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INTERNATIONAL MONETARY FUND

#8

Minutes of Executive Board Meeting 76/169

10:00 a.m., December 29, 1976

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
M. Al-Atrash	M. Finaish
	C. P. Caranicas
S. Y. Cross	
	H. G. Schneider
L. Dini	
	D. Lynch
	N. O. Caldera
F. Hollensen	J. H. Kjaer
A. Kafka	
M. G. Kaul	W. Rasaputram
B. Kharmawan	K. C. Ng
P. Lieftinck	T. de Vries
M. Matsunaga	
W. D. Mung'omba	
S. Nana-Sinkam	
E. Pieske	G. Laske
W. S. Ryrie	P. Kent
D. Simone	
J. H. Wahl	J. Foglizzo
R. J. Whitelaw	

W. L. Hebbard, Secretary
J. A. Kay, Assistant

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Also Present

African Department: J. B. Zulu, Director; C. L. Merwin, Deputy Director; R. J. Bhatia, P. J. Boxall, E. A. Calamitsis, S. E. Cronquist, C. A. François, K. Kwateng, C. D. Pham, M. Russo. Asian Department: A. Abadjis, D. A. Scott. European Department: H. O. Schmitt. Exchange and Trade Relations Department: E. Sturc, Director; D. K. Palmer, Deputy Director; M. Dakolias, P. Engström, H. M. Flickenschild, H. M. Stahl. Fiscal Affairs Department: W. A. Beveridge, Deputy Director; D. T. S. Ballali, R. A. Radford. Legal Department: J. Gold, General Counsel and Director; G. P. Nicoletopoulos, Deputy General Counsel; P. R. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: S. Eken, B. A. Karamali. Research Department: G. I. Brown, L. U. Ecevit, L. M. Goreux, G. Khatchadourian, K. Krishnamurty, R. R. Rhomberg, P. Sukachevin. Secretary's Department: J. W. Lang. Treasurer's Department: W. O. Habermeier, Treasurer; P. Gschwindt de Gyor, D. Williams. Western Hemisphere Department: E. W. Robichek, Deputy Director; A. J. Beith, S. T. Beza, J. Chacko, O. Gronlie. Information Office: J. H. Reid, Director; H. Hartmann. Technical Assistants to Executive Directors: K. A. Al-Eyd, V. Alipui, V. Amiel, S. Arancibia, E. Avillez, D. Berthet, I. K. M. Björk-Klevby, I. M. Cobbold, K. L. Deshpande, B. Goos, T. M. Johansen, A. Karimi, K. W. Kim, H. Kuroda, C. J. Lohmann, G. Meissner, Y. J. M. Mersch, A. G. Morris, A. K. Mullei, C. C. Ozumba, S. K. Panya, S. P. Upasani, A. van Dorssen, A. G. Zoccali.

1. BARBADOS - PURCHASE TRANSACTION - COMPENSATORY FINANCING

The Executive Directors considered the staff's analysis and recommendation with respect to a request from Barbados for a purchase under paragraphs 2, 3, and 4 of the Decision on Compensatory Financing of Export Fluctuations (EBS/76/523, 12/17/76; and Sup. 1, 12/28/76).

Mr. Lynch remarked that the Barbados case was clearly of a kind for which the compensatory financing facility had been designed. The country's economy had been affected substantially by the sharp decline in both prices and exports of sugar. Sugar was the main exportable product of the country, accounting for approximately half of its export receipts. While there had been a balance of payments surplus equivalent to SDR 10 million in 1975, there had been a deficit equivalent to SDR 9 million in 1976, and reserves had dropped to the equivalent of less than seven weeks' imports. There was therefore a definite balance of payments need. The request from Barbados amounted to only 27 per cent of quota. It was supported by a clear-cut staff paper, and he hoped that Executive Directors would endorse the request.

Mr. Dini stated that he agreed with Mr. Lynch that the Barbados request had met the requirements for a purchase under the compensatory financing facility. Barbados appeared to have a balance of payments need and to have suffered from an export shortfall resulting largely from temporary circumstances beyond the member's control. The estimation of the shortfall, made by the staff using a judgmental forecast, seemed reasonable with respect to both the volume and the price of sugar export projections for the two postshortfall years. Once again, the straight application of the shortfall formula yielded rather extravagant results, and the staff was right in paying little attention to them. He had no difficulty with the request, which he warmly supported.

Mr. Cross concurred in the staff conclusion that the Barbados request met the requirements of the compensatory financing facility; he would therefore support the purchase.

Making one observation and posing one question, Mr. Cross noted that the shortfall clearly related to the lower level of sugar prices and that the volume of sugar exports was actually expected to increase. It was encouraging that the overall decline in sugar yields of recent years had been reversed and that the new harvesting techniques and land use policies were expected to restore the former higher levels of production and exports. His question related to the staff comment on page 7 to the effect that the sharp fall in free market prices during September-October 1976 was not reflected in the export receipts during the shortfall period. He wondered whether the implication was that Barbados might qualify for additional compensatory financing in the relatively near future on the

basis of a shortfall year ending in the spring of 1977 or thereabouts. Alternatively, would the combination of higher export volumes and fixed minimum prices for 60 per cent of the sugar crop going to the United Kingdom preclude a further large shortfall that would justify an additional purchase?

Mr. Kent stated that he found the case to be a classic one for which the compensatory financing facility had been designed; he therefore warmly endorsed the proposed decision. He noticed that Barbados' reserves were down to what would normally be regarded as a rather low level, and yet the request represented the first time that Barbados had come to the Fund. He wondered whether Executive Directors might expect Barbados to return for more balance of payments support, perhaps at the time of the Article XIV consultation.

Mr. Kafka gave his full support to the requested purchase, which seemed to meet all the required conditions.

Mr. Whitelaw stated that he too supported the proposed purchase. The figures did, however, tend to show that the shortfall stemmed from the high level of total exports in 1975, which in turn had been brought about by the high level of sugar exports in that year. Pursuing the same line of thought as Mr. Cross, he had calculated that if the staff's estimates for export receipts in 1977-78 were fulfilled, there would be a shortfall in 1977 that could be the subject of another purchase. He was not using the argument to criticize the present application, which was entirely justified.

Mr. Lieftinck stated that, like other Executive Directors, he would support Barbados' request for a purchase under the compensatory financing facility. He agreed with Mr. Dini in his remarks regarding the outcome of the formula calculations. Indeed, he had become less and less happy about the formula and he was glad that the staff was using the judgmental approach to an ever greater extent. He had prepared a note on the deficiencies of the present forecast method, which he would make available to the Executive Directors (see Annex).

The staff representative from the Western Hemisphere Department noted that on page 7 (EBS/76/523) the staff had only been explaining why sugar prices had been high throughout 1976 as a whole, and why they could be expected to fall in the postshortfall years. It was certainly true that Barbados' reserves would fall by the end of 1976, and indeed the figures for December 21, 1976 indicated that the staff projections for the year were quite accurate. The reserves would fall to about the lowest level that the authorities would consider comfortable. They were engaged in preparing a set of policies designed to achieve a better balance of payments

result in 1977. Those policies, together with the support that would flow from the proposed purchase and from other sources, were likely to bring about a balance of payments position in 1977 that would cause the authorities no difficulty. Consequently, when the Executive Directors came to discuss the staff report on the Article XIV consultation, probably in the next two or three weeks, there would be no further request for Fund assistance.

The staff representative from the Research Department explained that the fall in sugar prices on the free market that had occurred toward the end of calendar 1976 had not been fully reflected in the export returns because most of the sugar crop was sold at the beginning of the calendar year. It was for that reason that the staff had forecast a decline in the average export unit value of sugar at some 5 per cent, a figure that would account fully for the projected decline in the proportion of sugar sold on the free market. It was not expected that the proportion sold under the EEC agreement would fetch any lower price.

Speakers had inquired whether Barbados might return to the Fund for a further purchase under the compensatory financing facility, the staff representative recalled, on the ground that the present request was for less than 50 per cent of quota. Mr. Whitelaw had been perfectly correct in commenting that the high export earnings of 1975, followed by the lower earnings in 1976 and the assumptions for 1977 and 1978 would technically give rise to a possible further drawing in less than a year. However, by taking calendar 1976 as the shortfall year, the staff had reduced that possibility.

Mr. Lynch remarked that the Barbadian authorities had shown considerable skill in managing their affairs, and he hoped that any future request for Fund assistance would be as modest as the present one. He was grateful to the Executive Directors who had supported the request.

The Executive Directors turned to the proposed decision, which they approved.

The decision was:

> The Fund has received a request by the Government of Barbados for the purchase of the equivalent of SDR 3.5 million under paragraphs 2, 3, and 4, of the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), adopted December 24, 1975). The Fund agrees to the requested purchase and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement on the repurchase terms set forth in the cable to the Fund reproduced in EBS/76/523, Supplement 1.

Decision No. 5295-(76/169), adopted
December 29, 1976

2. PEOPLE'S REPUBLIC OF THE CONGO - STAND-BY ARRANGEMENT, PURCHASE TRANSACTION - COMPENSATORY FINANCING, AND REQUEST FOR TRUST FUND LOAN

The Executive Directors considered a request from the People's Republic of the Congo for a stand-by arrangement in the first credit tranche equivalent to SDR 4.7 million, together with the staff's analysis and recommendation (EBS/76/530, 12/22/76); the staff's analysis and recommendation with respect to a request expected to be received from the People's Republic of the Congo for a purchase under paragraphs 2, 3, and 4 of the Decision on Compensatory Financing of Export Fluctuations (EBS/76/531, 12/22/76); and a request for a Trust Fund loan by the People's Republic of the Congo, together with the staff's analysis and recommendation (TR/76/24, 12/22/76).

Mr. Nana-Sinkam expressed appreciation to the staff for the speed with which the documents had been prepared for discussion by the Executive Directors. It was the first time that the Congo had requested financial support from the Fund, and the cases were clear cut. He therefore hoped that his colleagues would give their full support to all three.

Mr. Wahl stated that he would support the three requests by the Congo. He was confident that the diversified assistance requested from the Fund would help the country to meet its most urgent needs, thus enabling it to prepare during 1977 medium-term programs that would promote durable growth and equilibrium. It was clear that the Congo's present difficulties had begun in 1975, when petroleum output had fallen short of expectations which had led to the establishment of ambitious plans. The adverse consequences of the shortfall had been accurately described by the staff. The authorities were to be commended for having reassessed their situation fairly promptly; measures implemented under the 1976 budget--for instance, the increase in tax revenue and the restraints on expenditure--gave some assurance that the 1977 targets would be met.

He welcomed the imposition of a ceiling on total budget outlays and on current expenditures at the same level as in 1976, Mr. Wahl observed. He also welcomed the commitment to avoid, as far as possible, any increase in short-term and medium-term external debt in view of the heavy burden of debt servicing. However, he wondered whether the authorities were administratively in a position to monitor such parameters as suppliers' credit, which accounted for an increasing proportion of total external debt; and he was disturbed by the fact that arrears at present amounted to the equivalent of some SDR 60 million. Even if the counterpart of the proposed compensatory financing drawing was to some extent used for the repayment of such arrears, the overall reduction could hardly be much more than 10 per cent during 1977. The medium-term program for the following years should give high priority to the elimination of outstanding arrears; but to do so it would require a steady current account surplus instead of the deficit contemplated under the stand-by arrangement.

He hoped that the ceiling on current budget expenditure would in fact not be reached, Mr. Wahl remarked; keeping below the ceiling would make it possible to increase somewhat the share of budget expenditures to be allocated to investment. While it was certain that the figure of CFAF 17 billion for investment was too high in 1975, under the stand-by arrangement no more than CFAF 1 billion would be available for investment in 1977, and he wondered how the transportation difficulties hampering the development of timber production could be overcome with such small investment. The 5 per cent limit on domestic credit expansion seemed rather drastic, although appropriate; presumably a 5 per cent expansion would represent a net decline in real terms. It was his hope that the target would not be met at the expense of the undertaking to avoid building up new suppliers' credits. While he accepted the staff view that the program did not provide the basis for the resumption of sustained real growth in the economy or for an eventual equilibrium in the balance of payments, it should nevertheless be extremely helpful as a first step toward a full-fledged restructuring of the economy, perhaps with Fund assistance under the extended facility.

Mr. Mung'omba stated that he had no difficulty in supporting the three requests. The current financial problems of the Congo stemmed largely from the failure of the new petroleum sector to meet the needs and aspirations of the Congolese people. They were clearly disappointed with the sharp decline in petroleum output, which was attributable to technical difficulties and the delay in opening up new sources. He wondered to what extent the difficulties were due to the attitude of the mining companies. For instance, he noted a reference to the fact that the companies were at present contesting a government decree introducing higher royalties and income tax. In any event, he hoped that the difficulties would be overcome as soon as possible.

The program prepared by the authorities under the stand-by arrangement represented a reasonable effort to redress the financial imbalance, Mr. Mung'omba considered. The decision to cut capital expenditures was also reasonable, in view of the decline in revenues from petroleum. He noted with satisfaction that the authorities intended to maintain only those capital projects for which nonbank or foreign financing was available. Nevertheless, greater effort should be made to improve public sector savings. Expenditures could be further reduced, although he was fully aware of the extent of the existing commitments for current expenditure. The authorities had, for example, granted high wage awards in anticipation of a boom in the oil economy and they had recently been obliged to resort to short-term suppliers' credits. It was, however, possible to postpone nonessential government purchases and to lay greater stress on the operational efficiency of state economic enterprises. The measures to cut down on the expansion of domestic credit seemed to be reasonable.

As a result of the tight liquidity of the commercial banks, the Government could reasonably expect new bank credit mainly to be made available by the use of rediscount facilities, thus giving the central bank the possibility of stricter control over credit expansion.

The authorities had met all the essential requirements for a purchase under the compensatory financing facility, Mr. Mung'omba considered. While the prices of potash, coffee, cocoa, and timber products had declined sharply in the course of 1976, so that export values had tended to stagnate, imports had continued to rise at the rate of 15 per cent per year. The Congo had clearly had a balance of payments need, and the shortfall in exports was beyond the control of the authorities. The longer term prospects of the economy would depend on the vigor with which the authorities implemented their policy of economic diversification, using the resources from the petroleum sector. Development of the non-oil sectors should be accorded high priority, particularly because it was anticipated that the known oil reserves would be exhausted by 1982.

Mr. Lieftinck stated that he would endorse most of what had been said by preceding speakers. It was gratifying that the Congo had approached the Fund for a stand-by arrangement, even if it was rather late in doing so. Only part of the Congo's difficulties could be explained by external factors. It was evident that there had been great weakness in the financial management of the authorities. During 1975 they had allowed current expenditures to go beyond their resources, as was clearly brought out by the building up of a deficit in the balance of payments, the deficit in domestic financing, the creation of arrears of payment, and the large increase in foreign debt with a serious deterioration in the debt profile. The average rate of interest on foreign obligations had risen from 1.1 per cent in 1973 to 6.5 per cent in 1975, while the average maturity had fallen from 27 years in 1973 to 9.5 years in 1975, largely as a result of raising short-term credit abroad. Although the new program was only a temporary one, it did meet the requirements for a drawing in the first credit tranche because it constituted a reasonable effort. It was of course regrettable that the program left no money available for capital investment in a country that needed investment so badly. Investment expenditure had been cut by 80 per cent from the 1975 figure, and a considerable proportion of the remaining 20 per cent was to be used to finance the operating deficits of state enterprises, which was of course not true capital investment.

The terms of the stand-by arrangement were well considered, Mr. Lieftinck observed. He hoped that the authorities would manage to meet the requirements and to prepare themselves for a longer-term program that would provide a better basis for the economic future of the country. He too had noted the passage quoted by Mr. Wahl from the staff appraisal. It was clear that

much still needed to be done and that the Congo required assistance from the Fund. He hoped that it would be possible to work out an extended arrangement with the authorities, especially as the country required more foreign assistance in financial terms. It was of course true that oil exploration had led to a considerable capital inflow over the last two years, but that source of funds was likely to dry up when exploration was completed. While the country certainly had other resources that could be usefully exploited, it would require larger internal savings and considerable amounts of foreign assistance. He hoped that both would be forthcoming.

Mr. Cross considered it encouraging that the Congolese authorities had begun to prepare plans to correct the financial imbalance in the country in connection with their request for Fund assistance. The Congo was making its first use of Fund resources, and he hoped that the technical guidance offered by the staff and the self-discipline implied by the preparation of the programs would prove as valuable as the funds themselves. It could be argued that a more substantial effort was called for in view of the projected further balance of payments deficit in 1977 and the difficult external debt position. The projected credit restraint program appeared to be appropriate, but it might be unwise to hope that wages and salaries could be frozen at 1976 levels with the continued high rate of domestic inflation. It was clear that many of the Congo's difficulties, both domestic and external, were related to the decline in production of petroleum and timber. Without doubting the existence of some genuine technical difficulties relating both to the geology of the country and to unfavorable weather, he wondered whether the drop in production was not related to the widespread nationalization of both the petroleum and the timber industries. It was important to note that such actions could have serious adverse effects on a country's economic performance owing to disruptions in management and overall operations. In the present instance, both spending levels and imports had been allowed to expand rapidly in the apparent expectation that the economy would continue to function smoothly. While he would support all three requests in the hope that closer relations with the Fund would lead to improved policies and performance, he would consider a possible request for a purchase under the extended Fund facility at the proper time.

Mr. Kafka gave his full support to the three requests by the Congo. In so doing he inquired whether the statement that the Congo did not intend to introduce new restrictions on imports for balance of payments reasons had been willingly accepted by the Congolese authorities.

Mr. Dini noted that the economic and financial situation of the People's Republic of the Congo had been deteriorating for some time, and he was glad to see that the authorities had decided to introduce corrective

measures with assistance from the Fund. Although in recent years the economy had benefited from the development of petroleum production, output in other sectors had been spotty and in certain respects less than satisfactory. Despite the large increase in resources for petroleum exports since 1973, the financial situation had been allowed to deteriorate rather markedly. The government budget had recorded relatively large annual deficits, there had been a substantial accumulation of arrears, domestic credit expansion had been quite high, the balance of payments had been in deficit, and external debt had risen rapidly with a deteriorating profile. One key element in the deterioration had been the rapid growth of government expenditure, which had not only absorbed the rise in petroleum revenue but had continued unabated once that revenue had tapered off. The authorities had formulated a one-year financial program, which had been considered by the staff merely as a first corrective step providing an opportunity to formulate a more fundamental medium-term program, possibly as the basis for assistance under the Fund's extended facility.

The implementation of the 1977 program would be an important test for the determination of the authorities to pursue policies designed to correct the financial imbalance and to foster economic growth in the medium term, Mr. Dini considered. The program for the coming year consisted mainly of restraints on budgetary expenditure and credit expansion, while still leaving an overall balance of payments deficit. The staff had rightly remarked that arresting the growth of current expenditure would be difficult, and it was to be hoped that meeting the budgetary targets would not result in a further accumulation of payments arrears or the contraction of new suppliers' credits. He would support the three requests before the Executive Directors, and he offered best wishes to the Congolese authorities for success in their endeavors.

The staff representative from the African Department, in reply to comments, noted that the authorities had only recently begun to feel that they needed to take action to correct the economic situation. Hitherto, at least, they had felt that their resources were larger than the short-term requirements; they had therefore not introduced sufficiently corrective measures. They would still not claim that they had adequate means to enforce the necessary measures, but they certainly intended to adjust to the situation as it developed. While Mr. Cross was probably right to doubt the ability of the authorities to hold wages at the present level, most of the civil servants with whom the Fund mission had spoken appeared to understand that the authorities had been unwise to grant such large salary and wage increases during the previous year, so that they were prepared to argue in favor of holding wages at the present level. The staff had not thought of recommending a reduction of expenditure below the present figures because of the obvious difficulties. The authorities

hoped that current revenues would increase in the near future, so that if they were able to hold their expenditures at the present level the proportion of current expenditures to total receipts would decline, and they would be working toward their goal without inflicting the personal hardships that would be involved by an absolute cut in wages.

While it was unfortunate to have to reduce investment outlays in any developing country, the staff representative continued, in the Congo most investment was taking place outside the budget. For instance, the Agence Transcongolaise des Communications, a transport agency responsible for railways and other forms of transport, had a substantial investment program amounting to some CFAF 50 billion over the next four years, most of which was being financed by outside donors, including the World Bank. The Congolese authorities were only contributing between 5 per cent and 10 per cent of the total cost, and the staff hoped that the budget would be able to provide the necessary funds. Similarly, investment in the oil sector was entirely private; it would therefore not be affected by the cuts in public investment outlays.

As to Mr. Kafka's comment on the undertaking not to introduce new restrictions, the staff representative explained that there had been no dispute between the Congolese authorities and the staff mission because the People's Republic of the Congo was a member of the CFA franc zone, and all members had liberal exchange systems as part of the zone arrangements.

The Acting Chairman commented that, naturally, no Fund mission could impose a trade pledge on the authorities of a member country. It was of course true that, while the matter had not been dealt with conclusively by the Executive Directors, there were a number of cases in which commitments had been made by members in connection with stand-by arrangements.

Mr. Kafka inquired whether the commitments of the Congo under the CFA franc agreement applied to the imposition of restrictions outside the area or only to countries inside the area, and whether the Fund mission had advised the Congo authorities that the Fund had not come to a decision on the question of trade pledges as a general matter.

The staff representative from the African Department stated that the mission had not advised the authorities that the Fund had not come to any conclusion. The matter had not been discussed in any detail, because it was not a point that had caused any difficulty for the Congolese authorities. While he was not familiar with the details of the franc zone arrangements, in practice countries in the franc area followed the same trade system as France and, as the French franc was convertible, there were no particular restrictions in the CFA franc countries either.

Mr. Nana-Sinkam commented that the Agence Transcongolaise des Communications was acting appropriately in the transport field, with the help of the World Bank. The present project to repair the railway to the sea would, when complete, lead to a recovery in timber exports, which had been hampered by poor transport facilities. Commitments amounting to between CFAF 50 billion and CFAF 60 billion had already been received from investors abroad for the transportation sector.

Regarding Mr. Cross' question as to the effect of nationalization on the output of the petroleum products, Mr. Nana-Sinkam remarked that he did not believe that there had been any adverse impact. The authorities had told him in 1976 that the fall in production had been due to an error by the operating company. It had installed a pipeline to carry natural gas from the oil field; once the gas was exhausted the company was left without means of pumping the oil without undertaking prohibitive additional expenditures. The oil had therefore remained in the ground. As to Mr. Kafka's comments on import restrictions, he had explained the whole situation to the authorities, and they were aware of the discussions in the Executive Board. They had been prepared to accept the clause on restrictions because for the time being they had no restrictions on imports. Moreover, with the abolition of the preferential treatment to the French franc and EEC countries, all imports were subject to the same level of taxation.

Mr. Cross inquired whether the staff had a view as to whether nationalization had affected the output of petroleum products and timber.

The staff representative from the African Department stated that the mission had discussed production problems with the two oil companies and with the staff of the World Bank. The Fund mission had been convinced that the decline in output was a technical problem unrelated to any attitude on the part of the operating companies. That view was borne out by the fact that the companies' projections for the period up to 1982, when the oil was expected to be exhausted, showed no more than a small increase in output either from the existing field or from the prospective new one. The total output would be no more than 2.5 million tons per year between 1977 and 1982, when oil production from those fields would cease.

The Executive Directors then turned to the proposed decisions.

The Acting Chairman stated that the formal request for a purchase under the compensatory financing facility had not yet been received. He therefore suggested that the Executive Directors agree to the proposed decision in principle and that they should take a formal decision on a lapse-of-time basis when the technical arrangements were completed.

The Executive Directors accepted the Acting Chairman's proposal with respect to the request by the People's Republic of the Congo for a purchase under the Fund's compensatory financing facility.

The Executive Directors then approved the proposed decisions on the stand-by arrangement and on the Trust Fund loan.

The decisions were:

a. Stand-By Arrangement

The Government of the People's Republic of the Congo has requested a stand-by arrangement for a period of one year in an amount equivalent to SDR 4.7 million. The Fund approves the stand-by arrangement attached to EBS/76/530, Supplement 1 and grants any necessary waiver of the conditions of Article V, Section 3(a)(iii) of the Articles of Agreement.

Decision No. 5296-(76/169), adopted
December 29, 1976

b. Trust Fund Loan

1. By a letter dated November 19, 1976 the Government of the People's Republic of the Congo has requested a loan under the Instrument to Establish the Trust Fund ("Instrument") annexed to Executive Board Decision No. 5069-(76/72), adopted May 5, 1976, from the Trust Fund in respect of the first period in Section II, paragraph 1 of the Instrument.

2. The Fund as Trustee finds that the People's Republic of the Congo is qualified for the loan requested in accordance with the requirements of Section III, paragraph 3(b) of the Instrument, and the Managing Director is authorized to inform the People's Republic of the Congo that the Trustee has approved a loan for the People's Republic of the Congo on the basis of the request, on terms and conditions that accord with the letters approved by Executive Board Decision No. 5195-(76/134) TR, adopted September 8, 1976.

Decision No. 5297-(76/169) TR, adopted
December 29, 1976

3. PROCEDURES FOR ARTICLE VIII AND ARTICLE XIV CONSULTATIONS

The Executive Directors considered a paper on the status of 1976 Article VIII and Article XIV consultations, together with a draft decision on the procedures for 1977 (SM/76/234, 12/20/76).

Mr. Schneider stated that he was satisfied with the flexible approach followed by the staff in preparing concise consultation reports focusing on the main policy issues. He could therefore support the proposed decision. He had two observations on the procedure for making consultation discussions effective. First, he had found it useful, when in Vienna for the recent Article VIII consultation with Austria, that the mission had been provided in advance with complete sets of written answers to the questionnaire. The mission had thus had an opportunity to prepare itself thoroughly for the discussions with the authorities and to be in a position to pinpoint the main issues without lengthy explanations. Not only did such an arrangement show the authorities that the mission had a proper understanding of the member's real problems; it gave the officials who had worked up the answers, which were sometimes very difficult, the satisfaction of knowing that their work had been appreciated. He therefore recommended the use of the advance questionnaire procedure as widely as possible. Second, it was apparent that the mission had tried, and very successfully, to devote more time to the topic of exchange rate policy in anticipation of the new Article IV. His authorities had found the discussion useful, and he hoped that missions to other members would have equally frank discussions.

Mr. Lieftinck considered the present consultation practices to be satisfactory, so that the short length of the present paper was quite justified. The staff was to be commended for its consultation work during the past year. The annual consultations, both with Article VIII and with Article XIV countries, were a prominent part of the Fund's activities, benefiting not only the Fund but also the member countries, which received thereby a frank appraisal of their situation and policies. The staff performance of its consultation work was impressive and the reports to the Executive Directors on the consultations had reached a level of which the Fund could be proud. The frankness with which the staff's findings were being submitted to the Executive Directors was helpful, and the extensive coverage in the reports on recent economic developments was welcome. He would encourage the staff to try to bring about further improvements where needed, thereby assisting both the Fund in its operations and the members in their endeavors to meet the highest standards that could be achieved, often in difficult circumstances. The proposed decision was quite appropriate.

Mr. Laske commended the staff for the admirable quality of the consultation papers and the reports on recent economic developments. The fact that the recent economic development reports were highly considered outside the Fund was made manifest by repeated requests from many embassies in certain parts of the world whose staffs believed that the Fund papers were the most reliable source of information on economic developments in the countries where they were posted. He therefore had no difficulty in agreeing to the proposed decision.

As to the details of the procedures, Mr. Laske recalled that the Executive Directors had some years previously agreed that there should be flexibility in programing the consultations with individual countries. The paper showed that some 70 per cent of all member countries had held formal consultations with the Fund during the past year, so that over a three-year span each member would have two consultations. While that was an appropriate arrangement, the staff paper showed that there had not been a consultation with Belgium or Luxembourg for more than 18 months; that, although there had been consultations with El Salvador in both 1975 and 1976, neither had so far been reported to the Executive Directors; that there had been no formal consultation with Italy during 1976; and that there had never been a consultation discussion with Saudi Arabia. A number of Article XIV countries had also not held consultation discussions with the Fund during 1976; outstanding among those was the Philippines. It was true of course that, in the case of Italy, talks between the Fund and that country were under way about the possible use of the Fund's resources and that with regard to the Philippines there had been a review of the arrangement under the extended Fund facility. He therefore wondered whether those discussions could be considered as a formal consultation under Article XIV.

Mr. Nana-Sinkam, commending the staff for its paper, inquired whether there could not be a single form of consultation for Article XIV and Article VIII members, because there was no longer any real difference between the two categories. He was glad to see that the staff would be preparing a new paper on the possibility of combining the consultations required under new Article IV with those required under Article VIII and Article XIV. He could of course accept the proposed decision.

The Acting Chairman reminded Executive Directors that the recent staff paper on surveillance under Article IV (SM/76/235) did contain certain suggestions about combining consultation procedures under new Article IV with those under Article VIII and Article XIV.

Mr. Dini considered it a remarkable achievement for the staff to have been able to hold as many consultation discussions in 1976 as it had in 1975, despite the large increase in requests for the use of the Fund's resources. In reply to one of Mr. Laske's comments, he wished to assure the Executive Directors that there was no intention on the part of his Italian authorities not to hold Article VIII consultations with the Fund at regular intervals. If there had been any delay since the last consultation, the matter would certainly be corrected in the period immediately ahead. Both the existing procedures and the format of the staff documents were satisfactory, and no changes were required. He therefore supported the proposed decision for the coming year.

Mr. Kafka said that he too would support the proposed decision. In so doing he would endorse what Mr. Lieftinck had said about the quality and usefulness of the consultation discussions.

Mr. Matsunaga stated that he could support the proposed decision to continue the procedures adopted in 1975 until the second amendment of the Articles of Agreement came into effect. Nevertheless, while it was quite an achievement to have held consultations with some 80 members out of a total of 129 during the past year, if either the papers had been shorter or the number of members whose cases were discussed by the Executive Directors had been smaller, the discussions could have been more thorough and more interesting. In any event, he understood that the whole matter of consultations under the amended Articles would be discussed some time during 1977, and he was looking forward to the offered staff paper.

Mr. Kaul said that he too had no difficulty in accepting the proposed decision. Hitherto, he had worked for the Government in his own country, where he had found the Fund's consultation missions useful. The questionnaires supplied in advance of the mission's arrival were helpful in drawing the attention of the Government to the various matters of importance. The staff had always been understanding and tactful, and the consultations had by and large been constructive in nature. He understood, however, that the conduct of consultations might change considerably once new Article IV came into effect. His authorities were interested to know how greatly the form of the consultations would be altered; he would certainly take a keen part in the discussion that would follow the circulation of the new staff paper promised for 1977.

Mr. Simone commented that he was satisfied both with the way in which the consultations were carried out and with the quality of the reports. The reports were highly appreciated by the countries that were members of his constituency; he would therefore like to support the recommendation that the consultations should continue to be held in 1977 according to the procedures approved in 1975.

Mr. Hollensen said that he would support the proposed decision. He was, however, glad that a new paper was to be issued in order to enable the Executive Directors to consider the procedures for combining Article VIII and Article XIV consultations with those envisaged under the new Article IV. He had noted that the Fund had increased from 51 members in 1952 to 129 members in 1976. The increase in the size of membership would no doubt have some impact on the form of consultation. For instance, while the material contained in the reports on recent economic developments would be useful, he wondered whether the consultation reports themselves should not center more firmly on really important topics. The form of the two papers could perhaps be discussed in connection with the new proposals to be submitted to Executive Directors in 1977.

The organization of the consultations themselves might also bear looking into, Mr. Hollensen considered. He himself spoke for small countries that were members of several international organizations, and there was some risk of performing the work twice over. In addition, there was the problem of trying to accommodate a number of missions from different agencies in turn. He therefore wondered whether it would not be possible for the information prepared by a country for, say, OECD, to be used also by the Fund. Similarly, members of the OECD normally conducted consultations with that organization by sending small teams to the organization's headquarters in Paris; he wondered therefore why the Fund sent missions to countries. In general, the consultation work of the Fund was of a high standard, but some changes could well be introduced when the Article VIII and Article XIV consultations were combined with those required under new Article IV.

Mr. Mung'omba expressed the appreciation of the countries in his constituency for the way in which consultations with the Fund had been carried out. They appreciated not only the courteous manner but also the understanding shown by the Fund missions in the course of the discussions.

Mr. Lynch commented that only on the occasion of the discussion of procedures for consultations did Executive Directors have the chance to reflect on the immense amount of detail contained in the reports on recent economic developments and on the high quality and volume of the staff's consultation work. He was grateful for the staff activity, which was carried out in a thorough and flexible manner. The authorities in his constituency had been happy with the help they had received from the Fund over the years, and they had always had full and frank discussions with Fund missions. Although there had not always been agreement, the debates had certainly led toward a better understanding of the problem. While Mr. Laske was statistically correct in remarking that the Fund had not adhered to the schedule of consultations, it was desirable to take a practical approach to the matter and to bear in mind that countries were facing difficult problems that required more time to deal with than had been the case in the past. Moreover, smaller countries were sometimes quite happy to receive missions at a longer interval rather than a shorter one, not because of unwillingness, but simply because of a shortage of resources for providing the desired information. He therefore supported the proposed decision and looked forward to the paper on the integration of the consultation procedures with those to be required under the new Article IV.

Mr. Caranicas joined other Executive Directors in expressing the thanks of his chair to the staff for the keenness and the tactful manner with which the consultations were carried on. As to the frequency of

consultations, the increase in the number of members combined with the firm hand of management on the size of the staff made it difficult to carry out consultations on a strictly annual basis. The arrangement by which each member should have a consultation at intervals of between 12 and 18 months seemed satisfactory. It might of course be possible to reduce the length of consultations still further, especially if questionnaires were answered in advance in the way recommended by Mr. Schneider. The number of staff members composing a mission might also be reduced. At any rate, in the past, missions to small countries in attractive parts of the world had sometimes consisted of five or six members, when a smaller number might have been able to handle the work. Similarly, in some countries it had been noticed that the head of mission was not of the same high level as the head of mission to other countries.

Returning to the matter of the frequency of consultations, Mr. Caranicas remarked that it might be sufficient to hold a consultation once every 18 months with those members on which other agencies such as the OECD published regular reports. At the time when the Executive Board came to discuss the proposals for discussions under new Article IV, Executive Directors might put forward suggestions to somewhat reduce the burden on the staff without impairing the usefulness of the consultation reports. As to individual countries with which consultations had not been held during 1976, Cambodia, Saudi Arabia, Kuwait, Luxembourg, and Uganda were perhaps the most prominent. The cases of the first two were well known while the Fund was shortly to discuss the use of its resources by another country--Viet Nam--although there had been no consultation with that country for the past two years.

Mr. Whitelaw stated that he had no problem with the proposed decision, and indeed believed that the present procedures should be adopted for 1977. He hoped that the same procedures as at present would remain in force, in particular with reference to relations between Executive Directors and staff missions in the field. The staff deserved commendation on the way in which it cooperated with Executive Directors on the occasion of consultation missions to member countries, a matter that was becoming more important since the number of members was increasing and Executive Directors had often to attend consultation discussions without much chance of preparation. As to the absence of the Philippines from the list of countries with which consultations had been held in 1975 or 1976, Executive Directors would probably have noticed that the Philippines was in more or less continuous consultation with the Fund, and that quantities of material were regularly presented to them about the economic situation in the country. There had in fact been close cooperation between the Philippines and the Fund.

Mr. Al-Atrash associated himself with the remarks made by Mr. Lieftinck regarding the usefulness of the report on recent economic developments; the only comment he would make would be that perhaps more attention could

be paid to the long-term problems of members with which consultations were held, because very often short-term economic measures could only be judged appropriately in a somewhat longer time frame. Regarding the absence of consultations with Saudi Arabia, Executive Directors should note that the staff had circulated reports on recent economic developments in the country, so that the information was available. One reason why the authorities in Saudi Arabia had so far not agreed to hold consultations was that they were very busy and that the few capable people were otherwise employed. A consultation with Saudi Arabia had been scheduled for March or April 1977, and he hoped that the authorities would then be in a position to welcome a Fund mission.

Mr. Ryrie commented that it was almost inevitable that, with the increase in the work load on the staff during 1976 and the addition of new members, there would be some difficulty in keeping strictly to a timetable of annual consultations with all members. Indeed, the Executive Directors had agreed in principle that such rigidity was not necessary, and he saw no reason to complain of the flexibility introduced by the staff. He would endorse the compliments paid to the staff both on the conduct of the consultations and on the way in which the reports were written. The consultation program had been carried out most satisfactorily during 1976, and he would support the proposed decision.

The Director of the Exchange and Trade Relations Department recalled that in 1975 the Executive Directors, as the outcome of a two-day discussion on consultation procedures, had given the staff specific guidelines for the consultation work. Without going into details of the way in which those guidelines had been implemented, it was perhaps worth noting that all but one of the staff reports for consultations in 1976 had consisted of less than 20 pages. The reports on recent economic developments had also been shortened considerably; but they did contain supplements or appendices dealing essentially with the type of problems referred to by Mr. Al-Atrash. Moreover, at the suggestion of Executive Directors, as part of the report the staff prepared a bibliography indicating the most recent work on the country concerned by other international agencies, including the studies of the OECD, which were mentioned by Mr. Hollensen.

The staff had also tried to shorten the period between the return of a mission and the issuance of a report, the Director of the Exchange and Trade Relations Department explained. During 1976, 50 per cent of the reports had been issued in less than five weeks after the return of the mission. Work was still continuing to simplify the report on recent economic developments, but it clearly had to be rather full in order to enable Executive Directors to understand the purposes of the authorities and the justification for the staff appraisal or comments contained in the consultation report itself. The staff did already often send

questionnaires to countries in advance of the arrival of the mission, as suggested by Mr. Schneider. Indeed, on many occasions he had even sent the authorities a preliminary report on economic developments to enable them to correct any errors that might have occurred from a misreading of the information available at the Fund's headquarters.

Dealing with comments on the status of individual countries, the Director of the Exchange and Trade Relations Department explained that consultations were nearly always held at the same time with the authorities of Belgium and of Luxembourg. It was certainly the intention neither of the Fund staff nor of the Belgian and Luxembourg authorities to avoid holding a consultation at the proper time. The Executive Directors would recall that the Fund had held its annual meeting in the Philippines, something that tended to disrupt the work of both the staff and the Executive Directors. Nevertheless consultations had been held with 69 per cent of members during 1976, a considerable achievement when it was considered how deeply the staff had been involved with oil facility purchases in the first part of the year.

The Fund still hoped to institute regular Article VIII consultations with Saudi Arabia; information was of course available in papers on the economy of the country issued from time to time. Consultation reports on El Salvador had not been put before the Executive Directors for discussion because the authorities were in the process of formulating new policies and had asked the staff to wait until a new policy was ready.

The staff did of course collaborate very closely with the staffs of other organizations, in particular with that of the World Bank, the Director of the Exchange and Trade Relations Department maintained. However, their work was often focused with other objectives in mind, and hence it had been found that combined missions were not particularly helpful. They would be even less so if the Fund's mission were combined with missions of other organizations. Moreover, the confidential relations between the Fund and its members might possibly be impaired. The reason why the Fund sent missions to member countries instead of requiring the countries to send representatives to Washington was that the mission was considered to be a service to the members. While it was not very difficult for key officials of European countries to visit Paris and return to their capital in a day, it would be asking a lot of the officials of some members to come to Washington. Sending a staff mission to the member helped to make the consultation more elastic as well as more effective, because the mission could speak with the best qualified officials without taking them from their duties at home. The discussions were often held early in the morning or late in the afternoon with officials who were very busy during the day. That type of accommodation added to the quality of the reports.

The Executive Directors then turned to the proposed decision, which they approved.

The decision was:

> Article VIII and Article XIV consultations with members during the consultation year beginning January 1, 1977 shall continue to be conducted in accordance with the procedures approved by the Executive Directors for 1975.

Decision No. 5298-(76/169), adopted
December 29, 1976

4. CHINA - "RESTITUTION"

Mr. Wahl recalled that the Executive Directors had been asked to approve by lapse-of-time procedure on December 17, 1976 a paper relating to the first restitution of the Fund's gold to take place in early January 1977 (EBS/76/520, 12/16/76). No mention had been made in that paper of the problem of the restitution of gold to China. The topic of the restitution of gold to Cambodia was to be discussed by the Executive Directors on January 3, 1977, and on January 5, 1977 the Executive Directors were to discuss a draft reply to the Governor of the People's Bank of China in Peking. For those reasons his chair had indicated orally to the Deputy Managing Director on December 17, 1976 that it reserved its right to ask for inclusion of the subject of the restitution of gold to China on the agenda of the Executive Directors, confirming the oral communication by a memorandum dated December 21, 1976. He was therefore formally requesting the Acting Chairman and the Executive Directors to place the matter on the agenda of the Executive Board for Wednesday, January 5, 1977. At that time it was his intention to propose that the Fund should act in the case of China in the same way as it was recommended that it should act in the case of Cambodia. It seemed wise to defer any decision of the restitution of gold to China, since the subject of its representation both in the Fund and in the World Bank was pending. He did not mind whether the topic of the reply to the President of the People's Bank of China in Peking was expanded to cover the matter of the restitution of gold to China, or whether the two topics were treated separately. What was important was that the matter should not be decided on a lapse-of-time basis.

The General Counsel commented that the understanding at all times had been that the subject to be covered by the item already on the agenda for January 5 was the response to the communication received from the Governor of the People's Bank of China. The topic of the restitution of gold to China was a new subject. There were therefore two procedural matters that

ought to be decided: first, whether enough notice had been given for inscribing a new item on the agenda; and, second, whether a representative of the country concerned should be invited to attend. The notice given by Mr. Wahl was sufficient to enable the topic to be included in the agenda for Wednesday, January 5, 1977. The question of representation had still to be decided by the Executive Directors.

Mr. Cross indicated that in his view the orderly procedure would be to have the matter of restitution of gold to China discussed as a separate item. It did, however, seem to him that the Executive Directors would be reopening a decision already taken.

The Acting Chairman said that his understanding was that the decision taken on a lapse-of-time basis regarding the restitution of gold to members on December 17, 1976 would call for restitution of gold to China just as to other members, because no special exclusion had been made with respect to that country. Naturally, in accordance with the normal practice, a decision could be reopened at any time at the request of an Executive Director. While Mr. Wahl was therefore within his rights, he would certainly be reopening a matter that had been the subject of a decision, and that had already led to certain further procedural steps.

Mr. Wahl emphasized that in communicating orally to the Deputy Managing Director on December 17, 1976 and confirming its communication later in writing, his chair had tried to indicate that it had not accepted the decision on a lapse-of-time basis.

Mr. Hollensen supported the proposal made by Mr. Wahl to place the matter of restitution of gold to China on the agenda of the Executive Board for January 5, 1977. The position taken by the countries in his constituency at the time of the discussion of the reply to the Governor of the People's Bank of China had largely been based on the realization that the question of the restitution of the gold paid to the Fund by China would shortly have to be discussed.

Mr. Cross hoped that when the matter was brought to the agenda for discussion, the Executive Directors would have the benefit of a staff paper explaining the legal position.

The General Counsel undertook to prepare such a paper.

Mr. Wahl, reverting to the question of representation for China during the discussion, said that he would refrain from objecting to such representation. However, the question of representation ought to be treated symmetrically. The Executive Directors had twice discussed the reply to the letter from the President of the People's Bank of China,

which was not a mere procedural matter since there was a risk that a member government would be expelled as the representative of a member. Consequently, while he had no objection whatsoever to the attendance at a forthcoming meeting of a representative of the Republic of China, the Executive Directors should bear in mind that the procedure had not been adhered to in the past.

The General Counsel commented that the present question was whether the representative of the government recognized by the Fund for all other purposes in relation to the member called China should be invited to attend certain meetings of the Executive Directors. The staff had come to the conclusion that so far the topics discussed by the Executive Directors could be regarded as procedural rather than substantive, because hitherto the issue had been to draft a response to a government other than the one recognized in order to seek clarification of the views it had expressed in a communication to the Fund. He could agree, on the one hand, that it would have been possible to take a more liberal view and to come to the conclusion that it would be appropriate to invite the government recognized by the Fund to send a representative if it wished.

On the other hand, the item to be inscribed on the agenda according to Mr. Wahl's suggestion could not in any way be regarded as a procedural matter because it clearly involved the proprietary rights of a member, the General Counsel maintained. The issue that arose was also of a political character, and the right to send a representative to meetings of the Executive Directors, which had its roots in the prehistory of the Articles, had been thought to be particularly important when political questions affecting a member were raised. In the present situation it was the duty of the Executive Directors to determine whether the matter was one that would particularly affect a member. The concept was not altogether clear, but a similar point had arisen in the recent past, when the Executive Directors had decided that South Africa should not be invited to send a representative to attend a discussion of a general matter involving gold, on the ground that such an invitation would represent too broad an interpretation of the right to send a representative. At that time it had been decided that a good prima facie test was whether the name of a particular member appeared on the agenda, and that would certainly be the case in the present instance. His own view, therefore, was that the Executive Directors should follow the procedure laid down in Section 19(d) of the By-Laws under which whenever the Executive Directors were to consider a matter which had been determined particularly to affect a member not entitled to appoint an Executive Director, the member should be promptly informed by rapid means of communication of the date set for its consideration. The section went on to say "no final action shall be taken by the Executive Directors with respect to such matter, nor any question particularly affecting such member submitted to the Board of Governors, until the member has either waived its rights under paragraph (a) of this section or has been given an opportunity to present its views through an appropriately authorized

representative at a meeting of the Executive Directors of which the member had reasonable notice." To make the position quite clear, what had been discussed by the Executive Directors hitherto had been the draft of a reply to a communication from the President of the People's Bank of China. There had never been on the agenda an item relating to the expulsion of the Taiwan Government as the government representing China. If such an item were ever to appear on the agenda, it would clearly be a matter particularly affecting China. The topic proposed for inclusion on the agenda of Wednesday, January 5, 1977 affected the proprietary rights of the government representing the member.

Mr. Al-Atrash, speaking on behalf of the majority of the countries in his constituency other than Saudi Arabia, associated himself with the remarks made by Mr. Wahl and asked that any decision regarding the restitution of gold to China should be deferred for the time being. Even if the discussion of the topic mentioned by Mr. Wahl had to be postponed beyond January 5, 1977 in order to enable the government recognized by the Fund to be represented, he would say, on behalf of Pakistan and all other countries in his constituency other than Saudi Arabia, that his constituency would not at present support the restitution of gold to the Taiwan regime, and that he would like to discuss the matter at the appropriate time.

The Acting Chairman asked Executive Directors not to enter into the substance of the matter at the present meeting. Further, Executive Directors would recall that they had been notified that restitution operations were to take place between January 10 and January 14, 1977. In consequence, the Treasurer and his colleagues had naturally been making technical preparations. It would therefore be difficult to delay a discussion much beyond January 5, 1977.

Mr. Al-Atrash explained that he wished the matter of the restitution of gold to China to be deferred in the same way as it had been agreed to defer the matter of the restitution of gold to Cambodia. If gold were restituted to China at the present time, the consequences might be diplomatically serious.

The Treasurer observed that, in accordance with the instructions of the Executive Directors, the staff had been proceeding to make the necessary arrangements for the restitution of gold to members. Certain steps had therefore already been taken. In particular, China had been asked to state whether it wished to receive the gold or whether it wished to postpone receipt for balance of payments reasons, and the Chinese authorities had replied to that question. The staff had also begun to find a creditor that would be willing to cooperate with the Fund in order to channel the gold to China.

The Acting Chairman, summarizing the discussion, proposed that the agenda for Wednesday, January 5, 1977 should contain an item relating to restitution of gold to China. The General Counsel would prepare a paper dealing with the legal aspects of the matter, and he assumed that the Executive Directors would agree that, under Section 19 of the By-Laws, a representative of the Republic of China should be contacted in order to give the Republic of China the chance to be represented. The Government might of course waive its right to be present under Section 19 of the By-Laws.

Mr. Kharmawan inquired whether the invitation to be extended to the representative of the Republic of China should cover the discussions on both the reply to the communication from the President of the People's Bank of China and on restitution.

The Acting Chairman suggested that the representative might be given an opportunity to be present at the discussion of both topics.

Mr. Kaul, however, considered that it would be more appropriate if the representative of the Republic of China were not present during the discussion of the draft reply to the President of the People's Bank of China.

Mr. Caranicas commented that it would be unthinkable that a representative of the Republic of China should be present when the Executive Directors discussed a draft reply to a communication from the President of the People's Bank of China. It would be better to have two separate items, and to give the Government of the Republic of China an opportunity to be present at the discussion on the restitution of gold. In that connection it would be interesting to know whether the representative of the Republic of China should be invited to submit a memorandum setting out the views of his authorities, or whether he should be allowed to present oral arguments.

The General Counsel stated that the member had the right to do both. Questions similar to those raised by Mr. Caranicas had been discussed in connection with the withdrawal of Czechoslovakia. However, in the first instance, the correct procedure would be for the Fund to approach the designated representative of the member concerned to ascertain whether he wished to attend. It might be worth mentioning that the attitude of the Executive Directors in the past had been to take a rather narrow view of the right to send a representative to a discussion by the Executive Directors. The reason was that the Executive Directors did not wish to provide an easy or extensive right of representation. They felt themselves to be the proper channel through which members' views could be presented

to the Executive Board. It was only when there was a clear and obvious case affecting a particular member not entitled to appoint an Executive Director that in the past Executive Directors had been willing to allow representatives to attend.

Mr. Cross stated that there were clearly two specific items to be discussed. The topic of the restitution of gold to China unquestionably involved the rights of China, and a representative should be given the opportunity of attending. The other matter had not gone beyond the stage of drafting a letter in reply to a communication raising a number of questions, and it was therefore not in the same category. In the circumstances he would take the same line as Mr. Kaul and suggest that while the representative of the Republic of China should be given an opportunity to attend the discussion on the restitution of gold to China, he need not be given a similar opportunity for the discussion of the other matter.

Mr. Whitelaw said that he took the same view as Mr. Cross. However, the first question that the representative of the Republic of China was likely to ask when it was suggested that his country should not be treated like other members of the Fund was, why such a suggestion should be made. He hoped that the General Counsel would be able to explain.

The Acting Chairman, concluding the discussion, stated that an item respecting the restitution of gold to China would be placed on the agenda for Wednesday, January 5, 1977, and that a representative of the Republic of China would be given an opportunity to participate in the discussion of that item.

5. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Lieftinck on relinquishing his post as Executive Director in the Fund, which he had held since October 1, 1955. Extending his remarks, which had been circulated, he noted that Mr. Lieftinck intended to reside in Washington during his retirement, so that Executive Directors and staff would have the opportunity of seeing him in the future.

Mr. Kafka stated that it had seemed to Mr. Lieftinck's colleagues on the Executive Board that in view of his exceptional services to the Fund it would be appropriate that the Executive Directors should approve a formal resolution of thanks and appreciation to him.

The Executive Directors approved the proposal by acclamation.

The resolution read as follows:

RESOLUTION

WHEREAS, on December 31, 1976, Mr. Pieter Lieftinck will relinquish the post of Executive Director of the International Monetary Fund which he has held since October 1, 1955; and

WHEREAS, Mr. Lieftinck has indefatigably and devotedly sought to foster the spirit of international cooperation and to work for the realization of the ideals which the Fund was established to promote; and

WHEREAS, many generations of Executive Directors and staff members have valued Mr. Lieftinck as a friend and counselor;

NOW, THEREFORE, IT IS RESOLVED: That the Executive Directors express to their associate, Mr. Lieftinck, their sincere appreciation of his long and valued service to the Fund and to those associated with it, their profound regret at his retirement, and their hope that he will find new and satisfying activities in the future.

Adopted December 29, 1976

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Directors without meeting in the period between EBM/76/168 (12/22/76) and EBM/76/169 (12/29/76).

6. PAPUA NEW GUINEA - EXCHANGE SYSTEM

The Fund notes the exchange rate action taken by the authorities of Papua New Guinea as described in EBS/76/524 and notes their intention to collaborate with the Fund in accordance with Article IV, Section 4(a) of the Articles of Agreement. The Fund will remain in close consultation with the authorities of Papua New Guinea and in this respect the Managing Director will take appropriate initiatives (EBS/76/524, 12/17/76).

Decision No. 5299-(76/169), adopted
December 22, 1976

7. PAPUA NEW GUINEA - EXCHANGE SYSTEM

The Fund notes the change in the exchange rate system made by the authorities of Papua New Guinea as described in EBS/76/535. The Fund will remain in close consultation with the authorities of Papua New Guinea and in this respect the Managing Director will take appropriate initiatives (EBS/76/535, 12/23/76).

Decision No. 5300-(76/169), adopted
December 28, 1976

8. PEOPLE'S REPUBLIC OF THE CONGO - PROVISIONAL RATE OF EXCHANGE

The Government of the People's Republic of the Congo has proposed that the representative rate of the Congo CFA franc be the provisional rate for the currency of the People's Republic of the Congo. The Fund agrees that the representative rate shall be used for the payment of the initial currency subscription of the People's Republic of the Congo and for all computations by the Fund involving the currency of the People's Republic of the Congo (EBS/76/527, 12/20/76).

Decision No. 5301-(76/169), adopted
December 22, 1976

9. GOVERNMENT FINANCE STATISTICS COURSE

The Executive Board approves the proposal set forth in EBAP/76/301 (12/20/76).

Approved December 22, 1976

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/76/293, Supplement 1 (12/21/76) and EBAP/76/303 (12/21/76), and by an Advisor to an Executive Director as set forth in EBAP/76/304 (12/27/76), is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 77/58, April 18, 1977

H. JOHANNES WITTEVEEN
Chairman

ROGER V. ANDERSON
Acting Secretary

ANNEX

Note from Mr. Lieftinck to the Executive Board
on some Desirable Technical Changes in the Compensatory Financing Facility

I would like to present hereby some observations on two features of the present Compensatory Financing Facility which, in my opinion, are unsatisfactory and call for correction.

I. Geometric vs. arithmetic trend average - mathematical deficiency of the formula

Under the present practice the Fund uses an arithmetic average to represent the export trend despite the fact that for purposes of economic analysis the geometric and not arithmetic rate of growth is more generally applied. Since the arithmetic average is higher than the more appropriate geometric average, "compensable" shortfalls are identified even in cases with uninterrupted, constant growth of export earnings. Moreover - the higher this (uninterrupted) rate of growth is, the higher is the compensation.[1] This observation is true, of course, as well with regard to actual decline of exports from the trend: there the arithmetic average for calculating the trend adds an artificial element to the total calculated shortfall.

This problem had little practical importance under the 1966 Decision, which imposed a rather restrictive upper limit on export projections. There is no such limit under the 1975 Decision, and this calls for a more appropriate method of calculating trend averages than the present one.

II. Real vs. nominal data for extrapolating post-shortfall exports - lack of reason in projecting past price development into the future

The staff has often found in the past quite "unreasonable" export projections produced by the formula. Consequently, the judgmental forecast has been used more and more. The fact is that we could improve, at least to some extent, the present formula projections, if we eliminated the unfounded extrapolation of price developments from the past into the future. This could be done by using real data for extrapolation of export projections. An additional argument for adopting this technique is the fact that compensatory financing is extended to a member during the shortfall year or shortly after; its size should not be affected by future price developments.[2]

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1) In case of exports growing constantly at the nominal rate of 10 percent, the application of arithmetic average in the formula results in a calculated shortfall amounting to 0.7 percent exports (in any year); in the case of 30 percent nominal growth this figure reaches 7.3 percent.

2) This point is easily seen when brought to the extreme. Assuming high enough price rises in the post-shortfall years, we can arrive at figures for compensatory financing exceeding in real terms total exports (and multiples of total exports) in the shortfall year.

Table 1

The table illustrates for 36 countries the impact of applying the geometric average on the calculated shortfall (gross amount) under the judgmental method. As we can see, it results in the reduction of entitlements by 25 percent in average. However, even more telling is the fact that 75 percent of the total reduction concentrates among seven countries with characteristically high rates of export growth.[1)]

Table 2

The table consists of two parts: (1) a comparison of the judgmental post-shortfall exports with the exports extrapolated by the present technique and by the proposed one; (2) a comparison of the judgmental shortfalls with the shortfalls calculated under the present extrapolating technique and under the proposed one.

The proposed technique still leaves the extrapolated figures beyond the judgmental forecasts; however, the discrepancy is much smaller, reduced, on average from 26 to 14 percent.

Likewise, we also find a substantial improvement in the sizes of the "extrapolated" shortfalls. It has been often embarrassing to see that the "extrapolated" shortfalls bear no relation with the shortfalls calculated by applying the judgmental approach. With regard to the countries shown, the present technique produces shortfalls on average well over twice as high as the judgmental approach. Under the proposed technique these shortfalls would be still higher but the discrepancy would have been reduced to 41 percent.

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1) Australia, Egypt, Greece, Israel, Korea and Mexico.

Most of the work on this paper has been done by my Technical Assistant, Mr. Valery Amiel.

ANNEX

Table 1. Export Shortfalls and Related Purchases: A Comparison With the Geometric Average[1]

	Judgmental Shortfall						
	Gross amount		Net amount[2]		Purchase[3]		
	Arithmetic trend (1)	Geometric trend (2)	Arithmetic trend (3)	Geometric trend (4)	Arithmetic trend (5)	Geometric trend (6)	Reduction in purchases (7)=(5)-(6)
Australia	413.0	298.0	376.5	261.5	332.5	261.5	71.0
Bangladesh	40.0	39.0	20.0	19.0	20.0	19.0	1.0
Cameroon	31.2	25.0	31.2	25.0	17.5	17.5	--
Central African Rep.	5.1	4.6	4.9	4.4	5.1	4.4	0.7
Chad	12.1	10.3	6.7	4.9	6.5	4.9	1.6
Chile	239.1	205.4	235.8	202.1	79.0	79.0	--
Cyprus	15.4	14.9	15.4	14.9	13.0	13.0	--
Dominican Rep.	41.6	35.8	41.6	35.8	21.5	21.5	--
Egypt	121.0	86.0	121.0	86.0	94.0	86.0	8.0
Greece	86.0	26.0	86.0	26.0	58.0	26.0	32.0
Guyana[4]	22.6	21.3	22.6	21.3	10.0	10.0	--
Israel	82.4	52.4	76.1	46.2	65.0	46.2	18.8
Jamaica	53.8	41.3	53.8	41.3	13.25	13.25	--
	49.9	43.3	40.0	33.4	13.25	13.25	--
Kenya	28.4	22.0	28.4	22.0	24.0	22.0	2.0
Korea	1,115.0	672.0	1,115.0	672.0	40.0	40.0	--
Lao, People's Dem. Rep.	9.2	5.3	6.8	2.9	3.25	2.9	0.35
Malaysia	270.0	218.0	266.6	214.6	93.0	93.0	--
Mexico	284.0	194.0	284.0	194.0	185.0	185.0	--
New Zealand	110.0	103.0	84.8	77.9	50.5	50.5	--
Pakistan	90.5	81.0	72.5	63.0	72.5	63.0	9.5
Panama[4]	19.6	15.7	19.6	15.7	18.0	15.7	2.3
Papua New Guinea	61.0	58.0	56.0	53.0	10.0	10.0	--
Peru	227.0	199.0	186.1	158.1	61.5	61.5	--
Philippines	320.0	201.0	320.0	201.0	77.5	77.5	--
Portugal	132.8	126.0	121.6	114.8	58.5	58.5	--
Sierra Leone	7.0	6.8	7.0	6.8	7.0	6.8	0.2
	9.6	9.0	6.7	6.1	5.5	5.5	--
South Africa	230.0	179.7	160.0	179.7	160.0	160.0	--
Sri Lanka	15.8	13.1	15.8	13.1	15.8	13.1	2.7
Sudan	48.9	44.6	26.7	22.4	26.7	22.4	4.3
Tanzania	26.5	23.8	26.5	23.8	21.0	21.0	--
Thailand	131.0	108.0	129.7	106.7	67.0	67.0	--
Togo	25.0	24.0	25.0	24.0	7.5	7.5	--
Uruguay	27.3	23.1	25.9	21.7	25.9	21.7	4.2
Western Samoa	2.6	2.3	2.2	1.9	0.5	0.5	--
Yemen, People's Dem. Rep.	4.0	3.6	2.5	2.1	--[2]	--[2]	--
Zambia	285.0	264.0	269.2	248.2	19.0	19.0	--
Total	4,693.4	3,499.3	4,390.2	3,267.3	1,798.25	1,639.6	158.65

1/ Excluding the ten cases for which no judgmental forecast was given.
2/ Net of double compensation and/or stock adjustments.
3/ Excludes reclassification (SDR 19.06 million for Bangladesh, SDR 18.0 million for Pakistan, and SDR 2.5 million for the People's Dem. Rep. of Yemen).
4/ Requests are being processed or circulated to the Board and scheduled for review in December.

Prepared by the Commodities Division

Table 2: Export Projections and Export Shortfalls Under the Present and the Proposed Techniques.

Members 1)	Extrapolated post-shortfall exports in relation to judgemental forecasts of the staff		Export shortfalls under the formula approach in relation to judgemental shortfalls	
	Present Extrapolation	Proposed Extrapolation 2)	Formula including the present extrapolation	Formula including the proposed extrapolation 2)
	(deviations expressed in percentage)			
Australia	22	9	254	109
Barbados	86	46	525	275
Cameroon	23	18	145	110
Chad	- 21 3)	- 25	- 50	- 67
Chile	24	17	69	46
Congo	104	63	515	365
Cyprus	6	9	27	40
Dominican Rep.	73	37	512	260
Egypt 4)	6	1	- 32	7
Greece	41	24	474	277
Guyana	94	53	422	239
Israel	5	0	45	5
Kenya	9	4	79	39
Korea	33	26	86	- 54
Lao, PDR	32	27	33	33
Malaysia	42	27	253	160
Mexico	17	- 1	115	- 3
Pakistan	12	8	57	39
Panama	47	23	325	160
Peru	- 7	- 18	- 20	- 48
Philippines	31	19	136	84
Portugal	50	45	268	242
Sierra Leone	37	12	100	40
S. Africa	12	- 7	99	- 57
Sri Lanka	16	- 2	200	- 25
Sudan	- 12	- 14	- 45	- 51
Tanzania	- 12	- 9	- 65	- 54
Thailand	54	38	395	275
Togo	148	109	296	220
Uruguay	11	6	63	37
Western Samoa	297	238	19	- 12
Yemen, PDR	- 8	1	- 11	3
Zambia	40	36	52	47
Total	26	14	120	41

1) Choice of countries dictated by availability of data.
2) The two post-shortfall years extrapolated on the basis of real data in shortfall year prices (the necessary information supplied by the Commodity Division).
3) Normally, negative figures will appear in cases of judgemental expectations for an increased export capacity.
4) In this case, the impact of an expected increase in export capacity was added to the extrapolated results.