

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/29

10:00 a.m., February 27, 1981

FILES

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

Executive DirectorsAlternate Executive Directors

A. Buira

J. de Groote
B. J. Drabble

T. Hirao
J. C. Iarezza

A. Kafka
B. Kharmawan
S. Kiingi
G. Laske
G. Lovato

S. Nana-Sinkam
M. Narasimham
J. J. Polak
A. R. G. Prowse
J. Sigurdsson
Zhang Z.

O. Kabbaj
L. D. D. Price
E. M. Ainley, Temporary
M. A. Senior
D. E. Syvrud
O. Uçer, Temporary
M. Casey
K. A. Al-Eyd
A. Nagashima
R. T. Salazar
Y. A. Nimatallah
J. R. Gabriel-Peña

F. Sangare

C. P. Caranicas
T. Aulagnon
A. Alfidja

T. de Vries

G. Blöndal
Tai Q.

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

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Also Present

African Department: O. B. Makalou, Deputy Director; L. M. Goreux, Deputy Director; N. Abu-zobaa, R. F. Blin, R. O. Carstens, F. d'A. Collings, S. E. Cronquist, R. E. Daumont, I. A. H. Diogo, R. W. Eglin, C. Enweze, R. A. Franks, J. W. Kratz, M. Reichardt, U. Wilson. European Department: A. Arimo. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; E. B. Maciejewski. Fiscal Affairs Department: E.-A. Conrad, G. A. Mackenzie. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, Ph. Lachman, A. O. Liuksila, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; J. S. Smith. Treasurer's Department: D. Williams, Deputy Treasurer; M. N. Bhuiyan, A. J. Mathuran, O. Roncesvalles, T. Taya. Office of External Relations: S. I. Katz, G. P. Newman. Personal Assistant to the Managing Director: C. M. Watson. Advisors to Executive Directors: C. Bouchard, S. E. Conrado, A. B. Diao, M. A. Janjua, G. Jauregui, A. K. Mullei, F. A. Tourreilles. Assistants to Executive Directors: S. R. Abiad, H. G. Askari, A. F. P. Bakker, C. J. Batliwalla, M. J. Callaghan, M. V. Carković, C. Chipeta, L. E. J. Coene, J. L. Feito, F. C. Guena, J. U. Holst, K. V. Jännäri, M. Kusakabe, S.-W. Kwon, J. E. Leimone, G. B. Lind, J. S. Mair, L. Merckx, M. Michelangeli, V. K. S. Nair, J. R. Novaes de Almeida, P. D. Peroz, M. Z. M. Qureshi, J. Reddy, M. Shadman, H. Suzuki, Wang E., P. Wichert.

1. IVORY COAST - 1980 ARTICLE IV CONSULTATION; EXTENDED ARRANGEMENT,
AND PURCHASE TRANSACTION - FIRST CREDIT TRANCHE

The Executive Directors considered the staff report for the 1980 Article IV consultation with Ivory Coast and a draft decision concluding the 1980 Article XIV consultation (SM/81/41, 2/17/81; and Cor. 1, 2/18/81), together with requests from Ivory Coast for an extended arrangement and a purchase in the first credit tranche (EBS/81/34, 2/13/81; and Sup. 1, 2/26/81). They also had before them a report on recent economic developments in Ivory Coast (SM/81/45, 2/20/81).

A Deputy Director of the African Department commented that Annex C of EBS/81/34 contained a time schedule for the introduction of a series of measures during the first half of 1981. Thus far the schedule had been followed precisely. Accordingly, the Committee on Financial Coordination and Investment Control and its Secretariat had been established, and the current budget had been adopted by a parliamentary committee and its passage by the National Assembly was expected very soon. The tax and pricing measures mentioned in Table 2 on page 29 had also been adopted. The measure that had caused the greatest difficulty was the alignment of salaries paid by decentralized agencies and state enterprises with those of the civil service. A special commission had been created to deal with the particular problems that could arise in individual cases in implementing that measure.

On page 36 of EBS/81/34, the Deputy Director continued, the staff had noted that the conclusions of two comprehensive studies to be completed before June 15, 1981 would be submitted to the Government and to the Fund. The authorities had requested technical assistance from the Fund to carry out the study on possible improvements in the tax and budget systems, and a team of staff experts was to start work in Ivory Coast in about four weeks. Another technical assistance mission had visited Ivory Coast three weeks previously and would return shortly to help with the study on measures that could be taken in the field of education and training to restrain the growth of public expenditures and to adjust training to meet employment possibilities. Finally, a World Bank mission planned to visit Ivory Coast very soon to review the agricultural program in preparation for a possible structural adjustment loan.

Mr. Nana-Sinkam made the following statement:

I would like to convey to the staff the deep appreciation of my Ivorian authorities for the clear, comprehensive, and well-balanced presentation of the current economic and financial situation in Ivory Coast. This set of documents is the result of the very hard and commendable work by a qualified team. My authorities and I are in general agreement with the staff analysis and appraisal, which we found to be fair and thoughtful.

The constructive discussions between the staff and the authorities have led to the financial program presented for the Board's consideration and contained in EBS/81/34. I strongly recommend the approval of that program.

At the outset, I wish to recall and emphasize that the fundamental principle underlying economic activity in Ivory Coast relates to the full commitment of the authorities to a liberal economic system with generous incentives to investors (Ivorians as well as foreigners) and a fully convertible national currency.

The Ivorian economy has been characterized by dynamic growth over the past 20 years. Indeed, real GDP registered an average annual growth rate of 7 per cent between 1960 and 1975 and reached the impressive rate of 12 per cent in 1976.

Despite the various adverse developments (external as well as weather-related) which occurred from 1976 onward, Ivory Coast continued to enjoy a strong economic performance with real GDP growing at more than 9.9 per cent, 5.2 per cent, and 6.9 per cent in 1978, 1979, and 1980, respectively.

This remarkably strong economic performance of the Ivorian economy stemmed naturally from the determined and sustained commitment of the authorities to win the battle for economic development and to bring about a rapid improvement in the standard of living of the population at large. This commitment has been translated into economic policies conducive to the generation of a substantially high level of investment and into strong and sustained diversification efforts that have been largely successful. Indeed, although coffee and cocoa still remain the major resources for economic activity, the economic base has been broadened considerably. In agriculture, several other export crops--palm products, pineapples, rubber, and cotton--have become significantly important. The manufacturing sector has been thriving, with its share in GDP increasing almost threefold, from 4 per cent in 1960 to 11 per cent in 1980.

The economic success of Ivory Coast was further enhanced by the 1975-77 commodity boom, which brought about a two-fold increase in the country's terms of trade and made it possible for the Agricultural Price Stabilization Fund to increase its surplus tenfold, to an amount equivalent to 17 per cent of GDP in 1977. These financial resources, coupled with a substantial volume of capital inflows stemming from heavy external borrowing, made it possible to raise the level of public and semipublic investment by 83 per cent in 1977 and 40 per cent in 1978, when the investment level reached the unprecedented level of CFAF 480 billion, representing 25 per cent of GDP.

However, with the sharp downturn in international prices for coffee and cocoa--the country's major export crops--which started in 1978, the comfortable surplus of the Agricultural Price Stabilization Fund started to decrease rapidly, which adversely affected government revenues. Thus, in the face of slowly increasing government revenues and continuously and rapidly rising expenditures, the overall budgetary position shifted from a small

surplus in 1977 to a deficit equivalent to 8.8 per cent of GDP in 1978. The deficit widened further to the equivalent of 10.7 per cent of GDP in 1979 and 15.1 per cent in 1980. At the same time, the adverse effects of the declining terms of trade, coupled with a very heavy debt burden resulting from the afore-mentioned heavy external borrowing on highly unfavorable terms, led to a sharp deterioration of the external financial position, with the current account deficit widening from an equivalent of 2.8 per cent in 1977 to 9.9 per cent, 12.4 per cent, and 14.7 per cent of GDP in 1978, 1979, and 1980, respectively.

These are obviously overwhelming imbalances, and the authorities are fully aware that they cannot be sustained. This concern originally led the authorities to adopt financial programs supported by Trust Fund resources in 1979 and 1980. The results under the 1980 financial program were somewhat below expectations and have helped to shed light on the real magnitude of the difficulties involved. The authorities are more than ever fully conscious of the need for a prudent economic and financial policy stance and of the fact that the required adjustment can only be carried out under a medium-term program.

In fact, it was already clear during our last Article IV consultation on Ivory Coast that many of the problems facing the country will need medium-term and long-term solutions.

Accordingly, they have elaborated jointly with the Fund staff a program that is today submitted to the Board for examination and approval. It is a courageous and appropriately designed program. It clearly indicates the determination of the authorities to take strong corrective measures to bring about the financial stability required as a sound basis for the rapid and sustainable pace of economic growth and development.

With respect to growth and development, the overall objective of the authorities remains, indeed, that of bringing about an acceptable growth rate and a sustainable medium-term balance of payments position. Although growth is expected to take place at the creeping rate of 1 per cent or 2 per cent in 1981, due to the substantial reduction in investment outlays required to bring about conditions for a healthy basis for a financial recovery, the economy is expected to resume its strong growth by the end of the program, namely, 6 per cent growth in 1983. The authorities intend to follow prudent investment policies, taking fully into account the capacity to mobilize domestic investment resources and emphasizing a more efficient allocation of such resources toward the more productive sectors of the economy.

With respect to agriculture, the authorities will continue to pursue their positive agricultural pricing policies. Producer prices will continue to be fixed at appropriate levels; extension services will be provided where and when necessary with a view to

increasing productivity; and subsidies will be extended only on the basis of need and of availability of resources.

As for the industrial sector, the emphasis of policies will be less on import substitution industries and more on export-oriented activities, especially with a view to taking full advantage of the sizable market offered by the Economic Community of West African States. Moreover, action will be directed toward making local industries more efficient and more competitive on international markets. There is no doubt that the cooperation of the foreign markets will be essential to the attainment of these objectives.

In the energy field, Ivory Coast already has a significant network of hydroelectric power plants and has been active in this field on a regional basis. The authorities also are to be commended for their positive pricing policies with respect to electricity and oil products. Serious efforts have been made to continue the exploration for oil, and positive results have been registered. It is estimated that Ivory Coast will be self-sufficient in energy in 1983 and will be a net oil exporter by 1985. These are encouraging prospects and it is hoped that they will materialize sooner.

In the fiscal field, the authorities' objective is to reduce the overall budgetary deficit from an equivalent of 15.1 per cent of GDP in 1980 to 6.2 per cent in 1983. These results will be achieved essentially through tighter expenditure control, such as the one outlined in the 1981 austerity budget, and through the generation of a greater volume of government revenues. With respect to expenditure control, the authorities have set up a committee on Financial Coordination and Investment Control responsible for overseeing on a monthly basis the transactions of the public sector broadly defined, with a view to meeting the objectives set forth in the financial program. On the revenue side, significant efforts have already been undertaken to step up the generation of greater revenues. An increase in the gasoline tax has been effected and other tax measures are to be under following the fiscal review mission requested by the authorities from the Fund. A study has been commissioned for June 15, 1981 in order to determine ways and means of improving tax collection and administration and to review the system of tax exemptions, including those under the Investment Code. All this of course should make the tax system more buoyant, more efficient, and more equitable. Significant efforts are also being directed toward the improvement of the financial performance of public enterprises. The action started in 1980--the liquidation of inefficient public enterprises--will be pursued more vigorously and more effectively, while the pricing system in the entire public sector will be readjusted to better reflect market conditions.

In the monetary field, the authorities will continue to pursue a cautious policy stance with respect to credit so as to keep

private credit within the ceilings set forth in the financial program. The authorities intend to ensure that credit earmarked for a specific purpose, such as crop credit, will not be diverted to other purposes. The authorities also intend to strictly limit recourse to the banking system by the public sector to the ceilings established under the financial program. With respect to interest rates, the monetary authorities are committed to the maintenance of interest rates at levels that are competitive with those prevailing abroad, especially in France. Moreover, they intend to pursue efforts aiming at a greater development of the money market in the monetary union, with a view to making interest rates more flexible and further enhancing monetary and credit policy.

As for the external sector, the program's objective is to reduce the current account deficit from the equivalent of 14.7 per cent of GDP in 1980 to 8.3 per cent in 1983. These results will stem from the significant improvement in the trade balance expected from 1982 onward. Such an improvement will come about as a result of improved terms of trade, self-sufficiency in energy, and increased output of locally processed agricultural exports.

With respect to external borrowing, the authorities are rightly concerned over the heavy debt burden. Indeed, the debt service ratio has shot up from 10 per cent in 1976 to 25 per cent in 1980 and to an estimated 28-29 per cent in 1981. One of the major objectives of the present program is to scale down the proportion of external debt from 40 per cent of GDP in 1980 to 25-30 per cent at the end of 1983. This reflects the policy aimed at reducing the rate of growth of external indebtedness and improving the structure and terms of the external debt. In fact, while 35 per cent of the total new loans in 1976 were for 12 years or more, corresponding essentially to concessional borrowing from bilateral and multilateral sources, this proportion represented only some 16 per cent by the end of 1980. Meanwhile, the average interest rate on new borrowing increased from 7.45 per cent in 1976 to 12.31 per cent in 1980, and the grant element fell from 10 per cent to 5 per cent over the same period. There is no doubt that the different measures already taken and those to be taken shortly will help bring the situation under control.

Thus, the present economic and financial picture of Ivory Coast is a gloomy one. However, the Economic and Financial Policy Program elaborated by the authorities and which is to be supported by conditional Fund resources under the extended Fund facility embodies, we believe, the appropriate policy measures which will bring about the conditions for a much brighter picture by 1983. As already stated, the program is courageous and appropriately designed, and I strongly recommend it to the Board.

Mr. Aulagnon considered that the proposed extended arrangement and the requested purchase should make a significant contribution to solving the problems facing Ivory Coast. Since gaining independence in 1960,

Ivory Coast had maintained a dynamic development policy that had led to an average rate of real GDP growth of 7 per cent and an average rate of increase in per capita GDP of 4 per cent. The satisfactory economic performance had been achieved despite a lack of significant exploitation of mineral resources in Ivory Coast. Growth in Ivory Coast had been unusually broadly based compared with that in many other countries in the region. The agricultural policies of the Government had been particularly successful, as evidenced by the country's leading position in world exports of cocoa and coffee, which, in 1979/80, reached 58 per cent of the total export earnings and represented the equivalent of 20 per cent of GDP. The manufacturing sector had also been dynamic; its share of GDP had risen from 4 per cent in 1960 to 12 per cent in both 1978 and 1979. The Government had also made efforts to promote the cultivation of new crops, such as pineapples, palm trees, rubber, rice, cotton, and sugar.

Largely because of fluctuations in the prices of coffee and cocoa, Mr. Aulagnon continued, Ivory Coast faced serious financial difficulties. The authorities had decided to implement basic policy changes in the context of a three-year extended arrangement, which he basically accepted. The unusually large increase in coffee and cocoa prices in 1976/77 had enabled the authorities to borrow abroad massively and to increase public and semipublic investments by 83 per cent in 1977 and 40 per cent in 1978. The subsequent decline in the price of coffee and cocoa had created severe internal and external imbalances. The overall balance of the public sector had shifted from a small surplus in 1977--CFAF 14 million--to a large deficit in 1980 equivalent to 15.1 per cent of GDP, and arrears had accumulated. The debt service ratio was expected to rise to 29 per cent in 1981. The deficit on current account had risen from 1.8 per cent of GDP in 1979 to 14.7 per cent in 1980, while the overall external deficit had reached the equivalent of about 6 per cent of GDP in 1980.

The new financial program, Mr. Aulagnon observed, was aimed at avoiding any risk of a financial crisis occurring in the short run and at restoring the growth potential of the economy in the medium term. The overall balance of payments deficit was to be eliminated by 1983.

The most important elements of the new financial program were the fiscal, investment, and education and training policies, Mr. Aulagnon remarked. In the fiscal field, the authorities aimed to eliminate both recourse to net borrowing from the domestic banking system and domestic arrears by strengthening budgetary management and discipline. Their intention of reducing the budget deficit from 15.1 per cent of GDP in 1980 to 6.2 per cent in 1983 was welcome. The establishment of the Committee on Financial Coordination and Investment Control, which was to play a crucial supervisory role in the implementation of the new financial program, was also welcome. The new study on the tax and budget systems, which was to be completed by June 15, 1981, should prove useful.

In the investment policy area, Mr. Aulagnon continued, the Committee on Financial Coordination and Investment Control was to coordinate and monitor all public investment to avoid the kinds of errors that had been

made in the past. During the coming years, some previously agreed projects that were now thought to be nonessential were to be postponed or eliminated.

The authorities, Mr. Aulagnon noted, had decided that the entire education and training system should be thoroughly re-examined in the light of the needs of the economy. The main problem was the rapid growth in the cost of education, whose share in the current budget was expected to rise from 39 per cent in 1979 to 45 per cent in 1980. An important objective was to adjust education and training programs to meet prospective needs. To those ends, the authorities intended to undertake a study with the assistance of the World Bank and UNESCO; the preliminary conclusions should be available by June 15, 1981.

On the whole, Mr. Aulagnon concluded, the implementation of the proposed financial program should permit the establishment of economic and financial conditions that would contribute to balanced growth, especially if the Fund's assistance was reinforced by a structural adjustment loan by the World Bank.

Mr. Üçer said that he warmly welcomed the authorities' intention of making the structural reforms needed to establish a sound base for sustainable economic growth. He fully agreed with the staff that, despite the outstanding record of real economic growth after 1960, the organizational base of the economy was too weak to sustain future growth at a satisfactory rate. The weakness was structural in nature, and the authorities had wisely concluded that, without fundamental changes, the economy would become fully dependent on world markets.

The major problem facing the economy, Mr. Üçer considered, was the lack of organization in the public sector. Implementation of needed policies had been neglected since early 1977, and the economy had suffered from the accumulated adverse effects of many setbacks. An important surplus in public sector finances had been recorded in 1977, but a deficit equivalent to 8.8 per cent of GDP had occurred in 1978 and a further increase in current expenditures and net lending had led to a larger deficit, equivalent to 10.7 per cent of GDP, in 1979. At the same time, there had been a switch from external to domestic sources of financing, and the internal payments arrears of the public sector had substantially increased in 1980, reaching a level almost double that of 1979. Borrowing from the domestic banking system had increased to approximately 50 per cent of the public sector deficit. Those developments clearly showed the need for a medium-term program to solve the deep-rooted problems that had caused the financial imbalances. He wondered whether it was not best to dismantle controls and return the activities of public enterprises to the market economy rather than to establish tighter central government control over the public enterprises. The authorities' flexibility in the control over the public enterprises was welcome, but more justification was needed for the particular approach to the enterprises that the authorities had chosen.

Public and private investment had stagnated as a result of a series of mistakes in resource allocation combined with large-scale cost and price distortions and a high level of protectionism, Mr. Üçer remarked. In the light of the new budgetary discipline, the assistance of the World Bank should greatly help the authorities to increase the efficiency of investments in 1981; in the case of Ivory Coast, it was the World Bank's technical assistance rather than its financial assistance that would be instrumental. The recovery program seemed likely to place stronger emphasis on early maturing projects with high rates of return. He hoped that the expectations concerning oil exploration were not overoptimistic. If Ivory Coast was to become a net oil exporting country, prudent policies of investment and production, including effective use of newly acquired resources, would be essential.

During the program period, Mr. Üçer observed, the authorities would rely heavily on foreign funds, an approach that seemed acceptable, especially in the light of the medium-term expectations for Ivory Coast's exports. Given the high debt service ratio, the efforts to change the country's debt profile were welcome. The new monetary measures, such as the interest rate policy, should help to improve the economy. He strongly supported the new three-year program.

Mr. Syvrud stated that the new program seemed to include appropriate policies, and the proposed decisions should be approved. Given the very rapid rate of growth of public sector expenditure in recent years, the program was correctly focused on slowing the rate in order to reduce the budget deficit. The authorities should not delay in implementing tax reform measures. The efforts to improve resource allocation through better control of investment by public enterprises were welcome. The increase in interest rates in 1980 was also welcome, and the authorities should be urged to introduce further flexibility in interest rates in the future.

Thus far, however, the authorities had done little to deal with the considerable inefficiency in the industrial and education sectors, Mr. Syvrud continued. He was pleased that the World Bank was sending a mission to Ivory Coast to discuss a possible structural adjustment loan so that the authorities could take concrete steps to improve efficiency during the period of the proposed extended arrangement.

He harbored some doubt, Mr. Syvrud said, whether the crucial underlying assumptions about the external sector--the improvements in the terms of trade expected in 1982 and the achievement of self-sufficiency in petroleum in 1983--would be borne out in fact. Some forecasters expected a further decline in coffee and cocoa prices during 1982 which, together with normal price increases for imports, would cause a further deterioration, rather than an improvement, in Ivory Coast's terms of trade. The projected dramatic increase in oil production during the next three years might be overoptimistic, especially as the size of the petroleum reserves had not yet been assessed. What steps were the authorities prepared to take if actual developments turned out to be less favorable than those based on present assumptions? In particular, would a further

exchange rate adjustment perhaps be helpful in that event? Finally, he welcomed the technical assistance that had been given by the Fund, and the continued very close cooperation between Ivory Coast and the Fund.

Mr. Prowse said that he accepted the proposed decisions. The new program went in the right direction, and the tax study and recent establishment of the Committee on Financial Coordination and Investment Control were particularly welcome. However, the possible impact of the program in 1981 might leave something to be desired: consumption in 1981 was expected to rise as a percentage of GDP, while gross domestic savings and investment were expected to fall. The overall public sector deficit had been reduced during 1980 but was still somewhat larger than the deficit in 1979. Foreign financing under the new program was projected to amount to CFAF 201 billion during 1981, compared with CFAF 121 billion during 1980. He hoped that the decline in the relative importance of investment and domestic savings would not have any serious implications for the success of the new program. Had the staff given any thought to including a performance criterion having to do with public sector expenditure or the budget itself?

He was concerned, Mr. Prowse remarked, by the substantial increase in import quotas and licenses, and the prohibitions on imports of goods. The staff had mentioned that the protection extended by Ivory Coast was excessive, and he wondered whether the authorities planned to reduce the controls as soon as circumstances became more favorable.

The staff had also mentioned, Mr. Prowse noted, that Ivory Coast could not pursue an active exchange rate policy within the context of the West African Monetary Union, and the policies outlined by the authorities during the consultations and in the context of the extended arrangement constituted an important step forward. The exchange rate was of course a particularly difficult issue, but he wondered whether the recent increase in import controls was not a direct result of the Government's inability to pursue an active exchange rate policy.

Mr. Casey commented that, while the proposed decisions were acceptable, he wondered why an extended arrangement was being proposed rather than a stand-by arrangement. Ivory Coast clearly had financial problems and developmental needs, but the former had been caused largely by random factors, such as volatile cocoa and coffee prices and excessively hasty public investment. The precise extent to which the economic problems were structural in nature was unclear to him. It would also be useful to know whether or not supplementary financing facility funds were among the resources that Ivory Coast would use if the proposed decisions were adopted. There was, however, no doubt that Ivory Coast needed Fund resources to gain time to reduce the present very large fiscal and external deficits.

Commenting on the performance criteria, Mr. Casey said that the limit on short-term foreign debt was appropriate, given the relatively high debt service ratio. However, the ceiling on bank credit might not be very meaningful, for two reasons. First, if agricultural crops were better than were now expected, the credit ceiling would probably be exceeded; indeed,

the staff reports seemed to allow explicitly for that possibility, so that the ceiling did not seem to be very rigid. Second, bank credit was of course only one component of the money supply and, given the existence of the monetary union and the fixed exchange rate, the control of bank credit might well have little effect on the overall money stock. Consequently, the ceiling on bank credit probably would not make a significant contribution to increasing the control over total liquidity in the economy. He wondered whether the staff had considered having some measure of the fiscal deficit as a performance criterion. That approach seemed particularly appropriate in view of the high priority that the Government had given to correcting the fiscal imbalance. There were precedents for using fiscal aggregates as performance criteria, although that admittedly was not the normal practice.

The ambitious objectives of the three-year program should be realizable if the assumptions about the terms of trade and other key factors were accurate, Mr. Casey commented. Reducing the fiscal deficit from more than 15 per cent of GDP in 1980 to about 6 per cent in 1983 would depend to a large extent on the profits of the Agricultural Price Stabilization Fund, which had been erratic in the past. For instance, in 1977 the profits had accounted for more than 40 per cent of total government revenue, while in 1981 they were expected to amount to about 9 per cent. The authorities were to be commended for having already taken steps to widen the tax base and to become more selective than hitherto on the expenditure side. In addition, the reform of the public enterprises had been started and public sector salary adjustments were being moderated, although there were recent press reports of industrial action in the public sector with a view to increasing wages.

Commenting on the balance of payments, Mr. Casey said that the objective of reducing the current account deficit from almost 15 per cent of GDP in 1980 to about 8 per cent in 1983 was commendable. To that end, the reduction of oil imports as domestic oil came on stream would clearly help, but perhaps even more important was the planned growth of more highly processed exports. The diversification of output in general and of exports in particular was vital, and the fact that Ivory Coast was likely to become an oil exporter did not lessen the need for diversification. In that connection, he had been somewhat surprised to read that "other manufactured exports" were expected to fall to 7.9 per cent of total exports in 1983. He had also been surprised to see that salary remittances abroad in the recent past had tended to be rather high. What accounted for that development? In addition, were there any signs that the authorities planned to relax import restrictions in the near future?

It was rather difficult to judge what had been happening in the recent past on the supply side, Mr. Casey commented. He hoped that the emphasis on quick-yielding projects would enable growth to recover even while the budget deficit was being reduced. Apparently the assumption was that the planned change in the composition of investment would encourage growth even if investment in toto were to fall off in 1981. Finally, what steps did the authorities plan to take if the present assumptions about future developments, particularly with respect to the price of coffee

and cocoa, did not materialize? For instance, if the world price of coffee and cocoa fell, and the fiscal deficit began to widen, would the authorities adopt additional deflationary measures, something that would indeed be difficult?

Mr. Ainley said that he supported the proposed decisions. The performance under the 1980 Trust Fund program had been disappointing, and substantial adjustment was now required. The staff had emphasized the need to prevent a financial crisis in the short term, restore the growth potential in the medium term, and create conditions for maximizing oil benefits in the longer run. The program under discussion constituted a courageous start, and the clear delineation of the adjustment path in the medium term, as summarized in Table 2 of EBS/81/34, was particularly welcome. That the performance criteria for domestic credit had been set for the year to end-December 1981 was appropriate. The budget measures were far-reaching, and the contingency plans were sensible, although it would be useful to know more about what the authorities planned to do if, say, the terms of trade deteriorated.

As the letter of intent clearly showed, Mr. Ainley continued, political will was the essential precondition for the success of the Government's new program. In that context, the authorities' recognition of the problems facing the economy and their willingness to keep in close touch with the Fund and to provide the necessary data during the life of the new program were very encouraging.

The first priority in the short run, Mr. Ainley went on, was to restore financial discipline and to implement the necessary reorganization of the financial sector. Adherence to the 1981 financial targets would require firm control by the authorities, and the new Committee on Financial Coordination and Investment Control would have to play its role effectively. The efforts to improve the education sector were commendable, but they would probably take some time to show results. He wondered whether there was not some scope for immediate economies in that field in order to help to reduce current expenditure in 1981. On the investment side, there seemed little choice but to concentrate on quick-yielding projects with a high rate of return. Was there any room for lengthening the completion schedules for nonessential construction projects, thereby reducing the immediate disbursement of investment funds? He realized that such a course of action could be costly in some cases. World Bank advice in setting investment priorities in Ivory Coast would be essential to the success of the Government's new efforts.

On the monetary side, Mr. Ainley said, the staff had correctly stressed the importance of ensuring an adequate flow of credit to the private sector. That approach seemed to be the best way to encourage short-term productive investment. In that connection, the proposed reduction in public sector arrears was welcome. The criteria for domestic credit should not be met at the expense of slowing the reduction in arrears. Presumably the existence of data problems had kept the staff from suggesting that a reduction of the arrears should be made a

performance criterion. In any event, the arrears would have to be closely observed. Finally, he strongly endorsed the staff comments on the Government's import controls, which should be closely monitored; the authorities' intentions certainly went in the right direction, but any easing of the quantitative restrictions and tariff barriers would probably be a complicated and time-consuming process.

Mr. Polak considered that it was useful to view Ivory Coast in a longer perspective; in that context, it was clear that Ivory Coast's overall performance had been very good, and that it had maintained a high rate of economic growth. The present per capita income was nearly SDR 1,000. On previous occasions he had noted that, compared with other cocoa exporting countries in the region, Ivory Coast had shown how important a role policy played in the achievement of development objectives; the country's liberal policies, incentives for producers, and essentially open economy had played a key role in its development.

The success of Ivory Coast had been marred in recent years by unsound financial policies, Mr. Polak remarked; as a result, Ivory Coast was now experiencing serious distortions in the private and government sectors. He was pleased that the authorities wished to improve their performance, that major policy adjustments had been made, and that others were planned. He would see it as a sign of successful performance if Ivory Coast did not have to use all the quarterly tranches that had been provided for in the proposed extended arrangement.

A Deputy Director of the African Department commented that it was true that the size of the oil reserves had not yet been assessed. The oil companies conducting the exploration were naturally cautious about the data that they released. A recently returned mission of World Bank energy experts had said that they felt that the Fund assumptions were cautious and not unduly optimistic.

The price of coffee and cocoa in the near future was difficult to predict, the Deputy Director continued. In recent months the difficulty had been increased by changes in the exchange rate between the CFA franc and the U.S. dollar. However, the staff had emphasized that the authorities were aware that the price could be lower than they had forecast. The authorities had adopted a number of additional measures. For instance, they had circulated a list of investment projects whose implementation was to be delayed until the authorities reviewed the country's financial position with a staff mission in June 1981; and they were examining contingency measures but did not wish to publicize them in order to avoid encouraging speculation. In sum, the authorities were aware that they might have to take further steps, and they were prepared to do so if the need actually arose, particularly as a result of unfavorable prices for coffee and cocoa.

The spirit of the reform of the public enterprises, the Deputy Director remarked, was that certain activities should be undertaken by the private sector rather than by the public sector. Some of the assets

of public enterprises had been turned over to the private sector. Certain other public enterprises had been brought under closer control of the Government.

Ivory Coast could not unilaterally take any measure it wished concerning the exchange rate, which was fixed within the West African Monetary Union, the Deputy Director said. Accordingly, other measures were mentioned in the new financial program, some of which had to do with controlling imports. However, Ivory Coast had maintained one of the most liberal trade policies in the region. Some of Ivory Coast's industries--notably textiles--were not competitive in world markets and had experienced great difficulties. The question of import quotas and duties was a delicate one, and the staff had not been in a position to recommend specific measures. The World Bank staff was studying the import sector in depth, but it did not expect to make specific recommendations for some time. The newly created Ministry of Industry and Planning would have to consider what measures should be taken in the coming period.

The data on the increase in consumption and decline in investment as a share of GDP had to be approached carefully, the Deputy Director explained. The decline in real investment had been due in part to the deterioration in the terms of trade. In any event, an increase in investment and a decline in consumption were not necessarily favorable developments in all cases. Much depended upon the precise composition of investment. In the case of Ivory Coast, some of the investments had not contributed to future growth and had had fairly high recurrent costs. The World Bank was helping the authorities to assess the pattern of investment on a project-by-project basis with a view to eliminating projects that were meant merely to bolster the country's prestige and would not contribute much to future growth but would be quite costly in terms of recurrent charges. However, delaying projects that had been started could be costly; in the long run, the net cost of a delay could be greater than the cost of completing the project on schedule. Accordingly, the composition of the investment budget had not been dramatically changed in 1981 compared with 1980.

There had apparently been some strikes in response to the recently adopted measures in the field of public sector wages and salaries, the Deputy Director remarked. A commission had been established to deal with specific cases and to avoid inequities in the implementation of the new policies. The latest information suggested that a general increase in salaries had not been proposed.

The question had been raised, the Deputy Director recalled, why Ivory Coast wished to have an extended arrangement rather than a stand-by arrangement, and there was apparently some feeling that the fluctuations in certain important economic variables, such as the world prices for coffee and cocoa, had been random in nature. In the staff view, the fluctuations in the world prices for coffee and cocoa had been cyclical, and the magnitude of the present financial imbalances in Ivory Coast clearly showed that balance could not be restored within one or even two

years. Hence, a three-year arrangement seemed to be fully warranted. The financial imbalances had been caused by structural problems, and in recognition of that fact the World Bank was considering making a structural adjustment loan. In the field of education, for instance, the needed adjustments would certainly take more than three years to make.

The measures that the Government had adopted were courageous, the Deputy Director considered, and the staff felt that there was a will in the country to make the needed structural adjustments. Thus far, the Government had scrupulously respected the agreed time schedule for adopting measures.

Commenting on the selection of the performance criteria for Ivory Coast, the Deputy Director said that the volume of domestic arrears was difficult to measure. Much depended upon the particular definition that was used. The staff had asked the authorities to define the various types of domestic arrears, and the new Committee on Financial Coordination and Investment Control was to elaborate on the definition, make a systematic survey of the volume of arrears, and encourage their gradual reduction. At the present stage, it was impossible to use domestic arrears as a performance criterion. If progress in reducing the arrears was not made in 1981, the staff would certainly consider whether further measures in the area should not be taken. Similarly, there was a lack of sufficient fiscal data to enable fiscal developments to be included among the performance criteria. It was difficult to follow developments with respect to the budget deficit on a monthly basis. Accordingly, the performance criteria for Ivory Coast had been concentrated on money and foreign borrowing. In that connection, the staff and the authorities had discussed at length the ceiling on domestic credit and the possible effect of the need to adjust the ceiling for crop credits. The Central Bank of West African States normally did not have a ceiling on crop credits, and the staff had insisted that such credits should be included under the overall credit ceilings. However, the staff recognized that, if there were unusual conditions with respect to the volume of crops, the authorities could eventually request that an adjustment be made. The adjustment would not be automatic; a staff mission would have to visit Ivory Coast, and a staff paper on the matter would have to be presented to the Executive Board.

Commenting on the figures in Table 5 of EBS/81/34, the Deputy Director noted that they represented percentage changes in the composition of commodity exports. Accordingly, as the figure for one item increased rapidly--as was the case with exports of petroleum products--the figures for the other items naturally declined. Other manufactured products and processed products had increased their share in comparison with unprocessed products. The table underscored that Ivory Coast's comparative advantage was primarily in the processing of agricultural raw materials. Until Ivory Coast became an oil exporter, coffee and cocoa exports would continue to be very important for the country.

The remittances of salaries abroad had been fairly large because Ivory Coast had a relatively liberal policy on the capital and labor markets, the Deputy Director of the African Department explained. The remittances were attributable to Africans from neighboring countries who worked in Ivory Coast and to the so-called expatriates who played an important role in the economy's modern sector. Exceptional factors helped to explain the fairly large increase in remittances during 1980. More flexible interest rates and the development of the money market in Ivory Coast would probably constitute significant financial incentives to reduce the level of remittances in the future. As a member of a monetary union, Ivory Coast could not take steps in those areas unilaterally. The authorities had said, however, that they were examining the possibilities as expeditiously as possible.

Mr. Nana-Sinkam remarked that in the past there had been some problem in identifying appropriate investments in Ivory Coast. In 1980, when the financial situation had become difficult, the authorities had decided to eliminate some of the public enterprises and to make a greater effort to ensure that sound policies governing the investments and other operations of the enterprises were maintained. However, it was difficult for many African countries to shift all public enterprise activities to the private sector. Many of the enterprises were engaged in crucial operations and the Government was a major employer in the country. In the circumstances, the most appropriate course of action was to ensure that the enterprises were managed on a sound financial basis and were subject to effective control.

He agreed with the staff, Mr. Nana-Sinkam said, that the figures on oil reserves in Ivory Coast were not overoptimistic. The sources of the data on oil reserves and exploration were usually fairly conservative.

The authorities had decided, Mr. Nana-Sinkam commented, to introduce greater flexibility in the interest rate field. Interest rates in Ivory Coast were to be based on the average of interest rates abroad, mainly in France, but including rates in the United States and in other African countries. The authorities wished to be able to move interest rates whenever developments in the international markets warranted it.

The projections in the reports on the terms of trade were based on the staff's work in the commodity price field, Mr. Nana-sinkam commented, and he strongly hoped that they would prove to be accurate. There would be time to take the necessary measures if price developments were not as favorable as the staff and the authorities now expected.

Commenting on the declining trend in investment, Mr. Nana-Sinkam said that in the past the authorities had concentrated on infrastructure investment and on some projects that had not been directly productive. The authorities had recently decided to emphasize more productive investments. Accordingly, although the level of investment had been declining, the efficiency of investments had been increasing.

He did not agree with the view that Ivory Coast's exchange rate policy was completely inflexible, Mr. Nana-Sinkam stated. The countries in the West African Monetary Union had fixed their currencies to the French franc; accordingly, the exchange rates for the currencies involved were moving in line with the movement of the French franc rate in the market. Therefore, the exchange rate for those currencies concerned was flexible, and the authorities concerned could be said to be applying an active exchange rate policy. It was true that an individual country in the West African Monetary Union could not unilaterally move its exchange rate in the market to correct an imbalance in the country concerned. However, the country could achieve essentially the same result by adopting the appropriate fiscal measures.

The Government had come to realize, particularly after the experience under the one-year stand-by arrangement during 1980, Mr. Nana-Sinkam commented, that fundamental changes had to be made in the structure of the economy. Accordingly, Ivory Coast would benefit from a medium-term program under the extended Fund facility, rather than a short-term stand-by arrangement.

The Fund, Mr. Nana-Sinkam commented, usually did not include fiscal measures among performance criteria. Such a criterion would be difficult in a country that derived a major proportion of government revenue from customs duties. And a decline in imports could create a major shortfall in revenue; such an outcome was likely in many African countries whose borders were completely open, so that many imports could enter the country uncontrolled.

The authorities had certainly given thought to measures that would be appropriate if developments--such as the prices of coffee and cocoa--were not as favorable as expected, Mr. Nana-Sinkam remarked, and they had a number of policy options available to them. They would, however, not take any action in the expenditure field before the June 1981 review with the staff. The new flexibility of interest rates and the development of the money market in Ivory Coast had encouraged wage earners to keep their earnings in the country rather than transfer them abroad. In addition, the pressure on salary remittances abroad had eased in the wake of the mechanization of agriculture and the development of the industrial sector in Ivory Coast, which had lessened the need for imported labor.

The Chairman commented that part of the resources to be made available to the Ivory coast would come from the supplementary financing facility.

The Chairman made the following summing up:

My understanding is that the Executive Directors have generally agreed with the thrust of the views expressed in the staff appraisal of the report for the 1980 Article IV consultation with Ivory Coast. Directors noted that, although the growth of the real economy remained satisfactory in 1980, the financial imbalances widened considerably

as a result of excessive public spending and foreign borrowing in the context of a sharp deterioration in the terms of trade. This situation called for immediate and strong measures which the authorities are taking in the framework of a medium-term program.

They welcomed the authorities' determination to regain control of public finances, to restore the financial viability of public enterprises, to adjust public investments to more realistic levels, and to select carefully quick-yielding productive projects. Directors emphasized the importance of achieving a better balance between national savings and investments. In this connection, they welcomed the recent adjustment in interest rates and noted the importance of the authorities' decision to adopt a more flexible interest rate policy and to widen financial markets. They also noted that, with the development of the oil sector, the longer-term outlook for Ivory Coast's economy remains promising, provided necessary structural adjustments are implemented at an early stage. It is only with such adjustments that the problems which arose from the surge in cocoa and coffee receipts could be avoided when earnings from oil become substantial.

Finally, Directors stressed the important benefit to the Ivory Coast economy of continuing to follow liberal import and exchange policies and urged the authorities, when possible, to reduce the import restrictions that were recently introduced.

The Executive Board then took the following decisions:

Decision Concluding 1980 Article XIV Consultation

1. The Fund takes this decision in concluding the 1980 Article XIV consultation with Ivory Coast, in light of the 1980 Article IV consultation with Ivory Coast conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Ivory Coast continues to maintain an exchange rate system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 6758-(81/29), adopted
February 27, 1981

Extended Arrangement, and Purchase Transaction - First Credit Tranche

1. The Government of Ivory Coast has requested a purchase of SDR 28.5 million equivalent to its available first credit tranche.

2. The Government of Ivory Coast has also requested an extended arrangement for the period from February 27, 1981 to February 22, 1984 for an amount equivalent to SDR 484.5 million.

3. The Fund approves the purchase in the first credit tranche and the extended arrangement set forth in EBS/81/34.

4. The Fund waives the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement.

Decision No. 6759-(81/29), adopted
February 27, 1981

2. QUOTA CALCULATIONS - ECONOMIC CRITERIA

The Executive Directors considered a staff paper on the economic criteria entering quota calculations (SM/81/44, 2/13/81; Cor. 1, 2/24/81; and Sup. 1, 2/24/81).

Mr. Polak made the following statement:

We are embarking on a very long process of discussion, not just of the paper before us but of many papers still to come. I will on that account make a number of observations which, to some extent, stretch somewhat beyond this paper.

I am grateful to the staff for giving this material on which to begin work. I will be asking for additional material later on.

As I mentioned when we discussed the planning of this subject, there is a certain lack of realism in a discussion of economic criteria entering into quota calculations without at the same time discussing quota formulas and quotas themselves. One does not get very far in an a priori discussion of what are interesting variables to put in a quota formula unless one knows how important these variables are in determining calculated quotas; or without knowing how important calculated quotas are in determining the actual quotas that members will have in the end. Unless we want to waste a great deal of time on this paper, we must at every step ask ourselves: What does this really mean for actual quotas?

On some occasions, the answer to that question is exceedingly simple. For example, one section in this paper argues very convincingly for putting reserves in the quota formula as one of the elements that determine the ability of a country to contribute resources to the Fund. But Table 1 in SM/81/44, Supplement 1, shows that the oil producers' reserves do not enter into their quota formulas at all. This is an easy case, but in the great majority of cases judging the importance of a particular variable is very difficult; almost every conclusion that suggests itself

at first sight proves to be wrong on further analysis. We have succeeded in making the quota calculations so complicated that unless one runs a particular proposition through the computer, it would be very difficult to know whether it is true or not; we should, therefore, not spend too much time on any particular proposition before we test its effects.

This forces me to make some observations on formulas and quotas; I shall have to come back to these aspects at a later stage of my intervention.

One of the things that has to be borne in mind continuously in this exercise (and, although everybody knows it, it is continuously forgotten) is the enormous difference between the result of quota formulas and actual quotas. The ratios between calculated and actual quotas are very far apart. Unfortunately, we do not have at our disposal the most useful material with which to verify that proposition because the calculations available on calculated quotas for the Seventh General Review do not add up to the sum total of the actual quotas in the Fund. Present quotas are a little below SDR 60 billion. All the quota calculations made for the Seventh Review totaled about SDR 100 billion. That material was perhaps useful at the time in the staff's effort to persuade the Board (or the members) to make very large quota adjustments. However, the actual quota adjustment was only 50 per cent, from about SDR 40 billion to about SDR 60 billion. What we need now is a table--and I would ask the staff to circulate such a table--comparing actual Seventh Review quotas with calculated quotas adding up to the same total of actual quotas. I suggest that that calculation be made (as some other tables have been) in ascending or descending order of ratios.

On the basis of that table, we will see that for something like half the countries, actual quotas are much larger than calculated quotas. Since in all past reviews no quota has been reduced and all (or almost all) quotas have been increased by a minimum percentage, this means that for about half the members, the calculated quotas really have no importance. We do not have to worry particularly if by some slight change in formulas, or in the measurement of trade, for example, calculated quotas for these countries were to become 10, 15, or even 50 per cent smaller, because it would not have any effect on what happens to actual quotas.

All of this is by way of introducing the suggestion that perhaps we might not want to go too deeply into any of the technical details of the elements of the quota calculations before we check whether the various factors are important to actual quotas or not.

After this, I will want to make some comments on individual sections of SM/81/44, mainly on the third section concerning individual items, and on a section that is not there but for which the Appendix can serve as a substitute.

Section I, "Some General Considerations," provides a very important backdrop to these discussions, but to my mind it is not sufficiently developed. The obvious point is made that the quota serves four purposes: to determine the use that a country can make of the Fund; to determine the contribution it may have to make; to determine its voting power; and to determine SDR allocations.

But it is important to note the qualifications to these purposes that have crept into the Fund during its history and have made the first and second of these propositions only partially true by now.

As regards the use that members can make of the Fund, we have not only greatly increased the percentages in terms of quota; we have also made available other resources, which, while they are themselves determined by quota amounts, do not apply to members across the board.

In particular, we introduced in 1963 (and have made increasingly important since then) provisions for members that are subject to wide fluctuations in export proceeds--the compensatory financing facility. During the past few years, we have also made special provisions for members with low per capita incomes by selling part of the Fund's gold and setting the profits apart in a separate, and by now revolving, account that is used for Trust Fund loans. In these ways, the needs of members with widely fluctuating exports and the needs of members with low per capita incomes have been taken care of to some extent outside the quota formula.

As regards the contribution to resources, it has been recognized ever since the General Arrangements to Borrow were negotiated some 20 years ago that quotas cannot fully perform that function. Quotas cannot fully represent the amounts of resources to be made available by members, so that lending has to be an important element of the resources provided by members in strong positions. The current very large reliance on lending will not continue, I hope. But we do not have to stretch quotas or make them fully attuned to the amounts of resources that members can make available.

I have no particular comments on Section II ("Variables Used in Quota Calculations"). I turn, therefore, to Section III, dealing with individual variables in the quota calculations.

National income was inserted into the quota formula to make it possible to achieve a desired distribution of quotas among the most important original members of the Fund by means of a quota calculation. The Keynes Plan provided for quotas based on trade. Such an arrangement would never have given the United States the relative quota everybody agreed it should have. That was basically why national income entered into the quota formula.

Since that time, some new formulas have been developed for calculating quotas about which it is said--in the middle of page 9--that they include national income "with considerably reduced weight." A cursory look at the quota formulas in the Appendix might make this seem plausible because in the Bretton Woods formula the figure before national income (Y) is 0.01, and in the various other formulas the number is smaller. However, the statement referred to is, in general, wrong because the weight for national income in the Bretton Woods formula is not 0.01. This weight depends, for each country, on the multiplying factor at the end of the formula. As pointed out in an earlier staff paper, 1/ for a country with a ratio of exports to income that is quite high, the weight for national income can become negative. The fact that the Bretton Woods formula is essentially a quadratic function in Y also invalidates the calculations made in the supplement on the weight that national income plays in the quota calculations for industrial countries, listed there at 47 per cent. That figure is not so much wrong as unascertainable. Incidentally, the very low weight for exports in these formulas is wrong because of the arbitrary treatment of the non-linear equations.

I have no comments on the staff's interesting discussion on how precisely national income should be defined. I agree with its suggestion that one might move to GDP, and with their suggestions for conversion into U.S. dollars. My reason for agreement is not that I am convinced that these are necessarily the best ways of measuring, but because one must have one way of doing this, and the effect of the possible choices on the end result is unlikely to be all that great.

On reserves, I have no further comment to make.

On the data for international transactions, I think the staff is taking a definite step forward by suggesting that we no longer have any reason to limit international transactions data to trade only, even as an option, and that we should simply abolish formulas based on international trade and move to formulas based on trade plus invisibles. The tables in the text show that this does not make much difference anyway.

When one comes to the question of exports versus imports (or current receipts versus current payments), the particular oddity of the Bretton Woods formula in which imports enter directly and exports via a multiplier should be seen as just that, an oddity. Some people wanted the openness of the economy to be reflected in the formula, and for that reason there is X/Y , and some people wanted imports, and that is why there is M . Should one include

1/ RD-954, "National Income in the Quota Formula" (December 23, 1949).

imports and exports? Well, exports are already there. That, I think, is the basis genesis of this rather curious combination of imports and exports in the Bretton Woods formula.

I wonder whether the time has not come to abolish the Bretton Woods formula and to move to simpler formulas of a linear character. I will have something more to say about simplification of formulas later on.

There is an interesting discussion in the staff paper as to whether one should include exports and imports, or the larger of the two, and/or the difference between the two. The argument is made that the larger of the two would yield higher quotas. This, of course, cannot be true in general. Choosing the larger of the two would yield a higher quota for those countries where the larger of the two is proportionately greater than the smaller of the two, but not for the countries where the ratio is relatively small. For most countries, imports and exports are of the same general order of importance. Quite a number of countries have more or less persistent current account deficits. A smaller number of countries have more or less persistent current account surpluses. If these differences were the same in percentages, it would not make any difference whether one moved to the higher of the two for all countries. Somewhat larger numbers would have to be put into the formula, and, to achieve a Fund of a given size, a somewhat greater reduction would then have to be applied to all calculated quotas. There seems to be a case for moving to "the higher of the two" on principle, because in that way one would catch capital transactions as well. But principles that have no practical effect are useless in this exercise. When this issue was first discussed a long time ago, it turned out that "the higher of the two" made very little difference except for a few unusual cases, such as that of Viet Nam, a country with very large imports, all paid for by aid, and virtually no exports.

My recommendation on this aspect would therefore be to stay with what we have in the modified formulas: exports and imports with the same weight. Once this choice has been made, I can see no possible argument for inserting the absolute value of the current account balance as a separate variable. To add the difference between exports and imports to the sum of exports and imports produces twice imports or twice exports, i.e., one is back at "the higher of the two."

I now come to variability. This variable does not measure, as all other components do more or less, the economic importance of a country; but it was introduced to help a country with particularly variable exports to take care of what we now call "export shortfalls."

In the original Bretton Woods formula, which related, after all, to data for the 1930s, these were measured (not so badly at the time) as the difference between the highest and lowest exports over the period from 1934 to 1938. That measurement became unsuitable in the

1950s when the difference between high and low exports during any five-year period was predominantly a measure of trends rather than variability, or at least a measure of trends as well as variability.

The square of deviations from trends was therefore introduced in the Bretton Woods formula, as well as in the other formulas, as a measure of variability. That was a perfectly good measure for identifying the countries with problems of, say, fluctuating copper or cocoa prices during the 1950s and the 1960s. The data given to us by the staff (which were already available for the Seventh Review) now show that this particular measure has become quite unsuitable for measuring variability in the light of recent developments. It produces very large variability figures for all exporters, because the export values of these countries have gone up by steps as oil prices have increased. If one fits a trend to the exports of these countries, there are very large deviations on the negative side in, say, 1972 and 1973, and then again very large positive deviations in 1974 and 1975, when export prices were very much higher. The figures presented by the staff show that it is this aspect that has come to dominate the measure of variability. The staff makes some valiant attempts to adjust for this distortion. But they do not succeed with the adjustments they consider; and then they give up, concluding that the Fund should continue to use the current measure of variability.

I think more effort is needed to see if we cannot succeed now--as we did 20 years ago--in finding a variable that is appropriate to what variability was intended to measure. I have two suggestions for doing so.

One would be to measure variability on the basis of precisely the concept we use in compensatory financing: the sum of shortfalls as defined under the compensatory financing facility. Even that formula may still produce excessively large figures for the oil countries. In that case, I would suggest taking the smaller of either the shortfall in a particular year as a deviation from the five-year trend or the negative discrepancy of exports in that year below the average of the two preceding years. I would like the staff to work out examples with both of these measures.

A third possibility would be to drop the variability factor on the grounds that, as used, it distorts quotas and that the problem of variability has been taken care of, to a considerable extent, in the compensatory financing facility.

I should add that I am not impressed by the staff argument that, for some oil countries, the variable that was intended to perform as a measurement of need for resources now turns up on the other side as a yardstick of ability to contribute resources to the Fund. Such a measure could only be used, in any event, for those oil exporters that are low absorbers, whereas the impact on quotas occurs for all oil exporters.

With respect to population or per capita income, I think population, as a noneconomic variable, is not appealing as an element in a quota formula; but the staff suggests that in a sense it might be regarded as a kind of dummy variable that could perform as a poverty index. I do not see why we need a poverty index in the quota formula, and more so since the Fund has adjusted its quota-based policies by other measures to assist low per capita income countries. I already mentioned the Trust Fund. The Subsidy Account is also intended to assist low-income countries. Some Directors have also made the suggestion that per capita income could possibly play a role in the allocation of SDRs.

After these comments on the individual components of the quota formula, I would like to say a few words on the quota calculation formulas and the calculated quotas, briefly described in the Appendix.

If one takes the staff's suggestion of dropping half the calculated quotas and limits oneself to Set II equations, the current practice can be described as (a) averaging the lowest two of the last four equations and (b) taking the higher of these averages and the amended Bretton Woods calculation. One will see from the numbering of these equations (III, IV, M4, and M7) that they are just samples picked out of a much greater universe of other alternative calculations that the staff has made at various times.

I would suggest that this might be the occasion to take a giant step forward in simplifying the formulas. One of the difficulties with having a large number of formulas is that so doing suggests that different countries have different formulas. But that is of course not true. There is one single formula hidden somewhere in the computer which, in the end, given a certain quota total, produces the quota for each individual country. If, say, national income for that country happens not to be in "its formula," that does not mean that national income does not play a role. Other countries' national incomes have their effect on the figure for that country.

I think it would be helpful if we could try to do away with the illusion of a multiple formula by attempting to do, on a much less ambitious scale, what we tried to do in 1973. At that time, we tried to explain the existing quotas by some simple formula in terms of a few variables, ^{1/} and we did not succeed very well. What I would now suggest is that we try to explain the existing calculated quotas, calculated by the whole complex procedure that we now use, in terms of a single formula, which would contain three or four variables: national income, exports plus imports, reserves, and a new variability index, once we have agreed upon one, or no measure for variability if we agree to do without one.

^{1/} SM/73/275, "Statistical formulas Explaining Present Fund Quotas" (December 10, 1973).

I do not see why arguments to the effect that national income is very important for the United States and something else is very important for developing countries and so on should stand in the way of preparing a single formula that came sufficiently close to the calculated quotas of the great majority of members, especially as we must always bear in mind that the calculated quotas of about half the members do not determine their quotas in any event.

It would be a great simplification if we could move that way and, after 35 years, end up again with a single quota formula.

The Deputy Treasurer commented that the staff had conducted considerable testing, but to report the results was not the aim of the paper under discussion. The intention was to survey the procedures used in computing quotas and in particular to improve the basic data used in the computations. That intention seemed worth considering on its own merits, and the work would be the first step in the quota exercise. For instance, national income was clearly no longer as satisfactory a measure as GDP, the measurement of reserves could well be expanded, the current account was a better measure than the trade account, and the variability variable was defective. Other variables could be considered. Such changes should be regarded as evolutionary in nature; they would not necessarily have a fundamental effect on the nature of the formulas to be used in calculating quotas, but it was important that the new calculations should not depart too radically from previous ones. The improvement in data used in the calculations was one step; rationalizing the quota formulas was another. But it was a separate step, which the staff thought could better follow the examination of the data.

The staff could have reported the effect of each possible change on individual quotas, the Deputy Treasurer explained, but it seemed best to receive the Executive Board's advice and approval concerning the areas on which the staff might concentrate before the particular effects on one country or another were demonstrated. For instance, the testing by the staff had shown that using GDP rather than national income would shift the formulas in a particular direction. The staff had assumed that the executive Board would not wish to decide to use GDP merely because it shifted quotas in a certain way. The decision whether or not to use GDP rather than national income should be based on the merits of the proposal.

He agreed with Mr. Polak, the Deputy Treasurer continued, that the present form of the Bretton Woods formula should be dropped, and that the formula should be linear in nature, if a suitable substitute could be found. It was, however, important to agree on what variables should be included. The staff fully shared Mr. Polak's wish to have a single quota formula, rather than the present set of 34, and the staff had done a great deal of testing based on that approach, but that was not the topic of the present paper. The staff had tested a single formula with the particular variables favored by Mr. Polak--except that in its testing the staff had maintained the old variability concept--but the results had not been

favorable so far: the average deviation from actual quotas with a single formula was still more than 30 per cent. It seemed impossible to use a single formula without dramatically changing the relationships of the quotas calculated in previous reviews, and it would not necessarily be beneficial to break too sharply with the past. The suggestions in the present paper, if agreed, would, however, be significant improvements. In sum, the staff had attempted to keep its paper on economic criteria neutral, in line with the Executive Directors' original request made in 1977 for the study. The staff had produced a table on calculated and present quotas, although that table had been expressed in terms of ratios, rather than in absolute terms anchored to a given total; the table could be reissued in absolute amounts rather than in ratios.

As to the variability factor, the staff had not given up trying to improve the variable, the Deputy Treasurer said. The staff had again undertaken considerable testing and had concluded that, if any action was to be taken, it might be best to consider using a three-year averaging period rather than a five-year averaging period, but other approaches would be examined. The testing by the staff had shown the effect of quotas under the Seventh General Review of using a three-year averaging period: the calculated quotas of oil exporting countries would be lowered by 12.8 per cent, those of the non-oil developing countries by 5 per cent, and those of industrial countries by 3.5 per cent. Again, it seemed premature to discuss those preliminary results before the Executive Board had agreed with the staff's suggestions on the type of criteria to be included in the quota calculations. There were a number of important policy conclusions in Mr. Polak's statement that might be left for later consideration.

Mr. Price considered that the presentation of the figures on variability would be more useful if the sum of the calculated quotas was held constant to avoid the apparent anomaly of reducing all members' calculated quotas as a result of changing the averaging period to three years.

Responding to a question by Mr. Zhang, the Deputy Treasurer explained that, as part of its testing, the staff had substituted GDP for national income in recalculating the quotas under the Seventh General Review. The substitution had given a slight tilt in favor of the quotas of the industrial countries.

Mr. Polak considered that it was not realistic to expect Executive Directors to make decisions on quota calculations without being aware of the consequences for the quotas of individual countries.

Mr. Price said that he agreed with Mr. Polak. At the same time, the Executive board should certainly not base its decisions on the effects of particular calculations on specific groups of countries. The Fund was an institution of 141 individual member countries and not three groups of countries.

Mr. Al-Eyd inquired whether it would be useful to substitute GDP for national income in the quota calculations.

The Deputy Treasurer responded that the GNP measurement had been falling rapidly into disfavor, and the number of countries publishing GNP figures had been declining. One of the reasons the staff wished to move away from national income was that it had been having to do an increasing amount of estimation of the figures. Much less estimation would be necessary if GDP was used instead of national income. Finally, the staff would have no difficulty in presenting the results of calculations for each of the Fund's members. The staff had provided data in groups merely for the sake of convenience. All of its computer runs had been for individual countries.

Mr. Narasimham said that the present discussion was the first of what would probably be a large number on the subject of quota calculations in connection with the Eighth General Review. The factors given weight in the calculations should be broader based than the term "economic criteria" seemed to suggest. Economic criteria should be the dominant criteria in an international financial institution, but certain noneconomic factors should be taken into account, such as the way the Fund was set up at Bretton Woods, the manner in which it had evolved over time, the need for balanced representation on the Executive Board, and the objective of increasing the voice of developing countries in the Fund's decision-making process. There was some danger that excessive reliance on economic criteria might cause quotas to be determined merely by a kind of means test, ignoring the factors that were fundamental to continued international cooperation.

Commenting on the issues raised in the staff papers, Mr. Narasimham said that the staff had noted that quotas were supposed to be the basis on which contributions to Fund resources, voting power, SDR allocations, and access to Fund resources were determined. As the staff had noted, the need to achieve a reasonable balance in the distribution of quotas entailed certain tradeoffs. The quota formulas should be devised in such a way that the recognition of the importance of particular variables for some members did not disadvantage other members. The variables used in the quota calculations had for the most part remained unchanged since the early years of the Fund; accordingly, the present method of calculation was based on economic conditions that had ceased to prevail some time ago. Conditions had changed markedly in the 1960s and 1970s and the variables used in years past were not necessarily still appropriate--certainly not to the extent that they had been. The variables had tended to emphasize the contribution that members could make to the Fund's resources. Accordingly, great weight had been given to reserves and national income, thereby emphasizing the importance of developed countries. In any event, the present method of calculating quotas was complex, and there was a clear need for some simplification. The Group of Twenty-Four had stated in its Outline of Monetary Reform that both the variables and the weights attached to them should be revised. The staff papers under discussion did not deal with the relative weights to be attached to the various variables, and he planned to comment on that matter on another occasion.

Dealing with the variables that should be used in calculating quotas, Mr. Narasimham said that he strongly agreed with the staff suggestion for continuing to use a measure such as national income. Indeed, greater weight than hitherto should be given to that measurement. An international institution naturally tended to give the greatest weight to the external sector, but there was some danger that in assigning small weights to national income the Fund might fail to recognize the strength of a national economy as determined by the size of its national income.

In its discussion on national income comparisons, Mr. Narasimham observed, the staff had raised the issue of the use of nominal exchange rates. He understood the staff argument for using nominal exchange rates and he recognized that nominal exchange rates were important for the adjustment process, but they contributed to an underestimation of the national income of many countries. There were admittedly many practical difficulties in measuring purchasing power parities. If the concept of nominal exchange rates was accepted, the staff should examine the possibility of adopting a compensating factor. The staff had recognized that a number of countries contained an important nonmonetized sector, and he wondered whether an appropriate adjustment recognizing that fact could not be made.

He had no strong view, Mr. Narasimham commented, on whether GDP should be used instead of national income. In the light of the statistical problem in measuring depreciation, he tended to prefer using national income.

Commenting on the proposal for including SDRs in the measure of reserves, Mr. Narasimham noted that the SDR holdings of many countries were determined to a considerable extent by the size of their allocations, which in turn were related to their existing quotas. There would, therefore, inevitably be a degree of circularity in the determination of quotas if SDR holdings were included in a country's reserves, and there would be a bias in favor of the present structure of quotas. The developing countries wished to alter that structure.

As to the suggestion for including borrowed reserves in the measure of overall reserves, Mr. Narasimham said, in several countries borrowed reserves accounted for a significant portion of total reserves. Netting reserves to adjust them for borrowed reserves was often difficult to do, as the requisite data was sometimes unavailable. However, if the objective of quotas was to measure the potential contribution a member could make to the Fund's liquidity, short-term commercial debt should be deducted from a member's reserves.

He agreed with the staff, Mr. Narasimham commented, that the external current account was a more meaningful measure than the merchandise trade account. As for the use of current receipts and payments, he was attracted by the suggestion for using either receipts or payments, whichever was larger, in the quota calculation, as so doing would indicate the ability of the member to contribute to the Fund's resources of the member's need

for Fund assistance. There was some feeling that such an approach would not yield a neutral distribution of quotas among different types of countries, but the deviation from neutrality was probably not so great as to warrant rejecting the approach. The second best solution would be to retain both current receipts and current payments.

He had some misgivings about the staff's suggestion for considering the absolute value of current account balances, Mr. Narasimham commented. Such an approach would penalize a country whose current account was in approximate balance and would favor countries whose current account was not in balance. It could be argued, of course, that countries with an imbalanced current account were most likely to be in a position to contribute to the Fund or to have a need to use the Fund's resources, but he preferred a variable that did not adversely affect countries that had succeeded in keeping their current account in broad balance. In any event, if the current account balance was to be measured over a period of five years, he presumed that the same time period would be used in measuring current receipts or payments.

The staff comments on page 21 clearly showed the limitations of the present method of measuring variability--particularly the variability of exports--and emphasized the extreme influence of a sudden price rise on variability, Mr. Narasimham said. The suggestion to limit the size of the measure of variability in relation to a country's average export earnings was attractive. Under that approach, the variability of prices would be separated from the variability of export volume, and the latter would be assigned a larger weight than the former. The staff's conclusion on page 21 that "on balance, it is felt that the Fund should continue to employ the currently used measure of variability for calculating quotas under the Eighth Review," did not seem to follow logically from the text of the discussion on variability, and the staff should continue studying the matter.

He strongly favored including population, or per capita income, or both among the criteria for making quota calculations, Mr. Narasimham commented. Per capita income might be preferable, as it indicated more definitively than population figures the relative weakness of a domestic economic structure and a member's need for access to the Fund's resources. The idea of having a "poverty index" was useful, especially as the importance of the Fund was particularly great for the poorer countries, which often did not have adequate access to international capital markets; the Fund would remain a major source of external short-term finance for those countries. IDA eligibility was based on both per capita income and what the World Bank called "lack of creditworthiness," meaning the inability to service debt on normal or conventional terms. Section IV, "Summary and Conclusions," referred to the lack of access of poorer countries to alternative sources of finance, although that problem was not mentioned in the main body of the paper. He disagreed with Mr. Polak that the Trust Fund and other sources of Fund finance constituted an adequate substitute for a poverty index. Those sources of financial assistance did not have the same quality, or the same significance for members, as access to Fund resources on the basis of quotas.

The staff had usefully noted, Mr. Narasimham said, that it might be necessary to combine a number of formulas in recognition of the particular economic circumstances in different kinds of member countries. Even if it was feasible to do so, combining the various variables in a single quota formula that was applied uniformly to all members would be undesirable. In the coming period a number of developing countries were likely to face large increases in their energy and food import bills, which would probably exceed their export and current account receipts. Hence, their need for Fund resources would increase, and a way would have to be found to give them larger access to the Fund's resources, in part by adjusting their quotas to take into account the special economic circumstances they faced. Since the Fund had begun to finance structural adjustments, the main determinant of access to resources--quotas--would have to be such that members could receive adequate financing for medium-term balance of payments adjustments and structural changes. The quota formulas should give developing countries a larger share than hitherto in total quotas and create a better political balance than would be possible on the basis of a set of calculated quotas derived from narrowly defined economic criteria.

Mr. Kafka commented that the present discussion was probably the first of a long series in connection with the Eighth General Review of Quotas. None of the staff proposals were immediately and obviously attractive because of their inherent logic. For instance, national income was usually measured at factor cost while GDP was usually measured at market prices, and one included depreciation while the other did not. There was no reason to adopt a measure that would discriminate against countries which had a low proportion of depreciation and which received tax revenues mainly from direct taxes rather than indirect taxes. The quota exercise was not so much an economic one as a political one, and he was not prepared to accept any formula before examining the likely effect of it on each member's quota. The first step in the exercise should consist of a report by the staff on the results of its tests--both completed tests and those that could be carried out on the basis of suggestions made during the discussions. The fact that in the past there had been sizable differences between calculated and actual quotas showed that there were fundamental problems with the present method of calculating quotas. To avoid such an outcome for the Eighth General Review, serious consideration should be given to Mr. de Groote's proposal to agree on an immediate equiproportional increase in quotas in order to enhance the Fund's resources forthwith and, at a later stage, to agree on selective quota increases. In that connection, thought should be given to the possibility of freezing all quotas above a certain ceiling--based on a specified relationship to calculated quotas--and devoting the resources thus saved to increasing quotas that were below the ceiling.

Mr. Laske remarked that the present discussion constituted the first step in the preparation for the Eighth General Review of Quotas. the staff had listed on page 2 of SM/81/44 the four principal functions of Fund quotas, which should be kept in mind throughout the coming review. He attached particular importance to the use of quotas to determine both the contribution of members to Fund resources and members' use of those resources. As Mr. Polak had mentioned, the second function had been

somewhat diluted by decisions permitting members' access to Fund resources to be based in part on factors other than quotas; during the Eighth General Review, the Fund should not move further in that direction. The major criteria for determining quotas under the Eighth General Review should be economic in nature. He would have difficulties if noneconomic factors were to play a greater role than hitherto. The main objective should be to achieve and maintain an acceptable, fair, and reasonable distribution of quotas. Tilting quotas in favor of either users of Fund resources or contributors to those resources could undermine the cooperative nature of the institution. The situation with respect to quota calculations was complex, in part because the four principal functions of quotas were in a sense competitive with one another. It was difficult to construct a set of criteria that would support each of the functions in an equal way. There would have to be a balance among them that was acceptable to the membership as a whole.

His authorities' first, tentative impression, Mr. Laske commented, was that the present set of criteria was not wholly unsatisfactory and might well continue to serve the purpose for which they had been designed. The need to restructure the criteria was not fully self-evident. However, the existing formulas were complicated, and he was certainly willing to consider whether it would not be possible to simplify and reduce the number of formulas. Having a single formula would of course be ideal, but the staff had found that such a solution would probably not be feasible. The Executive Board had made an attempt at simplification in 1971 but had agreed on the present multiformula approach which, for practical reasons, apparently would have to be maintained. On the other hand, he doubted whether there should be a different formula for each group of countries. If there were to be different formulas, they should be designed to take into account particular economic circumstances in members. The Fund should not move in the direction of having a specific formula for each kind of country, thereby creating a number of completely disconnected formulas.

There had not been sufficient time to study in detail the various staff proposals concerning the economic criteria and, as Mr. Polak had shown, a number of factors in addition to those mentioned by the staff would have to be taken into account, Mr. Laske commented. As previous speakers had mentioned, it would be useful to have the results of the tests made by the staff, as Executive Directors could not be expected to take final positions without knowing what the actual effects on quotas would be. At the same time, he strongly agreed with Mr. Price that the quota exercise should be conducted on the basis of the interests of each individual member, rather than of specific groups of members.

He understood the staff's argument that GDP was a more widely used measure than national income and would involve less estimation, Mr. Laske went on. He did not yet have a clear preference for national income or GDP and he looked forward to examining the simulations of quota calculations under the Seventh General Review using GDP instead of national income. He agreed with the staff that reserves should be taken into account in the quota calculations, and that SDR holdings should be counted as reserves.

Commenting on the proposal for using current account transactions in the quota calculations rather than merchandise trade, Mr. Laske said that there seemed to be considerable merit in the idea of eliminating the so-called Set I data, so that only the Set II data would be used. The staff should report on the effect of that approach on calculated quotas. In any event, he wondered why official transfers were not included among current account transactions. On previous occasions, he had noted that in Germany official transfers were an important component of the current account balance.

The most complex economic criterion, Mr. Laske considered, was export variability. Mr. Polak's comments clearly showed that a close look should be taken at it and even that it could perhaps be eliminated as an economic criterion. The present approach favored countries with strong balance of payments positions and would therefore be useful in the context of ensuring sufficient contributions to the resources of the Fund. Finally, he was not strongly attracted by the proposal for including population or per capita income among the criteria entering quota calculations; the criteria should be limited to those that were purely economic in nature.

Mr. Narasimham commented that in his earlier remarks he had meant to say that the Fund should not be oblivious to noneconomic factors. He had not meant to say that such factors should play a greater role in the quota calculation process.

The Chairman remarked that, in a sense, population was an economic criterion, because it was one of the most important factors of production.

Executive Directors agreed to continue their discussion in the afternoon.

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Blöndal, who had completed his period of service on the Executive Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/28 (2/25/81) and EBM/81/29 (2/27/81).

4. BURMA - POSTPONEMENT OF REPURCHASE

Burma has proposed that repurchase of the balance equivalent to SDR 9,976,244 of the purchase equivalent to SDR 10 million completed on February 21, 1978 under the stand-by arrangement of

May 6, 1977 be made in three installments equivalent to SDR 2,000,000, SDR 2,900,000, and SDR 5,076,244 not later than February 15, 1981, June 15, 1982, and February 20, 1983, respectively. The Fund agrees to the proposal of Burma. (EBS/81/41, 2/23/81)

Decision No. 6760-(81/29), adopted
February 26, 1981

5. FINLAND - EXCHANGE SYSTEM

The approval of Finland's exchange restriction granted in Executive Board Decision No. 6410-(80/24), adopted February 15, 1980, is extended until December 31, 1981 or until the date of termination of the exchange restriction, whichever occurs first. (EBD/81/47, 2/20/81)

Decision No. 6761-(81/29), adopted
February 25, 1981

6. GRENADA - 1980 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/49 (2/20/81). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1980 Article IV consultation with Grenada until not later than March 30, 1981.

Decision No. 6762-(81/29), adopted
February 26, 1981

7. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/81/58 (2/25/81) and EBAP/81/60 (2/26/81) is approved.

APPROVED: August 3, 1981

LEO VAN HOUTVEN
Secretary

