil sector. From 1979 to 1981 crude oil production had increased by 69.7 per cent in volume, and oil export revenues had multiplied by more than five. The real cause for concern was that dependence on oil might become more misleading than dependence on certain other commodities, as the prospect of a lasting energy constraint might delay action to improve other parts of the economy. In the present circumstances, however, the performance of the Congolese economy did not seem worrying.

Commenting on the real economy, Miss Le Lorier noted that the growth in real GDP over the past three years had not been entirely due to the increase in the output of oil. Table 2 of SM/82/197 showed that agriculture, livestock, and fishing had shown real annual growth of nearly 5 per cent, while industry had grown at a real rate of some 15 per cent a year. Even though in real terms the state enterprises continued to suffer from severe financial difficulties and weaknesses in management, the manufacturing sector had been rather resilient. On the external side, non-oil exports had increased by 46 per cent in volume since 1978. Such results seemed commendable when compared with the experience of a number of other oil producing countries, which had seen their non-oil sector decline.

Taking up the financial aspects of the economy, Miss Le Lorier observed that the budget situation had improved significantly in 1981, in terms not only of outcome but of structure. The deficit that had been the normal experience until 1980 had turned into a net surplus in 1981 and a surplus was again expected for 1982. The authorities ought perhaps to take advantage of the present situation to substantially reduce outstanding domestic arrears. On the revenue side, government efforts to strengthen the tax administration had been effective, and the share of non-oil revenues in total revenue had increased from 39.8 per cent in 1980 to 44.2 per cent in 1981. The authorities fully intended to raise the ratio of non-oil receipts to current expenditures to 75 per cent.

On the external side, the current account deficit had deteriorated again in 1981, when it had reached 23 per cent of gross domestic product. The aim was to reduce it to 18 per cent of gross domestic product in 1982. The main source of the deficit, however, seemed to be the service payments related to the oil sector, as could be seen in Table XXXII in SM/82/197. Those payments had reached CFAF 145.8 billion (SDR 455 million) in 1981, amounting to roughly 28 per cent of gross domestic product, or more than the total current account deficit. Present and future oil production was a counterpart of those payments, and there was therefore perhaps no reason to be greatly concerned about the level of the current account deficit as such. Moreover, surpluses in the overall balance of payments during the past three years had enabled the Congo to liquidate all external payments arrears.

On the whole, Miss Le Lorier considered, the overall economic and financial performance had been quite satisfactory, and the strengthening of the basis for its sustained and balanced growth in the years to come did not seem far off, provided of course that the Congolese authorities continued to exercise caution in their economic management.

For the future, the Five-Year Economic and Social Development Plan might appear overambitious, Miss Le Lorier stated. The assessment of the absorptive capacity of the economy was, however, not entirely straightforward, as there might be a number of bottlenecks, notably in the transportation sector, whose removal was one of the main objectives of the plan. Another important constraint that could have a bearing on the implementation of the plan would be the prospects for the oil sector. She was not sure that those prospects were as poor as the staff seemed to indicate. The president of the main oil company in the Congo had stated a few weeks previously that his company would invest CFAF 238 billion in the Congo during 1982, instead of the CFAF 170 billion which had previously been planned, and that oil production in the Congo would reach 6 million tons in 1984. She would welcome staff comment on that particular information. If, nevertheless, financial resources were to become short, the authorities had undertaken to adopt a flexible approach and to adjust investment targets in line with the revenues accruing from the oil sector. Such an approach was most desirable, and a careful selection of projects based on a sound appraisal of their likely direct and indirect yields might well avoid the disillusionment of the late 1970s. Particular attention would of course have to be given to the recurrent expenditure required by the projects.

In working toward the diversification of the economy, the authorities should give the development of agriculture high priority, Miss Le Lorier observed. Not only new investment but also new incentives would be required in the agricultural sector. On October 15 the Government had decided to raise both producer and consumer prices for maize, paddy, groundnuts, beans, potatoes, coffee, and cocoa. As those prices had clearly been too low, the decision was a move in the right direction, and she would like to ask the staff whether the new prices would provide sufficient incentive.

The intention of the authorities to reform the educational system not only deserved full support, Miss Le Lorier remarked; it would need extra encouragement as any changes in the educational field took a long time to materialize, especially when the aim was to adjust training more closely to the needs of the economy. She also fully supported attempts to rehabilitate the state enterprises.

Mr. Sangare noted that in recent years the economy of the Congo had increasingly been influenced by changes in the petroleum sector, whose share in gross domestic product had risen from 2 per cent in 1970 to 36 per cent in 1981. With the recovery in the production of crude oil and favorable oil prices in 1979 and 1980, real GDP had shown strong growth in the past three years, at an average of 13 per cent between 1978 and 1981, and an estimated 11 per cent for 1982.

Nevertheless, the economy was experiencing some weakness, aggravated by technical difficulties in the production of oil. Agricultural production was still low, a situation that was likely to endure because of a lack of suitable land and, as in most African countries, the poor state of the supporting infrastructure, including the feeder road network. On the positive side, the supply of cassava, the main food crop, had improved in recent years. Furthermore, despite the decline in the share of agriculture in gross domestic product from 11.3 per cent in 1978 to 8.3 per cent in 1982 as a result of the increase in oil production, the rate of growth of agriculture had risen from 2.5 per cent a year in 1979 to 5.6 per cent in 1982, as shown in Table 2 of SM/82/197.

He was glad that the authorities understood the constraints on the economy, Mr. Sangare went on. In the first Five-Year Economic and Social Development Plan they were taking steps to improve the basic infrastructure and to develop the agricultural sector further by substantially increasing the level of investment in those areas. Nevertheless, he would agree with the staff on the need to take into account the country's absorptive capacity in designing the investment program in such a way as to ensure that it could really be carried out.

The financial position of the Government had also improved significantly, Mr. Sangare commented, mainly as a result of the substantial increase in oil revenues. The Central Government's overall surplus had been 3.7 per cent of gross domestic product in 1981, compared with budget deficits of 4.2 per cent and 3.5 per cent in 1979 and 1980, respectively.

The estimate for 1982 indicated a rapid decline in the overall surplus, reflecting the increase in government expenditure, largely on recruitment and training. Even so, he took the view that in light of the size of the investment program and the revival of economic activity, such a recruitment and training program could be absorbed without undue strain. It was of course important that the authorities should pay special attention to the manpower requirements of the country in working out development projects.

On the revenue side, Mr. Sangare stated, he welcomed the medium-term objective of improving the tax system with a view to making it more responsive to changing economic conditions and possibly to avoiding the risk of becoming too dependent on oil revenues. Considering how worrying the performance of the state enterprises had been as a result of their heavy reliance on government subsidies, the measures taken by the authorities to make them self-sustaining by improving management through the provision of technical and management assistance were welcome. The rehabilitation program was also a step in the right direction.

In the monetary field, Mr. Sangare commented, the policy pursued by the authorities was one of promoting economic growth under stable price conditions. In that connection, the increase in domestic credit limited only to the private sector had been in line with the acceleration of economic activity in both the oil and non-oil sectors. Government recourse to domestic bank credit had been reduced because of the upsurge in budget revenues resulting from increased oil production.

He was aware of the authorities' commitment to channel new external commercial borrowing into productive investment, Mr. Sangare observed. However, they ought to implement a development program with caution, in order to avoid worsening the debt service situation.

In the external sector, Mr. Sangare noted, the current account deficit in the balance of payments had increased, despite the substantial increase in export receipts from crude oil, reflecting, inter alia, transfers related to the exploration and development of the oilfields. However, the overall position continued to be in surplus, largely due to the inflow of private capital. It was encouraging to note that arrears on external debt had been gradually reduced, making it possible for the country to regain its credit standing. On the other hand, the debt service ratio, which had fallen to 6.8 per cent of GDP in 1980, was expected to reach 13.2 per cent in 1983, partly because of the need to develop the oil industry and partly because of the high international interest rates. He was aware of the authorities' commitment to channeling new external commercial borrowing into productive investment. However, they should be encouraged to implement their development program with caution to avoid worsening the debt service situation.

Mr. de Groote expressed his gratitude to Mr. Nana-Sinkam for his policy-oriented opening statement. During Mr. Nana-Sinkam's service the Executive Board had begun to acquire a great deal of knowledge about the situation in African countries, which in the past had had poor statistics and had only provided little information. He was most grateful to Mr. Nana-Sinkam for what he had done, in conjunction with the African Department, to improve the Executive Board's acquaintance with the countries in his constituency.

The staff had drawn attention to three aspects of the economy of the Congo that deserved further attention--the management of the economy, the exchange rate, and the state economic enterprises, Mr. de Groote stated. The authorities had undertaken a very ambitious investment program. In so doing, they should draw on the experience of other oil producing countries in not counting too heavily on oil income to finance the large gap between the cost of projected investments and national savings. Substantial cuts had already been recommended in the investment intentions of the authorities, and it might well be that further adjustments would be needed to keep the investment effort within bounds. The Five-Year Plan focused at the beginning of the period on the provision of fundamental infrastructure and would therefore generate a very high demand for existing resources, particularly labor. Tensions were almost unavoidable in the short run because of the concentration on the provision of infrastructure. The staff recommendation for moderation was therefore welcome and should be supported.

As the Congo was a member of a currency union, Mr. de Groote went on, it could not use the exchange rate as an instrument of adjustment. It was clear from SM/82/197 that the exchange rate had remained almost unchanged for a period of four or five years, during which the exchange rate for most other currencies had changed fairly substantially. The authorities had therefore been obliged to put the weight of adjustment on other elements and especially on fiscal policy in order to bring inflationary pressures under control. He was only making the point that countries belonging to a currency union had to use other instruments of economic policy to achieve the desired result.

He was rather more pessimistic regarding the outlook for the state economic enterprises than the view in the staff papers, Mr. de Groote stated. The enterprises indeed seemed to have escaped the control of the authorities. The price structure was not appropriate, and there had been no effort whatsoever to introduce an element of competition among the enterprises in order to create some kind of market mechanism, as was done in other countries where the government played a large role in the economic field. He had been impressed by the observation on page 32 of SM/82/197 to the effect that there was no comprehensive information on the sectoral distribution of actual investments in each of the three years under review. In fact, the Congolese Amortization Fund (CCA) was not fully equipped to provide adequate information on total investments, since projects financed by foreign grants and some from bilateral loans were not always included in the survey. Moreover, part of the outlays recorded as investments were not project expenditures but transfers and subsidies to state enterprises and public agencies. Such an arrangement represented a major danger leading to the cumulative disorganization of financial management, and he very much hoped that that element could be brought under control.

He congratulated the staff for having produced a document giving a complete view of the situation in the Congo, with not only short-term but also medium-term elements included, Mr. de Groote concluded.

Mr. Kohnert stated that he was in full agreement with the staff appraisal. The second major increase in oil prices in 1979/80 had provided the Congo with a second chance to put its economy on a solid basis. The rapidly growing revenues from oil had helped to improve government finances and to stimulate the non-oil sector. The authorities had taken the opportunity to strengthen the tax collection system, and had thus achieved a surplus in the government budget in 1981. A surplus was also expected for 1982, an outcome that was remarkable in comparison with that of most other countries. The authorities should also be commended for having taken the opportunity to eliminate external payments arrears, thus restoring their creditworthiness. Nevertheless, the oil revenues to some extent only served to hide the real problems facing the authorities, and the concerns raised by the staff were valid.

Apart from poor infrastructure, the authorities seemed to be in difficulties in the area of social policy, where there was a misallocation of labor resources that did not seem economically feasible in the longer run, Mr. Kohnert observed. First, the policy of offering jobs to every unemployed person in the public sector led to overstaffing and hampered any efforts to make the public enterprises efficient. If the public enterprises were to be restored to a reasonable operating condition, they would need not only more investment but also a different form of management. Perhaps the authorities would do well to shift the educational system more in the direction of vocational training for example. Second, producer prices, especially for agricultural crops, had for some time been too low, thus intensifying the migration of farmers to the cities so that foodstuffs had to be imported because the agricultural sector remained relatively inefficient, a situation that prevailed in many countries.

On page 9 of SM/82/197 the staff had mentioned that producer prices for most agricultural products had been raised to levels comparable to those prevailing in neighboring countries, Mr. Kohnert noted. It would be interesting to know whether the prices were also economically justified, since on page 13 of the same paper the staff had written that pricing policy was set more in accordance with social than with economic criteria. Price setting ought to be handled in a flexible manner and not, as at present, determined by a complicated bureaucratic procedure. Mr. Nana-Sinkam had indicated that the authorities were aware of the need to alter the economic system. However, it was clear from the substantial increase in the government wage bill that they were hesitating to implement the necessary measures to hold down current expenditures. If not corrected, the present expenditure policies were likely to create difficulties when there was insufficient revenue available from oil resources to cover the outlays.

On the investment side, Mr. Kohnert observed, despite the high growth rate of the economy, the capacity utilization of most factories remained very low. Although he could think of a number of possible explanations, he would be grateful for further comment by Mr. Nana-Sinkam or the staff. Finally, he hoped that the successful completion of the investment program that the Congo intended to undertake would enable the country to achieve sustained growth.

Mr. J. C. Williams stated that he was in complete agreement with the staff analysis and appraisal, and that he supported the proposed decision. In the Congo, positive exogenous factors had helped the process of economic growth and the task of management. Nevertheless, there were still a number of reasons for concern, particularly the persistent weakness of the non-oil sector. He shared Mr. de Groote's views on the state enterprises, especially in light of their dominant position. He was worried by the high level of external public and private indebtedness; he was therefore encouraged to read that the authorities had decided to lay the foundations for a viable post-petroleum economy by setting priorities in the first Five-Year Development Plan to promote the growth of the non-oil sector. While recognizing the need to overcome major structural bottlenecks and noting that priority was being afforded to projects with a considerable impact on production, he still wondered whether the authorities were not concentrating too heavily on infrastructure instead of increasing productive capacity. Experience suggested that the imbalance between infrastructure and productive investment might lead to insufficient utilization of the infrastructure, as well as leaving in its wake burdensome increases in maintenance outlays. He would welcome comments on the point by the staff or Mr. Nana-Sinkam. He also shared the staff's concern that the absorptive capacity of the country might not be adequate to handle the planned level of investment. He would therefore encourage the authorities to keep the situation under close review and be alert to the need to scale down investment plans if necessary.

He agreed with the staff that a more prudent fiscal policy was called for, Mr. Williams observed. The authorities were committed to raising the ratio of non-oil receipts to 75 per cent of current expenditure (excluding debt service) in the medium term, compared with 57 per cent in 1982. He wondered whether the staff considered that particular goal attainable or appropriate. He encouraged the authorities to continue their efforts to make the government revenue system more elastic, with particular attention to measures that would make the application of existing tax codes more rational and equitable. They should make a sustained effort to mobilize domestic resources from the non-oil sector.

On the expenditure side, Mr. Williams went on, while he fully concurred with the staff's analysis, any reform of the education system should be in the direction of making it more responsive to the country's needs. With its high rate of literacy, the Congo was endowed with a potentially valuable pool of human resources. Creating methods of tapping those resources would go far toward enabling the country to achieve its stated goals. He endorsed the prudent philosophy that the authorities had adopted with regard to external borrowing, and encouraged them to continue on a similar course. They should, however, be cautioned against the tendency to borrow against optimistic future revenue projections that might turn out to be completely unrealistic. Too often, when revenues turned out to be less than anticipated, a country's debt service obligations rapidly assumed unsustainable proportions. The Congo had found itself in that position in the 1970s; he adjured the authorities to avoid doing so again.

The staff representative from the African Department, replying to questions, remarked that the large investments in the petroleum industry were the essential determinants of the level of oil production in the Congo. An increase in investment by the oil companies should lead to an increase in oil output. As output was forecast to be 5.5 million tons in 1983, a figure of 6.0 million tons for 1984 seemed attainable.

Taking up the question of producer prices, the staff representative remarked that the Fund mission had explained to the Congolese authorities that they ought to increase producer prices for food crops. Their position however had been that producer prices for food should be viewed in the light of wages and salaries policies. They wished to strike a balance between the income of farmers and that of wage earners. Such a policy had in the past, according to the authorities, enabled them to avoid granting substantial increases either in wages or in producer prices for food crops, even though both had been raised in recent years. Although the latest information mentioned by Miss Le Lorier was not available to the staff, it did believe that a further increase would be a step in the right direction. In the absence of detailed statistics, it was of course difficult to determine whether a given level of prices was sufficiently remunerative.

The staff view on investment had been set out in the appraisal, the staff representative from the African Department mentioned. The staff believed that the level of investment was not consonant with the absorptive capacity of the economy, and might thus create some distortions. The attempt to cover 75 per cent of current expenditure by non-oil revenue seemed an appropriate target that would represent a significant improvement in the Congo. The authorities had not followed such a stance in the past and, when the prospects for the oil sector had become dimmed, they had been in a difficult financial situation. The Fund mission had in fact tried to persuade the authorities that their target should be to cover all current expenditure by non-oil revenue. They had, however, felt that such a target would be unrealistic for the near future, and they had preferred to aim at 75 per cent coverage. The staff had also emphasized the need to rehabilitate the state enterprises, particularly because of the large role played by the public sector in the Congolese economy. The authorities were quite aware of the need to follow the staff suggestion, but they did believe that it would be difficult to bring it about in the short term.

Mr. Nana-Sinkam remarked that the staff had written "In view of the constraints in the area of exchange rate policy arising from the Congo's membership in a monetary union, the maintenance of relative price stability is essential for the growth of the non-oil sector of the economy." He had not dealt with that sentence in his opening remarks because the Executive

Board would shortly have an opportunity to discuss the long-awaited paper on currency unions, and his chair would once again be able to explain its attitude. The currency of the Congo--the CFA franc--had devalued over the past years to the extent of 15-18 per cent. In those circumstances, he did not believe that it was proper to maintain that the value of the currency of the Congo had not been adjusted in line with international currency movements. Nor did he believe that the Congo received no benefit from using the CFA franc and belonging to the West African Monetary Union. However, he would not enter into substantive discussion on the matter.

There were of course only three ways in which a country could undertake adjustment, Mr. Nana-Sinkam commented. It could alter the exchange rate; it could act through the fiscal system; or it could combine the two. The members of the West African Monetary Union had not only followed the staff views regarding fiscal action, they had introduced an even tighter monetary policy, which had been one of the major elements in their success.

The Congolese authorities were worried about the increase in the debt service payments, Mr. Nana-Sinkam noted. However, the increase was due to an increase in interest rates as well as to a rise in the volume of debt incurred by the Congo. The country's concern had really no part in determining the interest rate, and could only act like price takers in respect of the cost of money. Fortunately for the Congo, the price of the main export commodity, oil, had been rising, and the Congo had been able to take advantage of the change for the better. It was true that the Congo had been borrowing in the market, but it had done so to invest particularly in the productive sector. The authorities had tried to use the revenue from the oil sector to improve the infrastructure because they believed that unless the infrastructure was reasonably appropriate, it was impossible to raise production. In practical terms, it was of little use growing crops in the countryside if they could not be brought to the towns where they would be consumed. As some revenue was available from the oil sector, it seemed perfectly reasonable for the Congolese authorities to develop the country's infrastructure, thus leading to an increase in the output of the agricultural sector, perhaps even in the short term. The authorities were admittedly reluctant to increase the producer prices for food crops; nevertheless, by improving the road system they would be making it easier for the growers to bring their crops to market, thus increasing their returns.

The question whether the Congolese authorities were preserving a proper balance between expenditure on infrastructure and expenditure on productive activities had been asked by Mr. Williams, Mr. Nana-Sinkam recalled. While Mr. Williams' point was perfectly valid, as the Congolese authorities currently had some revenue available to them, it would hardly be correct for them to spend it on the productive sector and then borrow in the market at a higher rate for investment in infrastructure. It seemed to him apparent that any country in the position of the Congo that had oil revenue accruing to it would be acting only properly in improving the country's infrastructure.

Discussing the intended reform of the educational system in the Congo, Mr. Nana-Sinkam remarked that the problem was common to nearly all developing countries, particularly in Africa. In the first place, any change in the educational system was bound to be a long-term process, and other countries in his constituency were also undertaking it. The governments of such countries were bound to employ those whom they had paid to educate, if only because in their circumstances it was impossible to devote 15 or 20 years to educating someone and then fail to make use of the investment. The authorities in the Congo were in touch with the World Bank for the purpose of seeking assistance in reviewing the educational system. The outcome was, however, unlikely to be perceived within the compass of the present development plan. He was grateful to his colleagues for the observations they had made, particularly at a time when the authorities were having to decide how they should act once the oil revenues ceased to flow. He would certainly transmit their comments to the authorities in Brazzaville.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the thrust of the views expressed in the staff appraisal for the 1982 Article IV consultation with the People's Republic of the Congo. They noted that following the recent upsurge in oil revenue the budgetary situation had improved considerably. The overall balance of payments had recorded sizable surpluses, and external payments arrears were liquidated. Performance in the non-oil sectors, notably agriculture and forestry, were somewhat less buoyant.

Directors also noted that the state enterprises' output has been well below capacity, and that their financial situation remained weak. Furthermore, the external current account deficit had widened to more than 20 per cent of GDP, and debt service obligations were rising. Directors stressed the need for fiscal restraint; in particular, the growth of current spending, and especially public sector employment, should be curtailed, while total public spending should be kept at levels consistent with absorptive capacity. The overstaffing of the public sector was underscored as one of the weaknesses of the fiscal situation that need rapid action. Overhaul of the educational system was also required. Coordination of budgetary and monetary policies should be improved.

Directors emphasized the importance of a thorough rehabilitation of state enterprises through strong corrective measures, including flexible employment and pricing policies, and better management. At the same time, restraint in the contraction of new external debt appears necessary to help preserve the country's borrowing capacity while avoiding undue buildup of debt servicing obligations. Oil production is expected to rise further in the next few years, but it is also expected to decline during the second half of the 1980s. The availability of resources should facilitate efforts to promote the development of the non-oil sectors of the economy.

Directors stressed, however, that in the implementation of the first Five-Year Development Plan--1982-1986--considerable attention would need to be given to the selection of profitable new projects. Supply policies should accord priority to those projects--particularly, in agriculture, forestry, and industry--which have the greatest impact on output. Great care will have to be exercised to see that public investment expenditures remain well within the limits of available resources.

The Executive Board then took the following decision:

Decision Concluding 1982 Article XIV Consultation

1. The Fund takes this decision in concluding the 1982 Article XIV consultation with the People's Republic of the Congo, in light of the 1982 Article IV consultation with the People's Republic of the Congo conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that the People's Republic of the Congo continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 7232-(82/138), adopted
October 29, 1982

2. FUND LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors considered a report on the Fund's current and prospective liquidity position and financing needs (EBS/82/180, 10/8/82).

Mr. de Groote noted that the second report on the Fund's liquidity position contained some interesting new features: first, the introduction of estimates for the year ending April 1985, though tentative, gave an idea of the Fund's possible liquidity situation at the time when the Eighth General Review of Quotas was expected to come into effect. Second, the estimates for the years ending April 1984 and April 1985 were based on a country-by-country survey rather than on a global estimate. The new approach was commendable, since it gave a more realistic picture of the expected use of Fund resources. A percentage figure applied to the expected imbalances did not easily lend itself to revision for changed circumstances, such as a shortening of arrangements with the Fund or changing attitudes by commercial banks. Third, the assignment of probabilities for potential drawings for the year ending April 1985, and the incorporation of those probabilities into the overall estimate, was so useful that he wondered whether the technique might not have been extended to estimates for the year ending April 1984. In any event, the changes would certainly enable Executive Directors to obtain a better view of the Fund's prospective liquidity position.

The main conclusions to be drawn from EBS/82/180, Mr. de Groote considered, were that the demand for the use of Fund resources would remain high through 1985, and that the Eighth General Review of Quotas should therefore not only lead to a substantial increase, it should be implemented rapidly to avoid placing the Fund's liquidity under severe strain. It was useful, especially in those circumstances, to use the potential demand for Fund resources up to 1985 as a basis for formulating a first approximation of the quota size desirable under the Eighth General Review, as indeed the staff had done in the paper on quotas to be discussed in the near future.

It was clear, Mr. de Groote went on, that the Fund would be forced seriously to curtail its intervention unless the Eighth General Review of Quotas substantially increased the Fund's resources, or unless the Fund's financing methods were altered to permit much heavier reliance on borrowing. Even if the Executive Directors envisaged new forms of borrowing, for instance, in the market, it was impossible to envisage that borrowing alone could meet most of the liquidity needs of the institution as described in EBS/82/180, especially as even in present circumstances the ratio of adjusted uncommitted ordinary resources to total reserve tranche positions and loan claims could decline from about 62 per cent in September 1982 to about 21 per cent in April 1984. In the short run, new lines of credit ought to be sought to avoid the onset of a commitment gap by April 1983. If the third tranche under the Saudi Arabian Monetary Agency (SAMA) agreement could be made available before then, it would afford a brief but most welcome respite. He expressed appreciation for the spirit of cooperation shown by the Saudi Arabian authorities hitherto. But, even if the third tranche became available shortly, on the occasion of the next review of the Fund's liquidity position the Executive Board would have to examine the question of the availability of further official borrowing, or other resources.

He had no comments on the estimates made by the staff, Mr. de Groote went on, except to say that they might turn out to have been rather too optimistic if the Fund continued to revise downward the growth projections made in the World Economic Outlook for the coming year. It was rather surprising that the projections for the use of Fund resources had not increased in view of the recent rather reluctant attitude of the commercial banks toward financing a number of developing countries. While that reluctance might make it easier for industrial countries to find access to market financing and thus reduce the likelihood of any resort by industrial countries to the Fund, the main reasons for revising the estimates downward would seem to be that arrangements with the Fund had been delayed or were expected to be for smaller amounts than earlier anticipated. Both those changes were cause for concern. It would be helpful if the staff could elaborate on the reasons for delays in concluding arrangements. The economic situation of most countries could only worsen if the necessary adjustments were delayed, and the adjustments when made would have to be even more restrictive for having been postponed. The outcome would be to exacerbate the present depressed economic conditions.

The smaller amounts shown reflected greater reliance on one-year stand-by arrangements in the place of multiyear stand-by arrangements or extended arrangements, Mr. de Groote observed. He wondered whether the Fund was not swinging too far in the direction of short-term programs in attempting to overcome difficulties that of necessity required longer periods for their solution. It might be easier to obtain some kind of adjustment effort by many countries if they could be assured of the availability of Fund financing for more than a year at a time. While it was possible for countries to obtain successive one-year stand-by arrangements, the example of the arrangement with Turkey clearly showed the advantages of multiyear arrangements for encouraging countries to introduce medium-term adjustment programs appropriate to the accomplishment of balance of payments objectives. Moreover, the Turkish example clearly showed how banks, and the financial community in general, were sensitive to the existence of multiyear arrangements when engaging in bilateral programs.

He stressed the urgency of completing the Eighth General Review of Quotas as rapidly as possible and emphasized the need to explore new lines of credit or new borrowing techniques, Mr. de Groote concluded. The Executive Board should give the Managing Director a mandate to begin work along those lines as quickly as possible.

Mr. Kafka stated that he endorsed everything that Mr. de Groote had said. It was urgent to start exploring all possible means of additional borrowing. Even in the best of circumstances, and even if the Eighth General Review of Quotas brought about an adequate increase, the Fund would still require a bridging credit. Moreover, if the world economy continued on its present course, the bridging credit would not be very small. The Managing Director should be encouraged to pursue all possible approaches, including borrowing in the private market.

Mr. Anson stated that he could agree with Mr. de Groote and Mr. Kafka that the Fund would need additional resources to cover the period until the Eighth General Review of Quotas took effect. It was also important to ensure that the Eighth General Review of Quotas did come into effect as soon as possible.

Commenting on EBS/82/180, Mr. Anson said that he welcomed the country-by-country approach for the whole period covered by the liquidity review; it should yield more realistic projections of the likely demands in the upper credit tranches than reliance on global estimates. It was also sensible, for more distant forecasts, to apply a probability factor as the staff had done. When more experience was gained with the reviews, it should be possible to see whether estimates derived from a country-by-country approach, with a probability attached to each country, had any systematic tendency to be higher or lower than actual commitments. If there was such a tendency it might be necessary for the Treasurer's Department to apply a further probability adjustment in future reviews. He would be interested to know in due course whether the staff had come to any preliminary view on the point. The projections assumed that the shift from extended arrangements toward shorter-term stand-by arrangements would continue. If indeed it did, it could have a significant effect on the stock of ordinary resources that the Fund would require in the second half of the 1980s; the trend therefore deserved further regular analysis in future liquidity reviews. It would be helpful if the staff could say what proportion of each year's commitment of ordinary resources was expected to be under extended arrangements and what proportion under stand-by arrangements, as the information would help Executive Directors to form an opinion both on the operations of the Fund and on its liquidity.

At first sight, Mr. Anson commented, the projections for compensatory financing facility drawings during the remainder of the current financial year looked rather high. It was surprising that the estimate remained SDR 2.5 billion for the year as a whole, even though purchases in the first five months of the financial year had totaled only SDR 0.7 billion. He wondered whether the staff could usefully apply a country-by-country assessment to the compensatory financing facility drawings as well as to drawings in the upper credit tranches.

In any event, Mr. Anson went on, the staff was certainly correct that the Fund would need access to more resources in the next year or two if it wished to provide confidence that any legitimate demand by its members could be met. In the first instance the Fund should look to official borrowing, and the staff should explore every possibility both under existing understandings and with countries that had not yet agreed to lend to the Fund, including both industrial members and other members in structural surplus. If official borrowing did not provide sufficient resources, his authorities would support borrowing in the market, especially in present circumstances when such borrowing was unlikely to displace, and might perhaps encourage, commercial bank lending. Whether the Executive Board decided to follow that route or not, it was important that contingency plans for approaching the market should be kept up to date. He hoped that the staff would examine the various options, including the timetable, for securing a major market loan. Useful lessons could perhaps be drawn from the World Bank's recent successful entry into the short-term market. If the Fund were to borrow from the market, and if it then became clear that the Fund could expect fairly ready access to funds as and when it required them, the Executive Board might consider whether it would still be necessary to cover all commitments in full, or whether it would be sufficient to arrange market borrowing to cover expected disbursements for a period ahead. Such an approach might be less costly and might allow the Fund to approach the market more gradually.

He could confirm that his authorities were prepared to see sterling become fully usable, as assumed in the paper, Mr. Anson stated. They were, however, concerned that no other currencies had become usable for some time and that very few, if any, were expected to become usable in the period before April 1984. His authorities wondered whether that assessment was still valid in view of the recent changes in the distribution of the global payments surplus. It might well be worth considering whether the criteria for defining "usability" might not have been defined rather too rigidly for present circumstances. He hoped that the staff would consider that point before framing the next operational budget. He agreed with the staff that it would be prudent to keep in mind the need for liquidity to cover possible use of reserve tranche positions. He was not convinced that the allowance of SDR 2 billion for the period to April 1984 was sufficient to cover not only potential drawings in connection with programs but also reserve tranche drawings by one or more major industrial countries. The possibility of such reserve tranche drawings was a further reason, in addition to the more general case he had made previously, for reviewing the size of the General Arrangements to Borrow. He would be interested to know whether, in addition to the brief analysis in the paper entitled "The Adequacy of Existing Arrangements to Deal with Major Strains in the International Financial System" (EBS/82/194, 10/22/82), the staff intended to produce a supplementary paper on the General Arrangements to Borrow. If so, he hoped that it would be ready in time for the Group of Ten Deputies to discuss it in December 1982.

Finally, Mr. Anson remarked that while he had found the various ratios set out in Table 2 of the Appendix to EBS/82/180 to be helpful, he considered them to be rather crude indicators of the Fund's financial position; they needed to be interpreted with a considerable element of judgment.

Mr. Vidvei commented that the exercise of reviewing the Fund's liquidity position and financing needs could be regarded as a useful early warning device. The staff paper underscored the pressing problems that the Executive Directors should tackle if the organization was to remain a viable instrument in maintaining confidence in the international monetary system. He could therefore support the view expressed by Mr. de Groote and others, and in particular the main conclusion, set out on page 5 of EBS/82/180, to the effect that "these estimates...confirm the view advanced earlier that the overall liquidity position of the Fund will come under considerable pressure by the early part of 1984 and that this pressure will continue thereafter. Thus, as has been stated in earlier reviews, it is clearly of great importance that the quota increases under the Eighth General Review should be in effect as soon as possible." He would go further than the staff and remark that the Fund might be in an uncomfortable situation as early as the spring of 1983. Table 5 clearly showed that a commitment gap could develop in about six months' time. The possibility of having to commit all available lines of credit by April 1983 strengthened the need to conclude negotiations for further borrowing arrangements for larger amounts than originally envisaged. All countries with a relatively comfortable foreign exchange position ought to participate. In that connection, he noted that the question of a third tranche under the SAMA agreement would be taken up in the next few months. The goodwill shown earlier by the Saudi Arabian authorities was commendable and should serve as an example for all. He hoped that the Saudi Arabian authorities would find it possible to continue following the same policy. At the same time, it would be interesting to have information from the staff on other possible forms of official borrowing by the Fund. On earlier occasions his chair had supported proposals that the Fund should issue promissory notes. He would be interested to know whether the staff was considering that proposal and, if so, on what terms. It would also be interesting to know how the U.S. proposal for supplementary permanent borrowing might influence the Fund's financial position.

His authorities believed, Mr. Vidvei continued, that the Fund should avoid finding itself in such a situation that members in pressing need would fail to obtain access to the Fund's resources because of a lack of available liquidity. The Fund's available lines of credit would soon be fully utilized. If it was only possible to borrow relatively small amounts from official sources because new lines of credit could not be concluded soon enough, the Fund should consider borrowing in the private market. While to do so in the near future might raise difficult problems for the Fund, the longer it hesitated the more difficult those problems would become.

Taking up a number of technical points, Mr. Vidvei welcomed the change in the method of estimating the likely demand for the Fund's resources. The shift to country-by-country estimates seemed likely to provide a more reliable basis for forecasting the borrowing needs of member countries. Also, it seemed reasonable to include in the estimates provision for the use of the Fund's resources by two member countries with quotas in excess of SDR 800 million. In future reviews of the Fund's liquidity, however, it might be better not to draw a line between members with quotas below and those with quotas above a certain level. Finally, in Table 2 on page 10 it was shown that purchases of SDR 1.8 billion were expected under the compensatory financing facility for the remainder of the financial year to April 30, 1983. The same figure had, however, been shown when taking account of the provisions for the two larger members. Would it be correct to infer that neither of the two larger members was expected to use the compensatory financing facility before April 1983?

Mr. Supinit commented that the financial position of the Fund was firmer than it had been at the discussion in December 1981 (EBM/81/154 and EBM/81/155, 12/11/81). The liquidity position for the near term seemed to have improved significantly. In December 1981 the staff had expected a commitment gap to exist for most of 1982 and to rise to SDR 2.7 billion in April 1983. In contrast, the present paper predicted that the commitment gap would emerge only in April 1984 and that then it would be no more than SDR 0.6 billion. Including provision for two larger members, a small commitment gap was now expected in April 1983 with a larger one of SDR 3.6 billion in April 1984. As the world economic situation was still critical, he could see only two possible reasons for such a change in the Fund's liquidity position. First, the estimate was now more realistic as it was based on country-by-country reviews. Second, there was a substantially lower demand for the Fund's resources, particularly from existing users.

His feeling was that conditionality might have been somewhat tighter than in the past, Mr. Supinit continued. The same point had been made by a number of Executive Directors including the one in his chair during the discussion on upper credit tranche arrangements in July 1982 (EBM/82/92 and EBM/82/93, 7/7/82). There had certainly been a larger number of failed programs, even though many of the countries concerned had met the established criteria. The staff had said on page 11 of EBS/82/180 that the cancellation of many arrangements could release undrawn balances of amounts committed earlier of some SDR 1.0 billion, while Table 1 on page 7 showed that the total net commitment of Fund resources had declined significantly from SDR 9 billion during the previous year to an estimated SDR 3.5 billion for members with quotas of SDR 800 million or less during the year May 1, 1982-April 30, 1983. The estimate for members with quotas of SDR 800 million or less for the period May 1, 1983-April 30, 1984 was SDR 5 billion. In total, then, the expected net commitment for the present and coming financial year would together be lower than that of the previous financial year. The change was striking in the face of a worsening world economic situation.

Another factor that might have contributed to such a dramatic change was the apparently more restrictive access of members to Fund resources, Mr. Supinit observed. The strict application of conditionality seemed to have affected the maximum access under the enlarged access policy. The new programs seemed to be mainly of one year's duration, with access amounting to 100 per cent of quota rather than 150 per cent of quota. In brief, there seemed to have been a de facto reduction of enlarged access.

Despite the somewhat stronger financial position of the Fund, his constituency looked to the future with some discomfort, Mr. Supinit remarked. The recent emergence of large requests for resources might have a serious implication for the Fund's liquidity position in the future. Since the liquidity position could shift rapidly and drastically, the Fund should be well prepared. The Eighth General Review of Quotas should be quickly concluded, and the possibility of borrowing from central banks and governments, and even from private markets, ought to be explored urgently. Perhaps the Executive Board could even consider an interim proportional quota increase. He was sure that the Managing Director's leadership would lead to a successful outcome; meanwhile he hoped that Saudi Arabia would continue to make an important contribution to the world's financial stability.

Mr. Lovato stated that he had been favorably impressed by the changes in the estimating procedures used by the staff; the new methods should provide a more precise idea of likely changes in commitments and in the Fund's resources for a given period. The change had already brought about a sharp revision in the estimates for countries with quotas lower than SDR 800 million. Unfortunately, the developments in some countries with quotas larger than SDR 800 million were such that the overall position was not substantially better than it had been on the occasion of the previous forecast in August 1982. The projections of the staff had traditionally been on the safe side; now, with access to commercial sources becoming more difficult for many countries and with the continued sluggishness in world trade, they did not appear to be unduly pessimistic. Some of the factors that had led to a reduction in the expected commitments for small countries were by no means helpful; they seemed to have led to a need to bring the adjustment process forward in time, and they had certainly contributed to the maintenance of an unbalanced world economic situation.

For the immediate future, the position seemed manageable until April 1983, Mr. Lovato went on. The small commitment gap in borrowed resources in the neighborhood of SDR 200 million expected toward the end of the fiscal year should not pose any particular difficulty, provided that it did not increase later. In the following months, the liquidity position might well change drastically if large countries found it necessary to come to the Fund for substantial help. If requests for help from such countries amounted to as much as SDR 10 billion, as suggested by the staff, the existing borrowing arrangements would prove insufficient, and the liquidity ratio would become uncomfortably low.

He was grateful to the staff for its efforts to extend the projections to 1985 in response to requests made in the Executive Board in April 1982 (EBM/82/56), Mr. Lovato observed. He tended to view the projections more as a possible scenario than as a reliable forecast, particularly in light of the intrinsically uncertain nature of international developments. For the time being it was important that the negotiations currently under way for the third tranche of the SAMA loan should be brought to a successful conclusion. It might also be appropriate to start thinking in some detail of other possible lenders if the need should arise. He reiterated his authorities' desire that borrowing should be confined to official entities. In any event, the financial position of the Fund and the need to increase borrowing from outside sources both pointed to the need to reach a speedy agreement on the Eighth General Review of Quotas; the increase should be large enough to enable the Fund to re-establish a more appropriate balance between its owned and borrowed resources.

Mr. Laske stated that he considered the projections presented by the staff to be reasonable, and he welcomed in particular the shift to a country-by-country analysis for countries with quotas smaller than SDR 800 million. The projections offered a very good basis for evaluating the Fund's borrowing needs until the quota increase under the Eighth General Review became effective. It was evident that the Fund's own resources would be reduced rather rapidly during the coming 18 months. In consequence, the discussions for the Eighth General Review of Quotas should proceed quickly. It was perhaps worth recalling that the Interim Committee in its latest communiqué had urged the Board to give the matter high priority so that decisions could be made in April 1983, at the time of the next meeting of the Interim Committee. The Fund's liquidity, in the form both of owned resources and of borrowed resources, seemed likely to be sufficient for the coming fiscal year. Nevertheless, a commitment gap might arise shortly before the end of the current fiscal year; he therefore hoped that the Managing Director's conversations regarding the third tranche of the SAMA loan to the Fund would start soon and come to a fruitful conclusion.

The staff had made tentative projections regarding probable requests for assistance by countries with large quotas, over and above the negotiations that were at present under way with two countries, Mr. Laske noted. The figures had not been changed since the previous review of the Fund's liquidity; without a more detailed analysis of possible country requests for Fund assistance it was almost impossible to form a view on the probability of the estimated size put forward by the staff being anywhere near correct. If such requests from countries with large quotas were received by the Fund, his authorities expected that they would be considered with strong external adjustment envisaged and that it was desirable to make the best possible use of the Fund's financial resources, which were not unlimited.

On the question of the Fund finding additional sources of funds, Mr. Laske mentioned once again that his authorities continued to have serious doubts about the advisability of the Fund trying to borrow from private markets, and they would be hesitant to consider the matter. Regarding the suggestions for the longer-term liquidity position and liquidity needs of the Fund, as set out on pages 8 and 9 of EBS/82/180, his authorities would welcome it if the considerations could be presented in tabular form in the next paper on the Fund's liquidity.

Mr. Buira commented that the staff review of the Fund's liquidity position and financing needs revealed clearly the financial strains being undergone by many members. The international economy was passing through one of the most difficult periods of the century, and not only financial agencies but many countries were suffering in consequence. Moreover, many of the long-standing principles of international trade and cooperation were being challenged by the introduction of new everyday practices in connection with trade and finance. It was therefore desirable to review the roles played by various institutions in the world economy, and it would be helpful if a stronger Fund were to emerge with adequate resources and a major role in the international financial system. The Fund's current and prospective liquidity position, and consequently its financing needs, reflected the pressures burdening the international environment.

The staff figures for demand for the Fund's resources through April 1983 seemed to be sound, Mr. Buira continued. He could also agree with the staff in its view that the likelihood of a substantial use of Fund resources would not diminish, and might well increase, in the two years ahead. Naturally, any estimate extending beyond the current financial year would have to be considered tentative. However, in the present circumstances, the prospects pointed to an upward rather than downward adjustment in the prospective demand for Fund credit in the near future. Consequently, he regarded the figure of SDR 22.6 billion as a realistic estimate of total net commitments through April 30, 1984. Indeed, it might turn out to be an underestimate if more than two large quota members were to resort to Fund credit during the period.

Two aspects of the staff analysis of the prospective demand for Fund resources over the next two years were worth underscoring, Mr. Buira observed. First, the estimates reflected a growing propensity of countries to borrow from the Fund. There seemed little doubt that the trend had resulted from the declining capacity of the private banking system to continue to shoulder the whole responsibility for financing the adjustment process. Second, there had been a change in the pattern of demand for Fund resources. Present arrangements with member countries showed a tendency toward programs involving shorter periods of adjustment and smaller amounts of finance. The reason for the trend might be found in the current position of the business cycle, which had increased the uncertainty surrounding economic prospects and eroded confidence in practically all economies. In the present circumstances the Fund ought not to rely too heavily on that sort of short-term financing with its demand for abrupt adjustment. The depression in world activity made adjustment more difficult, and the structural nature of the payments problems of many countries would seem to call for a lengthening of the adjustment period. In fact, the current liquidity crisis for many debtor countries was to some extent the result of a fundamental mismatching between the time profile of returns on projects and sources of finance. In other words, many countries had used short-term financing the necessary longer-term adjustments. Like Mr. de Groote, he believed that the Fund should look at longer rather than shorter arrangements as a way of stabilizing not only the members' economies, but also the expectations of the private banks. Ideally, the Executive Board ought to seek the pattern of medium-term finance that was most needed by the Fund's members in the current state of the international economy. In any event, he had noted that the shift in the pattern of credit away from longer arrangements toward shorter-term arrangements had been very sharp, and he would be interested to have the staff comment on the change.

As to the supply of resources to the Fund, Mr. Buira observed that the estimates of total net commitments for the near future, together with those for uncommitted ordinary resources, pointed to a sizable decline in the liquidity ratio, which might become even greater if more members with large quotas were to use the Fund's resources. The ratio could reach a dangerously low level after 1983, thus pointing to the need for an acceleration in the Eighth General Review of Quotas. The trend toward a growing discrepancy between the demand for Fund resources on the one hand and the Fund's holdings of ordinary resources on the other ought to be noted. Should the prospects for the use of Fund resources prove to be correct, a commitment gap could arise in the second half of 1983, and the chances of such a gap arising seemed fairly high. He therefore hoped that it would be possible to agree on the third tranche under the SAMA agreement, as well as other forms of borrowing by the Fund, as soon as possible. Taking into account the current and prospective liquidity position of the Fund, an approach should be made to the private market. Borrowing by the Fund could contribute not only to a smoother working of the institution but also to an improvement in the structure and efficiency of private banks' portfolios. The maturity structure of the Fund's borrowing should reflect the term structure of the patterns of finance most needed by members. It seemed reasonable to believe that the bargaining position of the Fund as a borrower vis-à-vis the commercial banks must have improved considerably. In conclusion, he commended the staff for an excellent paper.

Mr. Joyce commented that, despite the many uncertainties facing the world economy, the estimates provided by the staff did offer a reasonable basis for Executive Directors to plan their work. He welcomed the new estimating techniques that had been used on the present occasion, especially the resort to estimation on a country-by-country basis and the use of probability factors. He had no real problem with the estimates. He noted that the requirement up to April 30, 1984 had been reduced to SDR 22.6 billion, a figure well below that of SDR 27.6 billion used in the August 1982 papers. With the world in its present state, he would have anticipated an increase in the demand for the use of the Fund's resources rather than a decline. He would, however, accept the explanations given in the paper as to how the reduction had come about. The estimate of SDR 8.6 billion for the current year caused him no difficulty. For the year ending April 30, 1984 he noted that the estimates for the smaller countries had been radically reduced from SDR 10 billion to SDR 5 billion, on the grounds that the programs were likely to be for shorter periods and hence, for smaller amounts.

While Mr. de Groote had characterized the change as possibly being one more of appearance than of substance, he would appreciate any further information that could be offered, Mr. Joyce stated, on whether the move toward the increase in stand-by arrangements as opposed to extended arrangements reflected primarily the wisdom of management, or the choice of applicant countries. He could understand that management might feel that the Fund should proceed more cautiously than it had done in the past. The result might be that a country would opt for a series of one-year stand-by arrangements adding up to a total program. But it would be difficult for countries to plan for a medium-term period if they only had the assurance of one-year stand-by arrangements, regardless of what might be said for the future.

The staff felt that an amount of SDR 10 billion might be needed for countries with quotas of SDR 800 million or less for the year ending April 30, 1984, Mr. Joyce noted. On balance, the forecast seemed rather pessimistic. He wondered whether the figure reflected a judgment on the part of management or the staff, or whether it was simply a figure that had been arrived at by deducting from SDR 15 billion--the original amount--that had been set aside in the earlier paper on the Fund's liquidity the amount of SDR 5.1 billion that was being used for two countries in the current year. He had noted that the figure of SDR 10 billion was not included in Table 1 on page 7, which only showed SDR 5 billion. Some explanation of the difference would be welcome.

For 1985, Mr. Joyce went on, he agreed with the staff that any figures were bound to be conjectural and that in the circumstances there was little point in trying to use a country-by-country technique of estimation. For 1984 he accepted the conclusions set out by the staff to the effect that the overall liquidity of the Fund would come under considerable pressure by the early part of the year, if not sooner. The Fund's liquidity was falling rapidly, as could be seen in the liquidity ratio figures for the end of 1983 and the end of 1984. Nevertheless, it would be wrong to take an exaggerated view of the seriousness of the situation. The Fund's liquidity ratios had fallen to low levels in the past, and it seemed normal for them to do so toward the end of negotiations for quota increases. His understanding was that in the past the liquidity ratio had fluctuated between 15 per cent and 20 per cent for a considerable period, and that in 1977 it had fallen to 3.8 per cent. While it was certain that the Fund ought to act, it ought not to use the present position as a reason for cutting back on existing lending practices.

The lessons of EBS/82/180 were clear, Mr. Joyce considered. First, the Eighth General Review of Quotas ought to be brought to a conclusion as quickly as possible. Moreover, his chair believed that a substantial quota increase was necessary, perhaps to the extent of doubling existing quotas. Meanwhile, other steps needed to be taken, and he too hoped that the Managing Director would be successful in his discussions with the Saudi Arabian authorities. It would be most useful if those authorities would find it possible to be as generous as they had been in the past, not only in agreeing to making a third tranche available but also, if possible, to making it available soon. At the same time, the Fund ought to consider whether it should not attempt to acquire additional resources from other surplus countries.

The sooner the Fund was made aware of what the U.S. authorities had in mind with respect to their "safety net," the better it would be, Mr. Joyce considered. Only then would it be possible to see what effect the "safety net" would have on the Fund's liquidity. He also agreed with Mr. Anson that work should proceed on the reconsideration of the General Arrangements to Borrow, and that it would be helpful if the studies on that point could be completed in time for the meeting of the Group of Ten Deputies to be held in December 1982. As to other sources of finance, his chair had never ruled out the possibility that the Fund might need to go beyond seeking assistance of central banks and to approach private markets. However, "going into the market" could mean many things. In the past he had understood it to mean that the Fund should undertake some form of issue. But had any thought been given to sounding out whether the Fund might not at some time seek assistance directly from private banks? He was not making the suggestion that it should do so; he would be interested in knowing where the Fund stood on the matter.

Mr. de Vries commented that EBS/82/180 clearly showed that the Fund's liquidity position would be under strain by early 1984 at the latest. The financial world as a whole was overextended, and the Fund looked like it might be overextended in relation to its capital base. It was particularly unfortunate that the two events should occur at the same time. If the commercial banking system was overextended the Fund ought to be in a strong capital position. The conclusion he had reached, therefore, was that borrowing would not help the Fund at all; what was needed was that the members should validate the Fund's current lending policies by coming forward with a substantial increase in quotas. If they did not, the Fund would have no option but to review its lending policies.

A major question, Mr. de Vries considered, was how the Fund should act before the Eighth General Review of Quotas was completed. Naturally, he hoped that the Managing Director would be successful in his negotiations with the Saudi Arabian Monetary Agency. It would also be helpful if the Fund were to reconsider borrowing from smaller member countries willing to make their reserves available to it. He would have no objection to some borrowing from other sources, even those that had not yet been tapped. As to borrowing in the market, the Netherlands authorities remained somewhat doubtful. In practice, they were likely to be guided by what actually happened in the future. If a large country were to fall into difficulties, the Fund in its present liquidity position would have no recourse but to go to the market. On the other hand, unless there was such a major occurrence, it seemed most unlikely that the Fund membership would agree to allow the Fund to borrow in that way; and naturally, everyone hoped that the situation he had described would not arise. If it did, the Fund would have to send a mission to the country concerned and it would have some time--between two weeks and two months--in which to arrange its borrowing. Nevertheless, all the preparatory work should be carried out as soon as possible, even if the Fund as an institution did not particularly wish to do so. Countries that were opposed to the Fund borrowing in the market did so on the grounds that official borrowing had apparently led to some overextension by the Fund, a situation that was perhaps normal as the time for a new quota increase approached. Except in cases of very clear need, his authorities would not like to see a second round of major borrowing activities by the Fund, precisely because of the fear of overextension.

The staff had mentioned the existence of proposed supplementary borrowing arrangements, put forward by the U.S. authorities in general outline, with objectives that were fairly clear, Mr. de Vries went on. On November 19, 1982 the Executive Board would discuss the topic of how to deal with major strains in the international financial system. He hoped that by that time the U.S. authorities could have put their thoughts on permanent borrowing arrangements on paper. If they had not done so, Mr. Polak at the request of the Netherlands authorities, would make comments on the topic, unless the Chairman ruled him out of order. The staff paper on the Fund's liquidity had been very useful; the Executive Board clearly had to keep the situation under review, but at present no decisions were required.

Mr. Hirao commented that the staff estimates of the Fund's overall commitments for the coming fiscal year seemed to provide a reasonable basis for discussing its liquidity. It would perhaps have been more helpful if Table 1 had provided actual figures of commitments and financing for the first five months of the current financial year, May 1-September 30, 1982.

The staff had estimated that the Fund's adjusted ordinary resources would have been reduced to about SDR 10 billion by April 1984 and that the liquidity ratio could become too low, thus causing the Fund's liquidity position to come under considerable pressure by early that year, Mr. Hirao considered. The Fund's ordinary resources were not only its main resources; they were also its capital base. Without a solid capital base it would be difficult for the Fund to operate and to maintain public confidence so as to be able to assist members in times of balance of payments difficulties. The staff estimates, therefore, lent strength to the view that substantial quota increases were needed through the Eighth General Review of Quotas.

As to the need for borrowing, Mr. Hirao noted that it was desirable to continue making arrangements for new lines of credit, recognizing that the Fund's liquidity position would come under severe pressure toward the beginning of 1984. However, the Fund should be extremely careful in undertaking new borrowing, especially from the private market, since its activities would have wide-ranging implications. Taking a longer view, the question of the mismatching of maturities could have important implications for the Fund's liquidity; mismatching was a topic that would warrant careful study. He added that he looked forward to seeing the paper on strains in the financial system.

Mr. Jayawardena commented that the staff's well-documented paper confirmed the interpretation of the global economic outlook that his chair had accepted for a considerable time. It was little consolation to find his chair's attitude vindicated, if thereby the Fund was to be deprived of the possibility of playing its proper role in a world crisis that was likely to be of unprecedented proportions.

In the absence of additions to its usable currencies, Mr. Jayawardena noted, the Fund would soon be confronted with a serious liquidity constraint. The staff estimate showed that the Fund's liquidity ratio would fall from about 62 per cent in September 1982 to about 21 per cent in April 1984, and that the pressure on the liquidity position would continue thereafter. Two questions seemed to arise: first, at what speed should action be taken to relieve the strain, and second, what was the volume of resources needed for the purpose? If he had understood the Managing Director correctly, the Eighth General Review of Quotas could not be completed before 1984 or 1985. He wondered whether those dates were not too late and whether some measures could not be devised to provide interim relief, as Mr. Supinit had already suggested. One suggestion that might be worth considering was whether the Fund could not immediately agree on the equiproportional element of the quota increase and put it into effect as soon as practicable, pending the rather time-consuming process of deciding on selective increases. Such a two-stage exercise would have considerable merit.

The size of the dip in the liquidity ratio, Mr. Jayawardena considered, was also an indication of the sizable increase in quotas needed to rectify the situation. A doubling of quotas was justifiable in terms of the liquidity requirements of the Fund alone if the quotas were to be the primary source of Fund resources, as they should be, and if the Fund was to play its proper role in the international monetary system, which was likely to remain difficult in the years ahead. The staff estimates had also shown that a commitment gap in borrowed resources would emerge as early as April 1983. He was rather disturbed by the conclusion; a financial institution like the Fund ought to avoid the emergence of such a gap, even if it was in the nature of a commitment gap. Prudence required that the problems should be tackled well in advance, so that the Fund would be in a position to assist members with legitimate requests for assistance. His chair would therefore strongly support the Managing Director's efforts to ensure that the Fund had adequate resources with which to carry out its activities. He wished the Managing Director well in his discussions with the Saudi Arabian authorities regarding the third tranche under the SAMA agreement, although he felt that the awesome responsibility of upholding an orderly international financial system ought not to be placed so heavily on the shoulders of a poor developing country such as Saudi Arabia.

His chair's preference would be for the Fund, reflecting the intergovernmental character of the institution, to borrow as much as possible from official sources, Mr. Jayawardena stated. Along those lines, he would not rule out the possibility of short-term placements from the central banks of developing countries, some of which might prefer to hold Fund paper as a form of asset diversification. As a last resort, and only to the extent necessary, the Fund should be ready to enter the private market. For that purpose, the most prudent course might be to resort to the device of entering into lines of credit, which could be activated when necessary. It was essential that the Managing Director should have the necessary flexibility to finalize borrowing arrangements without being unduly constrained by any mechanistic interpretation of ratios under the guidelines for borrowing in the present difficult times.

He had noticed, Mr. Jayawardena went on, that on the present occasion the staff estimates had been based on a country-by-country review instead of on global projections. While such a review ought to help in providing more realistic assessments and in exercising judgment based on country experiences, it was not that change of procedure alone that had led to the substantial downward revision in the estimated needs of developing countries for the year ending April 30, 1984. He had noticed that the estimated requirements of developing countries with quotas of less than SDR 800 million had been scaled down for that year by one half to SDR 5 billion. With the deepening recession in the industrial countries, it seemed likely that the export earnings of less developed countries would decline still further, leaving those countries with the need for large amounts of finance. The reason given by the staff for scaling down its estimate of requirements was that countries seemed to be preferring arrangements for shorter periods, and consequently for small amounts. He would therefore like to know more from the staff as to how such a change in perception had come about. Had the change arisen from a staff perception that the current problems were more of a short-term nature than a long-term nature? Was it a device to make Executive Directors think that they were improving the liquidity ratio because commitments for short-term arrangements happened to be less than those for longer-term arrangements? If that was the situation, there would be no real difference in the Fund's position because it would probably prove to be necessary to extend the short-term arrangements over longer periods if the problems themselves were perceived to be of a longer-term nature.

It was his understanding, Mr. Jayawardena commented, that developing countries would continue to face considerable balance of payments deficits, and that the nature of the imbalances was such that they would require structural changes, longer adjustment periods, and supply-oriented measures. The shift toward emphasizing demand management, implicit in short-term arrangements, was not warranted by the economic environment faced by the countries concerned at the present time. The fundamental question Executive Directors would have to face was whether they were not shifting emphasis to more adjustment and less finance due to the constraints imposed by inadequate liquidity in the Fund. Was the change in fact the result more of informal persuasion than of perceived needs, or had the authorities themselves suggested to the Fund that they would prefer short-term rather than longer-term arrangements? He would be happy to see a renewed emphasis on shorter-term lending; but at the present difficult time, rather than tailoring members' needs to suit the resources of the Fund, it would be more appropriate to augment Fund resources to enable it to cater to the growing needs of its members, and thus promote international adjustment in an orderly and equitable manner. Rather than cancel programs when countries ran into difficulties, should the Fund not seek out the reasons for the difficulties and find appropriate solutions? The Fund was not an institution like a commercial bank whose object was maximum short-term profit, helplessly reacting to the outside environment. On the contrary, the Fund was a great international institution that should act decisively to influence the outside environment and move it in the direction it deemed best.

The Executive Directors agreed to continue their discussion of the Fund's liquidity position and financing needs in the afternoon.

3. EXECUTIVE DIRECTORS

The Chairman bade farewell to Messrs. Abdollahi, Buira, Iarezza, Kiingi, and Nana-Sinkam, Executive Directors; and to Mr. Legarda, Alternate Executive Director, on completion of their tours of duty.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/137 (10/27/82) and EBM/82/138 (10/29/82).

4. RELATIONS WITH GATT - THIRTY-EIGHTH SESSION OF CONTRACTING PARTIES AND CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the Thirty-Eighth Session of the CONTRACTING PARTIES to the GATT as set forth in EBD/82/258 (10/21/82).

Adopted October 27, 1982

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 82/73 through 82/75 are approved. (EBD/82/259, 10/22/82)

Adopted October 28, 1982

6. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/82/377 (10/28/82) is approved.

APPROVED: April 1, 1983

LEO VAN HOUTVEN
Secretary