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INTERNATIONAL MONETARY FUND

#8

FILES

Minutes of Executive Board Meeting 76/121

10:00 a.m., August 4, 1976

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
J. Amuzegar	
	J. H. Kjaer
S. Y. Cross	C. J. Lohmann, Temporary
J. de Groote	
N. Deif	M. Finaish
L. Dini	
B. J. Drabble	D. Lynch
S. Jagannathan	W. Rasaputram
	W. Temple-Seminario
K. Kawaguchi	R. Masunaga
	Sein Maung
P. Lieftinck	T. de Vries
H. R. Monday	
	G. Laske
	P. Kent
D. Simone	S. Sevilla
F. Suárez	G. Heyden Q., Temporary
	J. Foglizzo
E. J. Whitelaw	
A. W. Yaméogo	

R. V. Anderson, Acting Secretary
J. A. Kay, Assistant

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Also Present

African Department: M. Touré, Director; R. J. Bhatia, P. J. Boxall, A. W. Chang, S. E. Cronquist. Asian Department: L. Lipschitz, H. Roden, M. R. P. Salgado. European Department: R. P. Hicks, G. Tyler, C. Wollan. Exchange and Trade Relations Department: E. Sturc, Director; C. D. Finch, Deputy Director; D. K. Palmer, Deputy Director; E. H. Brau, B. Dillon, O. Johnson, T. M. Reichmann, R. Stillson, T. Sweeney. Fiscal Affairs Department: W. A. Beveridge, Deputy Director. IMF Institute: E. Kanoukounou, Participant. Legal Department: J. Gold, General Counsel and Director; J. G. Evans, Deputy General Counsel; G. P. Nicoletopoulos, Deputy General Counsel; P. R. Lachman, J. V. Surr. Middle Eastern Department: A. S. Gerakis. Research Department: G. I. Brown, L. U. Ecevit, L. M. Goreux, G. M. Khatchadourian, D. Papell, P. Sukachevin. Secretary's Department: K. F. Magurn. Treasurer's Department: W. O. Habermeier, Treasurer; R. J. Familton, Deputy Treasurer; A. M. Al-Samarrie, D. S. Cutler, R. H. Miller. Western Hemisphere Department: J. Del Canto, Director; E. W. Robichek, Deputy Director; F. A. Vera, Deputy Director; J. D. Guenther, M. E. Hardy, J. Restrepo, C. E. Sanson, J. C. Whiteman. Bureau of Language Services: J. S. Haszard, Director. Information Office: H. Hartmann. Advisors to Executive Directors: C. Bouchard, A. Malek. Technical Assistants to Executive Directors: V. Alipui, V. Amiel, S. Arancibia, E. Avillez, D. Berthet, J.-M. Bisson, I. M. Cobbold, J. M. Cock Londoño, M. Danusaputro, R. De Beckker, K. L. Deshpande, B. Goos, A. Karimi, H. Kuroda, E. Mannherz, A. G. Morris, K. Nakayama, C. C. Ozumba, M. Pietinen, E. Sacerdoti, S. B. Satyal, S. P. Upasani, A. van Dorssen, M. A. Wasfy, P. Zimmer.

1. ISRAEL - PURCHASE TRANSACTION - COMPENSATORY FINANCING

The Executive Directors considered the staff's analysis and recommendation with respect to a request by Israel for a purchase under paragraphs 2, 3 and 4 of the Decision on Compensatory Financing of Export Fluctuations (EBS/76/333, 7/21/76). The request was contained in EBS/76/333, Supplement 1 (7/30/76).

Mr. Lieftinck noted that, based on judgmental forecasts, the shortfall would exceed 50 per cent of Israel's quota even after an allowance had been made for double compensation. So far as the requirement of need was concerned, Israel had had a balance of payments deficit of over SDR 200 million in 1975, and the forecast deficit for 1976 was greater than 50 per cent of quota. The foreign reserve position had improved very slightly during 1975, largely owing to substantial short-term official borrowing at the end of the year, which had unfortunately caused Israel to be excluded from the final round of purchases under the oil facility. In those circumstances he warmly recommended approval of the request.

Mr. de Groote considered that the request by Israel was an interesting one in the sense that Israel's export receipts had actually increased during the shortfall year. The shortfall had therefore to be seen as a deviation from a rising trend of exports. Nevertheless, the request was certainly in accordance with the formula for the facility, and the case was attractive because it was one of the few in which both the formula and the judgmental forecast for once came close to the amount that the country was entitled to draw under the 50 per cent of quota limit. During many of the discussions on requests for purchases under the compensatory financing facility, the comments of Executive Directors had shown that they were not completely at ease with the system itself, largely because of the differences that tended to emerge between the calculated or forecast figures and those derived from an application of the quota limit. As to the question of need, it was clear that a criterion other than that of reserves was applicable, and Mr. Lieftinck had been correct in mentioning the deficit in the overall balance of payments. He would certainly support Israel's request for a drawing.

Mr. Lohmann stated that his chair would also support the request. It was clear that the recent balance of payments deficit demonstrated a requirement of need, and Israel's continuing cooperation with the Fund confirmed that the case satisfied the requirements of the compensatory financing decision. It was interesting to note that, although Israel had altered both the composition and the volume of its diamond exports, it had still suffered a considerable shortfall due to weak demand and the lower values. In view of the discussion that had taken place in connection with a request by Egypt for a drawing under the compensatory financing facility,

he was glad to note that the case for a drawing by Israel was in no way based on the loss of the Sinai oil fields. He assumed that the loss of the domestic production of petroleum would in future be an important factor in Israel's overall balance of payments position and in its possible need for assistance. He wondered whether the staff had any comment on the petroleum situation in the country.

The staff representative from the European Department noted that the petroleum produced in the Sinai oil fields had never been counted by Israel as part of its domestic production and that the petroleum products had been shown in the balance of payments as an import. The increase in the cost of oil imports had of course affected Israel in the same way as it affected all other net oil importers and had been a factor in the deterioration of the Israel balance of payments.

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

The decision was:

> The Fund has received a request from the Government of Israel for a purchase of the equivalent of SDR 65 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/76/333, Supplement 1 (7/30/76).

Decision No. 5168-(76/121), adopted
August 4, 1976

2. URUGUAY - 1976 ARTICLE XIV CONSULTATION AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report and proposed decision for the 1976 Article XIV consultation with Uruguay (SM/76/166, 7/21/76) and a request by Uruguay for a stand-by arrangement equivalent to SDR 25 million, together with the staff's analysis and recommendation (EBS/76/327, 7/21/76). They also had before them a report on recent economic developments in Uruguay (SM/76/113, 5/28/76; and Cor. 1, 7/15/76).

Mr. Simone made the following statement:

I shall begin by expressing my gratitude for the accurate and well balanced reports on the Uruguayan economy and stating that I am in basic agreement with the staff appraisal.

During 1975, Uruguay made considerable progress toward solving its economic problems. In 1974-75 the Uruguayan economy experienced balance of payments difficulties as a consequence of severe deterioration in the country's terms of trade: while the price of major import items increased by more than 200 per cent in 1974-75, the unit price of main exports declined by about 30 per cent as a result mainly of restrictions in foreign markets. In 1974 the deterioration of the terms of trade was 44 per cent and a further 19 per cent in 1975. In 1975 the inflow of foreign capital increased but was not enough to finance the current account deficit and the net international reserves declined by US$73 million. In any case the actual balance of payments deficit was substantially below that originally projected.

The rate of inflation--the second major area of concern--having increased up to 107 per cent in 1974, declined to 67 per cent in 1975. It should be emphasized that the reduction in the rate of inflation took place at a time when the rate of real economic growth accelerated to 3.6 per cent from an annual average of approximately 1 per cent during the previous decade.

Information available for the early months of the present year suggests that important further progress has been made in the area of balance of payments adjustment and domestic price stabilization. Actually, the trade balance recorded a surplus in the first six months of 1976, mainly as a result of a strong growth--59 per cent with respect to the comparable period of 1975--of exports. For the same period, the current account shows a deficit of only US$26 million which is equivalent to one fifth of the one recorded in the first semester of last year. For the six-month period ended last June, the rate of domestic inflation was 9.5 per cent, which compares quite favorably with 25.6 per cent in the first semester of 1975.

During the period under review, the exchange and trade system was substantially improved: the 35 per cent prior import deposit was abolished, exchange taxes on export proceeds were reduced, and the minimum financing requirements for imports were eliminated. The improvement of the balance of payments and of the exchange and trade system was due to the exchange rate and demand management policies that the authorities implemented. The Central Bank has continued the policy of adjusting the exchange rate in the

commercial market at frequent but irregular intervals. During 1975 the Uruguayan peso was depreciated at practically the rate of domestic inflation. During the first semester of the present year, the exchange rate adjustment in the commercial market has exceeded the rate of inflation; that also should facilitate the eventual unification of the commercial and financial exchange rates.

The monetary and credit policy has been designed and implemented so as to be consistent with the gradual deceleration of the rate of inflation.

The Uruguayan authorities assign great importance to the interest rate policy. Consistent with this, several adjustments have been made in the interest rates available to savers. As a result, by June 1976, the interest rates payable by commercial bankers on one-year time deposits had become positive in real terms since the nominal rate had risen to about 50 per cent while the rate of inflation during the previous 12 months had reached only 45 per cent. The interest rate is also being used to reinforce the credit policy and interest rates were set free in the early months of this year so that they could reflect market forces.

In 1975 the overall fiscal deficit was equivalent to about 4.5 per cent of GNP. The fiscal prospects for the present year are better, and the authorities have projected a reduction of the deficit to about 3.0 per cent of GDP.

A number of measures have been taken toward meeting this goal. Late in 1975 a temporary additional import tax was introduced affecting all imports except agricultural inputs and capital goods. Also, the coverage of the value added tax was extended, the bonus from prompt tax payments was eliminated and the penalty for late tax payments was raised. On July 1, a reduction in the rebates for nontraditional exports became effective, and a new scheme to facilitate collection of the tax on the potential yield of agricultural land was introduced. In addition the authorities have announced their firm intention to maintain strict control on government expenditures.

Economic growth during 1976 is expected to proceed at least at the same rate as in 1975.

My Uruguayan authorities are on balance satisfied with the results of the policies that they have been pursuing over the last two years. They realize, however, that additional effort

and time will be required to complete the adjustment of the balance of payments and to bring inflation under control. With these two basic objectives in mind they have designed an economic program for 1976-77 and are requesting a stand-by arrangement in support of that program.

The program calls for a reduction of the rate of inflation to below 38 per cent in 1976 and for limiting the overall balance of payments deficit to US$20 million. In pursuing these objectives, my authorities do not envisage at this point any changes in the orientation of their economic policies. This approach reflects their continuous concern for implementing realistic price policies in the market of goods and services--including public utilities--in the money and credit markets and in the exchange market. Interest rates will continue to play a key role in promoting savings, increasing the demand for monetary assets and allocating financial resources. The program calls for an expansion in the credit to the private sector of 40-45 per cent during 1976, which compares with an increase of 75 per cent in 1975. The authorities are aware of the need to continue maintaining strict control on government expenditures and they have stated their intentions carefully to review the fiscal developments at the end of each quarter. They also attach great importance to further improvement in the trade and payments system since they recognize its contribution to the growth of the economy through a higher level of efficiency in the allocation of economic resources.

The present policies of Uruguay have succeeded in accelerating the rate of economic growth and, at the same time in overcoming a very difficult balance of payments situation resulting from external conditions. These policies have also succeeded in substantially reducing the rate of domestic inflation and, on a long run prospective, in improving the allocation of resources, thereby promoting economic growth.

We think that these policies deserve the support of the International Monetary Fund.

Mr. Heyden Q., speaking on behalf of Mr. Suárez, observed that Uruguay had made impressive progress in 1975 and in the first part of 1976 toward reducing inflation, improving the balance of payments, and achieving sizable real economic growth. The progress had been achieved by adhering to the strict financial program adopted in 1975, and it had been assisted by the recovery of beef exports and of manufacturing.

One of the weaknesses of the Uruguayan economy, Mr. Heyden Q. continued, was the low yield of tax collections despite the introduction of several new taxes. The fiscal deficit, envisaged in the financial program for 1976 as being some 3 per cent of GNP, was still high, and in that respect he shared the concerns of the staff. Another weakness might be the situation of the external public debt, which had risen by some 50 per cent in the past two years, so that service payments had almost reached a critical level. The deterioration had of course been one of the effects of the closing of the beef market in Europe and of the increase in petroleum prices. His chair welcomed the efforts of the Uruguayan authorities to undertake the repayments of short-term loans scheduled in their financial program; the need to meet debt servicing payments seemed to be a sufficient reason for the request for a stand-by arrangement. His chair felt that the multiple currency practices and restrictions on imports adopted by the Uruguayan authorities were fully warranted in the present economic situation. He would have no difficulty with the proposed stand-by arrangement, and he could accept both the proposed decisions.

Mr. Lynch commented that, while it was encouraging that the Uruguayan authorities had made substantial progress during 1975 toward solving their problems, inflation was still high and they had a considerable way to go. The staff had been quite explicit both about the problems facing Uruguay and about possible remedies. Nevertheless, the urgency with which the staff appeared to have expressed its views in its appraisal had not carried over into the text of the proposed decision, where the only reference was to the desirability of a further strengthening of the government budget. Such moderate language was in contrast to that used in the appraisal on page 8 of SM/76/166, where the staff had written "a substantial strengthening of Treasury finances in the near future will need to be given the highest priority. Unless this is done it will be increasingly difficult to develop financial programs that are consistent with the Government's goal of reducing inflation... ." Unless there were particular reasons for not speaking plainly in the proposed decision (which would not be consistent with the course taken during the consultation with the People's Republic of the Congo, to be discussed as the next item), he hoped that the text of the decision could be strengthened to reflect the staff's views more closely.

Mr. Temple-Seminario said that he had been impressed by the results achieved by the Uruguayan authorities during the past year. Not only had they brought about a decrease in the rate of inflation; they had achieved an increase in the rate of real economic growth and reduced the current account balance of payments deficit despite the liberalization of trade restrictions. While he was slightly concerned by the rapid increase in wages, he was sure that the authorities would be as competent in dealing with that problem as they had been in handling the other economic variants.

Mr. Lieftinck noted that Uruguay had had a very slow rate of growth for many years, and that it was remarkable that in 1975--a period of adverse conditions--the country had achieved a real rate of growth of 3.5 per cent. Terms of trade had deteriorated dramatically as a result of the increase in the price for oil and the low prices received for beef; but both internal and external activity--and the balance of payments--had benefited from a remarkable increase in exports of manufactured goods.

The rate of inflation had also dropped considerably during 1975, Mr. Lieftinck observed, perhaps because of the effect of wage policies. There had indeed been a decline in real wages despite frequent wage adjustments. In general terms the Uruguayan authorities seemed to have adopted the discipline of the market in all their policies affecting prices, interest rates and foreign exchange. The interest rate had been allowed to become positive, and had indeed reached very high figures. Similarly, in the first six months of 1976 the balance of payments had improved considerably. Nevertheless, the fiscal deficit was still very high, and the authorities ought to take measures to improve the situation without much delay. If they did not, and there was a recovery of domestic activity, there were indications that prices might increase again at an unduly high rate. Improvement in the fiscal situation was perhaps being hampered by the efforts of the authorities to improve the tax system in the agricultural sector by reducing export taxes and substituting a tax on potential agricultural output. While theoretically such a tax had much to commend it, there was some doubt whether it would give the expected results and, meanwhile, the export taxes had perhaps been terminated unduly soon.

So far as the request for a stand-by arrangement was concerned, Mr. Lieftinck stated that he would accept the proposed program set out in the letter of intent. He had been much impressed by the action of the Uruguayan authorities in repurchasing their drawings under the previous stand-by arrangement when their balance of payments position had improved. In the circumstances, he could approve both the proposed decisions.

Mr. Laske noted that Uruguay had been severely hit by increases in the price of oil products. Despite such an unfavorable development, the authorities had had a successful year, which was particularly noticeable for the fall in the rate of inflation. Nevertheless, the rate of price increase of 45 per cent in the first half of 1976 was still very high, and the intention to reduce it to 38 per cent in the second half of the year was not very ambitious. There were, moreover, certain elements that seemed to preclude any rapid reduction in the rate of inflation. Among them was the 20 per cent increase in wages that had become effective one month previously, and he wondered how much that increase would contribute to a

further rise in production costs. Furthermore, the authorities envisaged a monetary expansion of 42 per cent during 1976, when more restraint might have been useful.

The most worrying aspect of the situation in Uruguay was certainly the position of the public finances, Mr. Laske considered. It had proved impossible to meet the target figures of the previous year, and he wondered why the state petroleum company had been unable to collect the petroleum tax from its customers. Moreover, there seemed to be some difficulty in collecting taxes in the agricultural sector; and he urged the authorities speedily to recover those taxes with the aim of increasing revenues for the Government and bringing the government accounts nearer to equilibrium. He was prepared to support the request for a stand-by arrangement, especially because Uruguay had been able to repurchase its drawing under the previous year's arrangement ahead of time.

Mr. Foglizzo stated that he had been informed by his authorities that the Uruguayan authorities had for more than a year been drastically limiting imports from France. As a result, French exports to Uruguay had dropped by more than 50 per cent in the first four months of 1976 compared with the corresponding period of 1975. The limitations were not the result of formal restrictions but of a deliberate policy of hampering imports by administrative devices. His authorities had made appropriate representations to the Uruguayan Government, both in Paris and in Montevideo, but without success. They considered that the time had come to raise the issue at the multilateral level, and that the Executive Board of the Fund was an appropriate forum for so doing. It might be argued that because the discriminatory policies he had described had no legal basis there was no reason to accuse Uruguay. Such an argument would certainly not hold up in any system of law. It might also be argued that the restrictions had not been imposed for balance of payments purposes and that they would therefore not come within the jurisdiction of the Fund. That argument was not valid either, because the commitment not to introduce restrictions on imports applied not only in the 1974 oil facility decision (under which Uruguay had drawn), but also in the 1975 oil facility decision, under which Uruguay had requested a purchase on September 4, 1975.

Under the oil facility decision for 1975, Mr. Foglizzo continued, it was permissible to inquire why the Uruguayan authorities had applied restrictions on imports from France. The answer was likely to be that the measures had been imposed in retaliation for certain European actions in connection with beef imports. He would certainly agree that the European actions had had an adverse effect on the economies of countries like Uruguay, which depended heavily on beef exports; but developments in the world market for beef were not fundamentally different from those in the world market for other commodities. It was the objective of all to stabilize

the prices of commodities in world trade and in the meantime to compensate countries for variations in export earnings. In that connection, Uruguay had had access to financial assistance from the Fund under the compensatory financing facility, and his country had supported Uruguay in its request. He could not, however, feel that the Uruguayan authorities had been right to retaliate against one particular member of the European Economic Community for measures taken by the Community as a whole in accordance with international agreements, including those under the General Agreements on Tariffs and Trade, for reasons beyond the control of any individual country.

It was all the more reasonable to object to the actions of the Uruguayan authorities, Mr. Foglizzo commented, because the arrangements for beef imports into the European Economic Community had been greatly liberalized, so that in 1976 the Community would be a net importer of about 100,000 tons of beef. Meat imports into the European Community in general were likely to increase still further in 1977 as a result of the drought that had affected most European countries. It might be worth adding that France was Uruguay's second largest customer for beef. His authorities were not fundamentally opposed to the adoption of restrictions on imports without exception. Executive Directors would recall that when the Argentine authorities had requested a drawing under the 1975 oil facility, his chair had reacted more favorably than many others to the existence of import restrictions because it had been convinced by the arguments of the Argentine authorities that the emergency justified their use. In the present case, however, his chair saw no such justification. He would therefore like Mr. Simone to inform his Uruguayan authorities of the deep concern of the French Government. He would be interested to hear whether the staff had any information on the matter, so that Executive Directors could consider whether action might be required in connection with drawings by Uruguay both under the oil facility and in connection with the previous and the proposed stand-by arrangement. Meanwhile, he would abstain from supporting the request for the stand-by arrangement.

Mr. Rasaputram noted that in real terms the rate of growth of the gross national product of Uruguay had doubled from 1.8 per cent in 1974 to 3.6 per cent in 1975. At the same time, real per capita income had risen at a rate of about 2.4 per cent per year. The staff paper seemed to indicate that the annual rate of increase of the population had been around 0.2 per cent per year for the period 1966-75. Comparing the rate of growth for GNP with the increase in real per capita income in 1975 seemed to show that the rate of increase of the population in that year had been about 1.2 per cent. He wondered whether it was possible to conclude that the population had started increasing more rapidly than it had been doing in earlier years. Second, interest rates had been adjusted upward to take

account of growing inflation, and the staff had indicated that deposits had been showing a positive yield. It would be interesting to know whether there had been an increase in savings to take advantage of the higher yields or whether all that had happened was that other forms of savings had shifted into the banking sector. There had apparently been a 10.6 per cent increase in domestic fixed investment, which would seem to imply that at least some of the savings had gone into investment unless a considerable volume of funds had become available from outside sources to take advantage of the increased interest rate, which had risen by almost 50 per cent in 1975. He would of course approve the request for a stand-by arrangement by Uruguay.

Mr. Lohmann remarked that Uruguay had made substantial progress especially in the first half of 1976 toward reducing the high rate of inflation and the large balance of payments deficit experienced in 1974 and 1975. He was pleased that the improvement in the balance of payments had been so great that Uruguay had been able to repurchase the first credit tranche drawing made in January 1976 and that the authorities had been able to state that they hoped they would not have to utilize the funds that would become available under the requested stand-by arrangement. Nevertheless, it was clear that Uruguay still had a requirement of need. The balance of payments was expected to be in deficit in 1976, and the authorities had to make large repayments on short-term loans, presumably at least in part by rollovers that might be facilitated by the Fund's endorsement of a financial program. Moreover, the program itself was a logical extension of recent successful policies. It correctly placed emphasis on reducing the fiscal deficit. As that was one field in which the authorities had been unable to meet their commitments under the previous stand-by arrangement, he hoped that the staff would give particular attention to budgetary performance in the review that was to take place no later than January 1977. In conclusion, he would support both the proposed decisions. However, in so doing he would endorse in particular the suggestion that Uruguay should take advantage of its improving balance of payments in order further to reduce its multiple currency practices and restrictions on imports and payments.

Mr. Dini observed that, considering that the terms of trade had deteriorated so severely, the Uruguayan authorities had been generally successful in managing their resources. Nevertheless, the rate of inflation, although less than it had been, was still considerable, and the fiscal performance had been less good than had been expected. He wondered whether the staff could explain why the rate of inflation had been higher than anticipated during the period of the recently expired stand-by, even though the balance of payments had been favorable.

The justification for the requested stand-by arrangement, Mr. Dini considered, must be the country's relatively low level of reserves, since the balance of payments projection for the coming year was generally favorable, and the authorities themselves expected the balance of payments to be roughly in equilibrium. In the circumstances, he had been slightly surprised to note that the stand-by arrangement did not contain any precise reference to possible reductions in restrictions. He would of course support both the decision on the stand-by arrangement and that for the Article XIV consultation.

The staff representative from the Western Hemisphere Department, replying to questions, stated that the population of Uruguay had begun to grow faster than previously in 1975. Not only had the economy begun to pick up in Uruguay but there had been a slowdown in Brazil and Argentina in 1975. Consequently, many Uruguayans had returned home from those countries. Inflation had been higher than anticipated in 1975 mainly because it had been impossible to hold wages down in the way that the authorities had intended. It was also because of the difficulties of controlling wage rates that the staff and the authorities had been cautious in predicting a large decline in the rate of inflation for 1976, even though inflation had been low in the first half of the year.

The Deputy Director of the Exchange and Trade Relations Department, commenting on Mr. Foglizzo's remarks, stated that the staff had been aware for about a year of the situation mentioned by Mr. Foglizzo. It had understood that delays in import registrations had occurred in reaction to difficulties with meat exports, not only to the EEC but also to countries in the Middle East due to competing exports from France. The staff would certainly agree with Mr. Foglizzo that it was not in accordance with the Rome communiqué for any country to escalate restrictions, and it had indeed discussed the matter with the Uruguayan authorities at that time. They had been both responsive and understanding, noting that no formal policy for delays existed and indicating that they would look further into the report. The staff had reported the matter to Executive Directors in connection with the oil facility drawing by Uruguay in September 1975. Thereafter, it had believed that the problem had been eased, until it had been raised again in the course of a GATT consultation with Uruguay in June 1976. In response to a complaint by the representative of the European Communities, the Uruguayan representative at that meeting had indicated that he would bring the matter to the attention of his authorities. The staff had reported that to the Executive Board. If the registration delays should persist, it would not affect Uruguay's access to a stand-by arrangement, which only contained a performance clause in relation to restrictions for balance of payments purposes. Nevertheless, the staff would of course discuss the matter again with the authorities.

Mr. Simone remarked that the Uruguayan authorities were fully aware of the need to reduce the public sector deficit from a level of 4.5 per cent of GNP to 3 per cent of GNP. The 3 per cent figure was consistent with the targets for monetary expansion and the rate of inflation that had been mentioned in the letter of intent. Moreover, the authorities had already taken a number of measures to reduce the rate of inflation, such as extending the value added tax, introducing a flat rate tax on imports, imposing penalties for nonpayment of taxes, improving the efficiency of the land tax collection service, and floating bonds on the market. In addition, they were looking very closely at the expenditure side. Taking all the authorities' actions together, it seemed likely that they would reach the targets they had set for themselves.

As to the rate of inflation, the figure had fallen from over 100 per cent in 1974 to 67 per cent in 1975, Mr. Simone noted. In the first six months of 1976 the rate had been 9.5 per cent and, even though there had been a wage increase of 20 per cent on July 1, 1976, it was possible that the authorities would reach their target of 38 per cent by the end of the year.

On the question of restrictions, Mr. Simone said that Uruguay had adopted a policy of liberalizing its foreign trade in the immediate future, a courageous step in view of the difficulties experienced by Uruguay because of import restrictions elsewhere. Specifically on Mr. Foglizzo's statement, he had only heard of the matter very recently, and he would convey the concern of the French authorities to his Uruguayan authorities. Nevertheless, he regretted very much that the French chair had decided to abstain in connection with the stand-by arrangement for Uruguay.

The Executive Directors turned to the proposed decision for the Article XIV consultation.

To meet the point made by Mr. Lynch, the Acting Chairman proposed that the opening of the third sentence in paragraph 2 should be amended to read "the Fund believes that these policies should be continued, and that a further strengthening of the government budget should have high priority... ."

The Executive Directors approved the proposed decision for the Article XIV consultation with Uruguay as amended. They also approved the proposed decision for the stand-by arrangement, with Mr. Foglizzo abstaining.

The decisions were:

a. 1976 Article XIV Consultation

1. This decision is taken by the Executive Directors in concluding the 1976 consultation with Uruguay pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. Uruguay has succeeded in reducing inflation while maintaining the level of economic activity and adjusting the balance of payments to the higher prices for fuel imports. This had been accomplished through a broad financial program, including wage, credit, and exchange rate policies, which has led to increased output particularly in sectors oriented to export. The Fund believes that these policies should be continued, and that a further strengthening of the government budget should have high priority, in order to restore internal and external stability and provide a sound basis for long-term economic growth.

3. Uruguay has also made considerable progress during the past two years in reducing multiple currency practices and restrictions on imports and payments and transfers for current international transactions. However, the exchange system remains complex, and the dual exchange market has been maintained. The Fund believes that Uruguay should reduce further its reliance on multiple currency practices and restrictions in the near future. In the meantime, and in view of the circumstances of Uruguay, the Fund grants approval until August 15, 1977 of Uruguay's multiple currency practices and restrictions on payments and transfers for current international transactions as described in SM/76/113 (5/28/76).

Decision No. 5169-(76/121), adopted
August 4, 1976

b. Stand-By Arrangement

The Government of Uruguay has requested a stand-by arrangement for a period of 12 months and for the equivalent of SDR 25 million. The Fund approves the stand-by arrangement set forth in EBS/76/327, Supplement 1, and grants any necessary waiver on the conditions of Article V, Section 3(a)(iii). of the Articles of Agreement.

Decision No. 5170-(76/121), adopted
August 4, 1976

3. PEOPLE'S REPUBLIC OF THE CONGO - 1975 ARTICLE XIV CONSULTATION

The Executive Directors considered the staff report for the 1975 Article XIV consultation with the People's Republic of the Congo (SM/76/52, 3/17/76; Cor. 1, 6/21/76; Cor. 2, 6/25/76; Cor. 3, 7/26/76; and Sup. 1, 7/30/76). They also had before them a report on recent economic developments in the People's Republic of the Congo (SM/76/80, 5/3/76; Cor. 1, 5/6/76; and Cor. 2, 7/26/76).

Mr. Yaméogo said that his authorities regretted the delay of over seven months between the time of the mission's visit to the Congo and the discussion by the Executive Directors. The delay had been due to a request by his authorities on April 23, 1976 to postpone discussion until they had been able to make the comments incorporated in the various additional papers before the Executive Directors. The purpose of the comments was to enable the Executive Directors to take account of the views of his Congo authorities, particularly regarding monetary and credit policy.

As the staff had said, Mr. Yaméogo continued, the economic and financial situation of the Congo had been satisfactory from 1971 through 1974, with the growth of GDP averaging 5 per cent per year despite the worldwide recession. The deterioration of the situation had started in 1975 and continued through 1976, as could be seen clearly in Table 1 of SM/76/52, Supplement 1. The main result of the deterioration had been a negative growth of GDP in 1975, reflecting a drastic decline in oil production to a total of 1.8 million tons, coupled with a decrease or stagnation of output in most other sectors of the economy. The impact on both the internal and external side of the national economy had led to a drop in fiscal revenue, which had shown an increase of only 0.3 per cent in 1975 compared with one of 81 per cent in 1974. Moreover, the falling off in domestic revenue had not been accompanied by a corresponding decline in current expenditure, which had risen by 74 per cent in 1974 and by a further 18 per cent in 1975. A considerable increase was also expected for 1976. If capital expenditure was included, it could be seen that the public finances had deteriorated seriously. In order to finance the deficit, domestic credit had increased by 46 per cent and the money supply by 11 per cent.

On the external side, Mr. Yaméogo stated, the decline in oil exports by 9 per cent in volume terms and the increase in imports by some 20 per cent during 1975 had led to a deterioration both of the trade balance and of the current account, together with a reversal of the balance of payments position from the surplus in 1974 to a deficit of some SDR 10 million in 1975. At the same time, gross official reserves had fallen by SDR 7.6 million in 1975, so that the present reserve level was equivalent to only about three weeks' imports. Consequently, the staff was right to

encourage the Congo authorities to introduce better demand management and more appropriate fiscal and monetary policies. The aim of the authorities should be to eliminate the deficit in the balance of payments, restore the external and internal financial situation, and create a better basis for economic growth.

So far as the country's economic development was concerned, Mr. Yaméogo remarked, the Congo had an abundance of natural resources: mineral, agricultural, and marine. Only 1 per cent of the country's land was cultivated, the remainder awaiting the accumulation of the necessary resources to exploit it. The country's main weakness still lay in the shortage of human resources. With a population of 1.3 million and an area of 350,000 square kilometers, the ratio of population to land was very small. His authorities therefore intended to devote greater efforts to increasing the efficiency with which the economy was managed. Particular attention would be paid to agricultural production, which employed 70 per cent of the population. The authorities also intended to concentrate their efforts on manufactures, communications, and educational training in order to obtain adequate inputs for the economic and social development of the country.

Mr. Foglizzo commented that the Congo had suffered heavily in 1975 from the downturn in its oil production, so that most official forecasts, which had relied on a continuing increase in taxes and royalties from the oil sector, had had to be drastically revised. The developments of 1975--consisting in part of a deficit on central government finances, excessive capital expenditure compared with the resources available, an overrapid expansion of domestic credit, and a deterioration in the balance of payments--called for a reassessment of the economic situation and for the introduction of a stabilization program.

His chair welcomed the steps taken in March 1976 to improve the situation of the central government budget, Mr. Foglizzo observed. In particular, he was glad to have seen the cautious evaluation of taxes and royalties in the oil sector, and to note the anticipated increase in other revenues, leading to a small current surplus in the central budget. The authorities were to be commended for their realism in reviewing the investment program. It was to be hoped that developments in the oil sector in 1977 would allow the authorities to complete some of the investment projects that had had to be interrupted. In that respect, the earmarking of foreign revenues for financing government investment, although not a satisfactory procedure for the longer run, would be helpful in the near future. Finally, he wondered whether it would not be advisable to amend the proposed decision to take account of the measures recently adopted by the authorities.

Mr. Monday said that he would associate himself with Mr. Foglizzo in suggesting an amendment to the proposed decision to take account of the measures that the authorities had recently introduced. The Congo's new-found offshore petroleum appeared to have created problems of economic and financial management for the country. It was therefore satisfactory to have heard Mr. Yaméogo say that the authorities would be giving increasing attention to manpower training. The breakdown in the onshore oil wells in 1975 and the unavoidable delay in beginning offshore drilling had led to a sharp curtailment of petroleum production for export, thus creating problems for the budget--including the continuation of development expenditures--and bringing about a deterioration in the balance of payments. Moreover, as the authorities had committed themselves to continuing the expansionary policies begun in 1974, there had inevitably been a sharp increase in prices.

It was therefore encouraging, Mr. Monday considered, to learn that the authorities had trimmed their three-year investment program to a more manageable level, particularly in view of the doubts about the early resumption of oil production at the previous high level. Public sector savings could be further improved, and it was unfortunate that the authorities had awarded a wage and salary increase in the public sector amounting to some 30 per cent during the previous year. Current expenditure commitments also appeared to be excessive. The Congo continued to depend on foreign assistance, and the recent sharp increase in short-term debt might well have impaired its ability to continue to attract foreign resources. Further scope also existed for tapping non-oil revenues. The recent tax measures, including the 1 per cent tax on consumption loans, did not seem adequate.

While the authorities had taken appropriate steps to improve the managerial ability of the public enterprises, Mr. Monday observed, it might be necessary to review their pricing policies and to cut down their dependence on government subsidies. More action should also be taken to control the level of domestic credit, something that might be almost impossible as a result of the excessive liquidity acquired by the commercial banks. Further diversification efforts were called for to lessen dependence on petroleum and the forestry sector, for whose products there had recently been a worsening in foreign demand. An increase in producer prices might be necessary to encourage agricultural production, and he was glad to have noted Mr. Yaméogo's statement that the authorities intended to give more attention to agriculture.

Finally, Mr. Monday stated, he fully endorsed the staff's recommendation that the authorities should further reduce the large payments arrears and endeavor to reconstitute the Treasury's position with the central bank. By and large, an improvement in financial management deserved high priority.

Mr. de Groote commented that it was regrettable that the Fund mission to Brazzaville had taken place seven months previously, and that there had been no discussion of the added information. It was also regrettable that the staff mission had apparently not had access to those responsible for decisions affecting economic policy. The behavior of the authorities gave rise to doubt whether it was desirable to send further staff missions to a member that could not provide them with contacts at the decision-making level or enable the Fund to use the results of the mission's discussion at the proper time.

On the substance of the report, Mr. de Groote observed that the economy of the Congo appeared to be divided into distinct systems, one depending on ambitious economic planning, the other on a reliance on private and mixed enterprises, with the advantages of neither. Planning should be accompanied by a rational allocation of resources on the basis of selective criteria, which should in turn depend on correct choices and effective administration. Unfortunately, in the Congo the investment program had been established without providing an administrative structure for selecting between different objectives, the price structure was distorted by the public sector where costs were not covered by selling prices, and the Government had to subsidize its own products very heavily. Paradoxically, there had been a fall in output in all those fields that were subject to programing. At the same time, the incentives on which private enterprise normally depended had not been allowed to play their normal role, and there had been declines in the output of the private sector as well. The decline of the oil sector was certainly related to the reluctance of producers to continue to invest in the circumstances of the Congo.

More generally, the performance of the Congo economy threw light on the dangers of the establishment of an enclave sector, Mr. de Groote mentioned, a point stressed in some economic models like that devised by Professor Fay. The case of the petroleum industry in the Congo was one of the most striking illustrations of the danger that an insulated sector, or enclave, could create poverty through abundance. The advent of the petroleum industry had had a negative effect on the Congo economy, since it had diverted resources from normal fields of production, including agriculture, thereby reducing the income multiplier of the resources, with adverse effects on the public finances. It had also created euphoria on the part of the authorities, who had overestimated the resources available to them, and the Fund should be careful in similar cases to draw the attention of the authorities to the risk of relying on any economic enclave.

The Congo authorities, Mr. de Groote commented, had been borrowing from abroad to a considerable extent. It was comforting to see that

neither United States banks nor Luxembourg banks had been involved, and that France, the Soviet Union and China had been the home countries of the banks most involved. It would be interesting to know whether the lenders to the Congo had followed the same criteria as those adopted in other cases, in which certain commercial banks had been criticized for overlending. In any event, it was quite certain that the help received by the Congo had to some extent at least prevented the authorities from acting to correct the situation. He hoped that the authorities would succeed in improving their management of the Congo economy. The very low level of real income in the country made it desirable that they should lose no time in closing the gap between the economy of the Congo and the economies of other countries in Africa whose authorities had succeeded in managing their affairs more effectively.

Mr. Sein Maung noted that Mr. Yaméogo had said that the Congo authorities were conducting trade programs to increase human skills. He recalled that, at the time when the Executive Directors had discussed a consultation report for Burma, Mr. Yaméogo had suggested that his Burmese authorities should import foreign technology and foreign skills in order to overcome some of their difficulties. He wondered how Mr. Yaméogo would react to the suggestion that the Congo authorities should adopt the same course.

Mr. Lieftinck remarked that on reading the staff report for the consultation with the Congo he had been depressed to learn that despite the bleakak outlook for 1976 the authorities had so far refrained from introducing comprehensive measures to correct both the external and the internal imbalances that had emerged. However, after reading Supplement 1 he had come to the conclusion that the appraisal in the staff report needed some correction, and that an amendment to the revised proposed decision, which was even more gloomy than the original one, would be justified. The new decision, for instance, stated that overall growth appeared to have been negative in 1975, but it made no reference whatsoever to the promising actions that had been taken recently. He did of course agree with the staff's assessment of the situation and with the recommendations offered by the staff in the original report. In support of Mr. Foglizzo's proposal for amending the second paragraph of the revised proposed decision, he noted that the Congo appeared not only to have a payments agreement with a nonmember but bilateral trade arrangements with a number of members, including Yugoslavia and Mauritania. He wondered why the staff had not covered that point in the consultation paper, and why it was not mentioned in the proposed decision. If the bilateral trade arrangements were still active, some reference to them should be made, as was usual in such cases.

Finally, Mr. Lieftinck observed, in 1970 and 1971 the staff had assisted the country in drafting national accounts. That effort seemed,

perhaps unavoidably, to have been discontinued. It would, however, be interesting to know the present situation, because helping the country with its national accounts could be a way of assisting it to improve its economic and financial management. He hoped that the authorities would give full attention to the staff report, not only by cutting down the ambitious investment program, but also by adopting the other measures it had suggested.

Mr. Dini stated that he agreed with other speakers, and particularly with Mr. de Groote, on the circumstances of the Congo economy. It was regrettable that most of the additional resources received by the Congo in 1974 following the increase in oil prices had been used to increase current expenditure. In those circumstances it was not surprising that, with the decline in oil production and oil exports during 1975, the country's economic and financial situation had come under severe pressure. Since the prospects for 1976 were not favorable, the staff had been correct to call for a reappraisal of policies and for measures to restrain domestic demand. He supported the staff recommendation for the introduction of measures designed to control overall credit expansion, perhaps along the lines of the recommendations adopted by the Central Bank of West African States. He had been encouraged by the measures announced by the Congo authorities in early 1976, but much remained to be done to strengthen the Congo's economy and to obtain a meaningful improvement in the financial situation.

Mr. Lohmann remarked that the situation described in the staff report and in Supplement 1 was disheartening. There were two factors that were particularly disappointing. First, the very high expectations generated by the discovery of oil had clearly not materialized, and he wondered to what extent the difficulties were really of a technical nature, or whether they were due to disagreements between the oil companies and the authorities regarding tax or investment arrangements. Second, while Supplement 1 was encouraging in certain respects, it had not prompted the staff to change the language of the decision with regard to the lack of corrective measures in response to the obvious financial deterioration. In particular, he noted that one of the measures was a reduction in the investment budget; while that action was satisfactory in itself, because it had been clearly necessary, it would have been more effective if the authorities had also reduced current expenditures. Moreover, Supplement 1 referred to several measures that the authorities maintained they intended to bring into effect, but it did not state that any positive action had been taken. He therefore wondered whether it would in fact be correct to amend the revised proposed decision to indicate that certain measures had been taken.

While it was of course to be hoped that the performance of the oil sector would improve, Mr. Lohmann observed, if oil revenues did not reach the projected levels, the budget would clearly have to be altered accordingly. In that connection he agreed with Mr. de Groote's comments on the adverse effects of an overemphasis on the oil sector; it was particularly important that greater attention should be given to the traditional sectors of agriculture and forestry. Finally, he regretted that it had taken so long for the outcome of the Fund mission's discussions to be brought before the Executive Directors, and he noted Mr. Yaméogo's comments in that respect.

Mr. Jagannathan stated that he agreed with the comments made by Mr. Dini and others. The adjustments indicated in the proposed decision were clearly necessary. However, before agreeing that a substantial cut in current expenditure was desirable, he would like to know whether current expenditure included outlays on education, manpower training, health, and the like. In some countries such expenditures were shown under outlays for development plans, while in others they were considered to be part of the current budget.

The staff representative from the African Department, replying to questions, noted that official national accounts for the Congo had only been available for 1970 and 1971. During the consultations, the staff had tried to use those accounts as a basis for estimating national account aggregates for later years. While the staff's estimates were of course highly tentative estimates, they did give some guidance with respect to the development of the economy, and the staff hoped to improve the estimates in future consultations. The staff certainly agreed that there was a need for technical assistance in that connection, if the authorities so requested.

The staff did not have any more recent information on the development of oil production than had been mentioned in the report, the staff representative continued. The opening of the Loango field, which had originally been scheduled for 1975, had been postponed to 1977. Naturally, once that field had been opened up the output of petroleum would increase quite substantially, at least for a few years.

To reply to Mr. Jagannathan, the staff representative said that expenditures on education and welfare had traditionally been relatively higher in the Congo than in neighboring countries, and he cited as an example the fact that the scholarization rate approximated 90 per cent. While expenditures on social welfare thus had always occupied a large share of current budget, those expenditures had not shown the largest increases in 1974 and 1975. It was outlays on wages and salaries in other sectors and on matériel that had brought about the rapid increase in current expenditure.

With respect to an amendment of the proposed decision to take account of the 1976 budget measures, the staff representative explained that an amendment had not been proposed, since the staff had not had an opportunity to discuss the measures with the authorities. Naturally, the staff would see no difficulty in inserting a sentence to the effect that the authorities had announced the introduction of the measures.

The staff representative from the Exchange and Trade Relations Department commented that the trade arrangements entered into by the Congo were strictly trade arrangements that did not have payments features associated with them; they were therefore not subject to Fund jurisdiction. Reference was only made to such arrangements in decisions for consultations when they were found to be restrictive in terms of payments and transfers.

Mr. Lieftinck commented that, while he would not insist on changing the proposed decision, he had understood that the Fund had jurisdiction over bilateralism whether the agreements affected trade alone or both trade and payments.

The Acting Chairman commented that, regardless of the juridical situation, the staff would be free to give advice on such matters to the authorities in the course of consultations.

Mr. Yaméogo stated that he would communicate the views of the Executive Directors to his Congo authorities. As to Mr. Seing Maung's remark concerning the desirability of importing technology and foreign skills into the Congo, it might be worth bearing in mind that the Congo had a population of only 1.3 million, compared with the 30 million inhabitants of Burma. Both countries possessed considerable natural resources, and one of the main differences between them was perhaps that the Congo was more open to free competition between East and West because it was receiving technical assistance and other cooperation from Russia, China, Romania, Yugoslavia, and other members of the Sino-Soviet bloc although it was an associate member of the European Economic Community and Europe was its main trading partner and the main source of foreign capital, management and training skills.

The Executive Directors turned to the revised proposed decision set out in SM/76/52, Supplement 1.

After some discussion, the Executive Directors agreed to insert the sentence "some measures in these fields were announced in March 1976" at the end of paragraph 2 to indicate that they had taken note of the actions of the authorities.

The decision as amended was approved.

The decision was:

1. This decision is taken by the Executive Directors in concluding the 1975 consultation with the People's Republic of the Congo, pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. Owing to the decline in oil production and relative stagnation in most other key sectors of the economy, overall growth in 1975 appears to have been negative. Expansionary fiscal and credit policies, moreover, resulted in a rapid increase in demand and in a deterioration of the internal and external financial situation. The Treasury not only utilized central bank financing up to the statutory limit to finance its deficit, but there was also a substantial increase in domestic payments arrears. Prices rose sharply, but only a small part of the increase was due to higher import prices. Corrective measures in the fiscal and credit fields are urgently required to restrain demand. Some measures in the fiscal field were announced in March 1976.

3. Extensive use of foreign borrowing, including particularly suppliers' credits, has brought about a rapid increase in debt service that will impose an increasingly heavy burden on the balance of payments and on the government budget in 1976-78. Close control over further foreign borrowing on commercial terms will be required.

4. The Fund notes with satisfaction the maintenance of a relatively liberal system of trade and payments.

Decision No. 5171-(76/121), adopted
August 4, 1976

4. 1976 ANNUAL MEETING - FORMAL NOTICE AND BRIEF AGENDA

The Executive Directors considered a draft formal notice and brief agenda of the 1976 Annual Meeting prepared for despatch in accordance with Sections 4 and 6 of the By-Laws (EBD/76/156, 7/26/76).

The General Counsel remarked that one possible course of action in connection with Governors' allowances--the last item on the agenda of the present Board meeting--could be to include the topic in the agenda of

the 1976 Annual Meeting. It might therefore be desirable to agree that any action taken on the agenda should be subject to anything that might be decided in connection with Governors' allowances.

Mr. Lieftinck referred to item 4 of the proposed brief agenda "Review of the performance of the Development Committee." The wording could be interpreted as being rather critical of the performance of the Development Committee, and some other language might be preferable.

The General Counsel explained that the term "Review of the performance of the Development Committee" had been adopted because it reflected the language of the Board of Governors' Resolution. It would of course be possible to refer to a review of the Development Committee under paragraph 7 of the resolution.

Mr. Jagannathan stated that he agreed with Mr. Lieftinck.

Mr. Amuzegar inquired whether it would not be possible to combine items 3 and 4 of the proposed agenda.

The General Counsel explained that item 3 called for the Development Committee itself to make an annual report to the Board of Governors on its work during the past year and that item 4 dealt with the review that the Board of Governors had to make of the past two years in the history of the Development Committee.

Mr. Yaméogo proposed that item 4 should be entitled "Review of the activities of the Development Committee"; the language would be in line with that used by the OECD in connection with the Development Assistance Committee.

Mr. Dini supported Mr. Amuzegar's proposal that items 3 and 4 should be run together. He would, however, prefer to talk of the performance of the Development Committee rather than to refer to the resolution number.

Mr. Lieftinck said that he could accept the suggestion that items 3 and 4 should be run together, with two sub-items.

The Executive Directors accepted the proposal put forward by Mr. Lieftinck.

Mr. Foglizzo noted that item 9 read "Applications for Membership." He wondered whether there would in fact be more than one.

The Acting Secretary noted that it was expected that there would be at least one application before the Governors; it was, however, not yet possible to be certain of the number.

The decision was:

The Executive Directors instruct the Secretary to communicate the notice and brief agenda as amended by cable to members and by airmail letter to all Governors and Alternate Governors in the period August 16-20, 1976.

Adopted August 4, 1976

5. REPORT OF THE COMMITTEE ON RULES FOR 1976 REGULAR ELECTION OF EXECUTIVE DIRECTORS

The Executive Directors considered the report of the Committee on Rules for the 1976 Regular Election of Executive Directors (EBD/76/158, 7/28/76). They also had before them a note confirming that Trinidad and Tobago had become a republic within the Commonwealth on August 1, 1976 and that Trinidad and Tobago was therefore an American Republic for the purpose of Article XII, Section 3(b)(iv) (EBD/76/162, 8/3/76) together with a worksheet prepared for the information of the Committee on Rules for the 1976 Regular Election of Executive Directors (EB/CREED/76/1, Supplement 1, 8/3/76).

The Acting Chairman informed the Executive Directors that the staff had completed calculations with respect to the Fund's use of member currencies as of July 31, 1976, and that no member that was not entitled to appoint a Director under Article XII, Section 3(b)(i) would be entitled to appoint a Director in accordance with the terms of Article XII, Section 3(c) when the 1976 Regular Election of Executive Directors was held.

Mr. Jagannathan, Chairman of the Committee, noted that the outcome announced by the Acting Chairman had been assumed by the Committee members, and a statement to that effect was included in paragraph 1 of the draft report. In paragraph 2 the Committee proposed that Executive Directors should express the view that no change in the number of elected Executive Directors was required, and that they should report that there was a strong feeling among many of them that a lack of acceptable balance in the representation on the Executive Board would call for prompt corrective action. The Committee had taken note of the intimation that the Republic of China did not intend to participate in the election; the Republic of South Africa had not made its intentions known. The information regarding the status of Trinidad and Tobago had been circulated separately for the information of Executive Directors. The conclusion reached by the Committee was that there should be the same number of elected Executive Directors as previously and that the same percentage of votes should be required to ensure election to a seat.

Mr. Monday stated that he could certainly approve the report. With respect to Trinidad and Tobago, a member of his constituency, he confirmed that the country had become a republic on August 1, 1976, and that under the present Articles Trinidad and Tobago had no option but to vote for an Executive Director from a Latin American constituency. However, when the proposed amendment became effective, that legal anachronism would be eliminated, and Trinidad and Tobago would be free to join whatever constituency it wished at the election of 1978. The figure shown against his name in paragraph 6 of the worksheet excluded the votes of Trinidad and Tobago.

The decision was:

> The Executive Directors approve their report and the proposed Resolution on the 1976 Regular Election of Executive Directors for despatch to the Board of Governors on August 10 for a vote by mail. They set the closing date for the receipt of votes at September 7, 1976.
>
> Decision No. 5172-(76/121), adopted August 4, 1976

6. EXTENDED FUND FACILITY - REVIEW

The Executive Directors considered a paper on the review of the extended Fund facility, together with a proposed decision (SM/76/169, 7/21/76).

Mr. Amuzegar welcomed the staff's initiative in suggesting an increase in the use of the extended Fund facility and for taking action in initiating the review. He felt that most Executive Directors would share his disappointment that only SDR 282 million had been made available under the facility during the past two years, and then for no more than two countries. The staff had provided an accurate list of reasons why the facility had not been used more extensively. However, the strongest reasons for the lack of interest on the part of members had been the onerous conditionality attached to the use of the facility, namely, the necessity of undertaking difficult basic domestic policy adjustments in order to receive a relatively small amount of aid. He believed that the facility's conditions should be carefully reviewed in order to make it more attractive.

So far as the size of the drawings under the facility was concerned, Mr. Amuzegar stated, he would like to see an increase of 45 per cent rather than one of 33 per cent, in order to put access on the same footing as that approved by the Interim Committee for regular tranche drawings

during the period before the amendment became effective. He could of course accept 33 per cent if necessary. However, any increase, welcome as it was, should not be allowed to prejudice the need for larger quotas at the time of the next review. In fact, the small size of access under the extended Fund facility was a compelling reason for substantially increasing the quotas of Fund members, and particularly those of the developing countries.

Mr. Kjaer stated that his chair could accept the proposed decision.

Mr. Sein Maung associated himself with the remarks of Mr. Amuzegar, and he commended the staff for putting forward the proposed decision.

Mr. Cross remarked that he found the review useful, and that in general he agreed with the statement of the objectives of the facility, and of the desirability of considerable preparatory work, close coordination with the World Bank, and contact with a broad range of officials and agencies in the borrowing countries.

He understood the difficulties faced by developing countries in undertaking commitments to make basic policy adjustments over a three-year period, Mr. Cross continued. Nevertheless, the fact that the Fund was prepared to devote additional resources, both financial and technical, to an extended arrangement justified the more elaborate conditionality that was required. Moreover, it should be remembered that the policy initiatives expected of the purchaser under the facility were not merely a requirement for Fund assistance; they were mutually agreed measures that were expected to bring about beneficial structural improvements in the country concerned. Consequently, while he agreed with the staff that shortage of data should not preclude a member from access to the facility, a certain amount of quantitative information was necessary if the Fund was to be able to assess economic progress and to ascertain the extent of the need for financial assistance.

He did not agree with the staff's argument in support of a proposed expansion of access to Fund resources under the facility, Mr. Cross remarked. Given the Fund's liquidity situation and the present availability of unconditional financing from other sources, the Fund ought not to try to encourage countries to request financing that they might not need. The comment by the staff that certain potential borrowers might postpone their request pending an increase in quotas suggested that the borrowers concerned might not have a particularly legitimate case for immediate access. The proposed increase would not merely restore the difference between the maximum amount available under the extended facility and that normally available in the higher credit tranches--140 per cent of quota as against 75 per cent of quota--but it would increase the differential to 187 per cent

of quota for the extended Fund facility as against 108.75 per cent of quota for the regular credit tranches. Moreover, the Interim Committee had agreed to the temporary expansion of regular credit tranches only after difficult negotiations, and it had given no indication of any intention to recommend the expansion of other facilities in the same way. He would be greatly concerned about the expansion of the extended Fund facility being used as a precedent for the further expansion of still other facilities. It would be unfortunate if changes in the size of tranches in the various facilities meant that when the new quotas were adopted there would be a reduction in the total funds available. Consequently, while he appreciated the review of the operations of the facility, he would be opposed to expanding access to the Fund's resources under the extended Fund facility at the present time.

Mr. Temple-Seminario remarked that his views were akin to those of Mr. Amuzegar. There were basically two reasons for lack of interest in the facility. One was a certain lack of flexibility and the other was a lack of resources. An increase in the access available under the facility by 45 per cent would be very welcome. Moreover, as the Interim Committee had recommended an increase of 45 per cent in the credit tranches, a parallel increase in access to the extended Fund facility would be consistent. In any event, an increase in access to the extended Fund facility should not be used as an argument against enlarging Fund quotas at the next review.

Mr. Monday also associated himself with the remarks of Mr. Amuzegar. In particular he believed that it would have been more logical to increase access by 45 per cent than by one third. The staff had indicated that taking the drawings by Kenya and the Philippines together with possible drawings by between four and six members in the near future, total use of the facility would be well below the sum of SDR 2 billion referred to in the decision as an occasion for a review. As to Mr. Cross' remarks on access to the facility, the Fund was the main source of financial assistance for most developing countries, which did not have access to financial markets on the same scale as the developed countries. Nevertheless, certain developed countries had come to the Fund for large drawings. The suggestion that access to the extended Fund facility should be restricted on liquidity grounds was therefore not very appropriate.

Mr. Kent said that his authorities believed that the extended Fund facility was a useful facility. It was particularly welcome because it required close cooperation between the Fund and the World Bank, and because it involved not only the treasuries and central banks of the members availing themselves of the facility but also the planning agencies of the countries concerned. He also endorsed the staff's conclusion that the conditionality associated with the extended facility was appropriate in view of the difficult adjustment problems facing many members.

However, it was not his view that the facility had not been more fully used because the resources available to members were not large enough, Mr. Kent stated. It seemed more likely that it was the conditionality that had deterred members from using the facility when a number of other parallel resources had been available, including the compensatory financing facility, the oil facility and--in some cases though not all--the ability to borrow in international capital markets. It was true that only some SDR 282 million had been drawn after two years compared with an estimate of SDR 1.8 billion to SDR 2 billion in five years. However, the possible future drawings under the facility would increase the total amount to something like SDR 1 billion after three years. Consequently, the growth in the use of the facility would be roughly in line with original expectations.

He also agreed with what Mr. Cross had said about the Fund's liquidity position, Mr. Kent continued. There was no real call to increase the resources available under the facility until members had shown both the need and the willingness to use the amounts already available. It was not convincing to suggest that members needing both the funds and the structural changes requiring a program that would qualify for a drawing under the facility would delay such necessary changes because the amounts available under the facility were not large enough. He would therefore be opposed to adopting the suggestion set out in paragraph 2 of the proposed decision. At the time when Executive Directors had been discussing the requests by Kenya and the Philippines, there had been some suggestion that perhaps the targets and the access related to them had been rather rigidly interpreted. He had, however, been satisfied with the staff replies to the effect that the suggestion was unjustified, and he welcomed the statement in the paper that the staff would take a flexible attitude. If there were to be any improvement in the facility at the present time, it could perhaps best be attained by encouraging the staff to take a flexible approach toward the right to draw under the facility in relation to the programs for structural change submitted by the countries, which would clearly have to be reviewed as the program progressed.

Mr. Laske commented that the operation of the extended Fund facility had so far been satisfactory, one reason being that the members interested in using the facility had devoted considerable attention to formulating comprehensive programs. Given the far-reaching nature and the complexity of the programs involved, it was indeed not surprising that only two applications had so far been approved. It seemed likely that the negotiations with other members about possible use of the facility would be sucessfully concluded in the near future. In those circumstances, the proposed substantial extension of access to the facility was somewhat surprising. The concern expressed by the staff that members interested in using the facility might postpone requests until they had received quota increases

under the Sixth General Review seemed to be unwarranted. Indeed, on grounds of principle, he would not wish to see any extension of access to the facility in anticipation of the forthcoming quota review.

Another concern with any extension of access to the facility, Mr. Laske explained, was that it was likely to have an adverse effect on the Fund's liquidity. Six countries were expected to draw on the facility in the coming year, during the period prior to the entry into effect of the increased quotas, and that drawings might amount to as much as SDR 800 million. Much more had been drawn under the liberalized compensatory financing facility than had been expected, and the Fund might soon be asked for assistance by one or the other of its larger members. Consequently, the preservation of the Fund's liquidity was of the greatest importance. Furthermore, although the issuers of certain currencies were enjoying comfortable reserve positions, their currencies were still not available for use in Fund transactions. In brief, he did not believe that it was desirable to take the proposed decision at the present time; it would be better to wait until the new quotas became effective, an action that would automatically bring about an enlargement of access to the facility.

Mr. Jagannathan associated himself fully with Mr. Amuzegar's remarks. In particular, he agreed with him that the main reason why the facility had not been more widely used was the onerous conditionality attached to it. He saw no necessary conflict between the view that the conditionality had had a good deal to do with the limited use so far made of the facility, and the possibility that members would prefer not to use the facility until they had greater access. Consequently, he considered the staff proposal to be an excellent one.

In particular, he welcomed the statement by the staff that it would be flexible on the question of annual adaptations of programs, Mr. Jagannathan continued. While many Fund members did have experience with the preparation of economic plans for five years at a time, many did not; and there would surely be general agreement that it was difficult to prepare a plan that did not require annual adaptation.

Like Mr. Amuzegar, too, Mr. Jagannathan said, he considered that an increase of 45 per cent in access to the facility would be logical, although he would accept the 33 per cent increase proposed by the staff as a compromise. The adoption of a 33 per cent increase would of course serve to overcome Mr. Cross' fear that 45 per cent might become the conventional size of increases in access to the Fund's facilities.

As to the availability of resources from other Fund facilities, a point made by a number of speakers, Mr. Jagannathan observed that the oil facility was no longer disbursing funds and that, while the compensatory

financing facility had been used by a large number of members, there were many countries with stagnant or only marginally improved exports that did not qualify for drawings under it and were unable to break into the capital market. As he understood the situation, members could either apply to use the extended Fund facility or they could draw under the enlarged credit tranches. In passing, the Fund did not seem to have had to disburse any very large sums under the enlarged tranches, although of course some major members might be preparing to draw under the new arrangement. While he did not underestimate the problems of ensuring that the Fund had sufficient liquidity, the effect of enlarging access to the extended Fund facility appeared likely to be small.

As to the reasons why the facility had not been more used, Mr. Jagannathan remarked that if the small size of the access was considered to be one of the main obstacles, enlarging the access by 33 per cent would not make much difference. In brief, he welcomed the staff assurance about flexibility; he agreed with some comments to the effect that the programs were complex, but countries needed to observe complex programs subject to reasonable adaptation in particular circumstances; he welcomed the review of a Fund facility that members were just beginning to use; and he warmly supported the proposal for a 33 per cent increase in access, which he considered a reasonable compromise.

Mr. Drabble explained that his Canadian authorities felt that more experience with the extended Fund facility was desirable before trying to decide how appropriate it was for the Fund to be engaged in that particular facility at all. It was of course true that many developing countries were facing structural problems that had to be overcome over a period of years if their balance of payments was to be adjusted, and that the time frame provided for in the facility was appropriate; in that sense, it was difficult for the Fund not to become involved in general development questions. On the other hand, the facility did tend to draw the Fund into an area that was outside the scope of its normal work. The facility required close consultation with planning ministries and with other agencies that were normally involved with World Bank consultations but were not within the Fund's normal areas of surveillance. That could lead to various kinds of practical problems between the Fund and its members.

While his Canadian authorities were not opposed to enlarging access to the facility, Mr. Drabble continued, he noted like Mr. Cross that the resources drawn under the facility were available for a period longer than that likely to be required for the introduction of the new quotas. It was therefore desirable to ensure that any temporary increase in access should not be more generous than the access that would exist later. The proposed increase of one third was in line with the proposed average increase in quotas, but many of the countries likely to draw under the facility would

only be receiving quota increases of slightly over 21 per cent; and it would be a mistake to increase the access beyond the likely increase in quotas for the majority of the likely user countries.

He recognized the arguments regarding pressures on Fund liquidity, and particularly those put forward by Mr. Cross and Mr. Laske, Mr. Drabble remarked. Nevertheless, any extension of access to the extended Fund facility was not likely to make much difference in the period prior to the introduction of the quotas. All the same, it would be unwise to provide an incentive for drawing in the immediate future by making the facility more attractive before the entry into force of the new quotas than after, especially as the facility made funds available for a number of years. He therefore suggested that while there should be some increase in access to the facility, it should be less than the 33 per cent proposed.

Mr. Yaméogo supported the remarks made by Mr. Amuzegar, and he invited those who opposed an increase in access to the facility to reconsider their position on the grounds that they had already successfully prevented any additional allocation of special drawing rights or a link between the allocation of special drawing rights and development assistance. Moreover, the reform of the international monetary system had in fact turned into a general acceptance of floating currencies, which had obliged developing countries to devalue against their wishes, thus creating pressures on their balance of payments. In addition, gold had been demonetized, and 95 per cent of the gold holdings of central banks was located in the industrial countries. While it would have been desirable to substitute special drawing rights for gold, what was actually happening was that the U.S. dollar and the deutsche mark were becoming both the main de facto reserve assets and the leading intervention currencies.

In the present circumstances, Mr. Yaméogo continued, the developing countries had a current account deficit of SDR 35 billion that they were unable to transfer either to any other developing countries or to the industrial countries. The question therefore was where the developing countries would find the resources with which to finance a deficit on that scale. What was clear was that any funds drawn by the developing countries under the extended Fund facility would return in large part to the industrialized countries. Consequently, if there was no agreement among the Executive Directors to extend access to the extended Fund facility, he had been instructed to raise the matter in the Interim Committee. More generally, however, if the Executive Directors did not wish to extend access to the facility, they should decide to abolish it. The Fund had had a similar experience in the past with the compensatory financing facility, from which only two members had drawn in the period from 1963 to 1969, when it had been liberalized. He would therefore like

once again to invite those chairs that were opposed to extending access to the extended Fund facility to reconsider their position, which was after all a political one.

Mr. Lieftinck recalled that he had from the beginning been a warm advocate of the extended Fund facility, and he had indeed been one of the original proponents. He therefore regretted that he could not wholeheartedly support the staff proposal. He was not surprised that the number of cases in which a member had agreed with the Fund for a drawing under the facility had not been larger; it was after all difficult to establish a medium-term program, and not many countries were in a position to undertake the preparatory work. He did, however, hope that the cases of which the staff had spoken would soon reach the position where they could be approved by the Executive Directors.

The arguments put forward by the staff in support of the proposed decision were not particularly strong, Mr. Lieftinck observed. He was, for instance, not convinced by the argument that, as a result of a temporary increase in the size of a credit tranche by 45 per cent, the difference between the maximum amount available under the extended Fund facility and that normally available in the higher credit tranches had been temporarily narrowed until the effective date of the second amendment of the Articles. The existing differences were by no means normative, and there was no need to take action to adjust them. As to the argument about members deciding to delay their requests until after the effective date of the second amendment of the Articles, when larger quotas had become effective, he hoped that the date of the second amendment would be very soon. In any event, it took members a considerable time to prepare their program for a drawing under the extended Fund facility, and any delay in making funds from the facility available to them should be accepted.

There was, however, another matter that concerned his Netherlands authorities in particular, Mr. Lieftinck mentioned. During the Jamaica meeting of the Interim Committee a compromise had been reached to extend temporarily the size of the credit tranches by 45 per cent. It was also in Jamaica that the Committee had endorsed the decision taken by the Executive Directors to liberalize the compensatory financing facility. In the present paper the staff proposed to enlarge the access to the extended Fund facility. If the proposed decision were adopted, there seemed to be no reason for failing to increase access to any other Fund facility, including perhaps the buffer stock facility. Such a procedure would however represent a piecemeal approach that would deviate from the compromise reached in Jamaica, and he would not wish to take that course unless there were strong arguments for doing so. The increase in access to the credit tranches had been agreed upon in Jamaica to deal with what it was hoped would turn out to be only temporary financing problems prior

to the effective date of the second amendment. The decision had also been taken to some extent because it was understood that the Trust Fund would not become operative in the immediate future.

The extended Fund facility on the other hand, Mr. Lieftinck commented, required the preparation of medium-term programs, and would not be dealing so much with the special circumstances of 1976 or of the period before the amendment became effective. There was therefore no convincing parallel between the circumstances of the extended Fund facility and the ordinary credit tranches. The Netherlands authorities were opposed to any such piecemeal extension of access to the Fund's various resources and they objected to the position that would arise if the extended Fund facility were increased by 33 per cent on top of increases of 45 per cent for the ordinary credit tranches and 25 per cent for the compensatory financing facility. After all, the only action taken by the Fund to ensure an increase in liquidity to meet the additional potential demands was to require that six months prior to the effective date of the second amendment countries would make their currencies usable as far as possible. Such an action might not be particularly effective, because many countries were not in a position to have their currencies included in the Fund's currency budget.

In the circumstance he had described, Mr. Lieftinck concluded, his Netherlands authorities were most reluctant to accept the proposed decision. They would prefer to see everything possible done to obtain the introduction of the amendment as soon as possible. There would then be a more normal situation in which all the Fund's facilities were attached to quotas in relatively similar proportions, so that the assistance the Fund could offer members would be in reasonable balance.

Mr. Foglizzo said that his chair welcomed the existence of the extended Fund facility, and particularly the fact that it had led to greater cooperation between the Fund and the World Bank. However, he was not in a position at the present meeting to support the proposed extension of access to the facility. First, his chair believed that there was an urgent need to review the Fund's liquidity before taking any measure that might exert a strain on its resources. Second, his chair had agreed to a 45 per cent enlargement of access under the credit tranches because of the termination of the oil facility, which had provided member countries with a valuable form of assistance. In the present case, there was no particular need for any similar extension. The size of access to facilities should be related to actual quotas in order not to disturb the working of the periodic quota review. The limited benefits to be gained from enlarging access to the extended Fund facility--which would in any event be used by only comparatively few members in the coming months--should be set off against the risk that Governors might be reluctant

further to increase quotas if their decisions were continuously by-passed by decisions of the Executive Directors to increase access to the resources of the Fund more than proportionally to quotas. His authorities would therefore prefer to see a further review of the extended Fund facility only after the Executive Directors had examined the Fund's liquidity.

The Executive Directors agreed to return to the topic in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Directors without meeting in the period between EBM/76/120 (8/3/76) and EBM/76/121 (8/4/76).

7. UNITED NATIONS BOARD OF GOVERNORS OF THE SPECIAL FUND - FIRST SPECIAL SESSION - FUND REPRESENTATION

The Executive Board approves Fund representation at the first special session of the United Nations Board of Governors of the Special Fund, as set forth in EBD/76/159 (7/28/76).

Adopted August 3, 1976

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/76/188 (8/2/76) and EBAP/76/189 (8/2/76) is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 76/164, December 13, 1976

H. JOHANNES WITTEVEEN
Chairman

W. LAWRENCE HEBBARD
Secretary