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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 76/97

10:00 a.m., July 2, 1976

W. B. Dale, Acting Chairman

| Executive Directors | Alternate Executive Directors |
|---|---|
| | R. Khonsary, Temporary |
| P. Åsbrink | J. H. Kjaer |
| S. Y. Cross | T. Leddy |
| | H. G. Schneider |
| | M. Finaish |
| | E. O. de Toledo |
| B. J. Drabble | D. Lynch |
| R. Gavaldá | S. Sevilla |
| S. Jagannathan | |
| A. Kafka | |
| K. Kawaguchi | M. Wakatsuki |
| | A. Malek, Temporary |
| P. Lieftinck | |
| H. R. Monday | J. B. Zulu |
| E. Pieske | |
| W. S. Ryrie | P. Kent |
| F. Suárez | |
| | J. Foglizzo |
| R. J. Whitelaw | R. S. Deane |
| A. W. Yaméogo | |

R. V. Anderson, Acting Secretary
B. J. Owen, Assistant

Also Present

African Department: E. L. Bornemann, P. J. Boxall, J. McMurtrie, J. B. Nairn. Asian Department: B. Smith. European Department: L. A. Whittome, Director; R. Evensen, R. J. Hides, P. Holden, A. F. Mohammed, H. Vittas, B. B. Zavoico. Exchange and Trade Relations Department: E. Sturc, Director; D. K. Palmer, Deputy Director; E. H. Brau, P. M. Keller, J. B. McLenaghan, T. Sweeney. IMF Institute: C. Tognetti. Legal Department: J. Gold, General Counsel and Director; G. P. Nicoletopoulos, Deputy General Counsel. Middle Eastern Department: A. S. Gerakis. Research Department: J. J. Polak, Economic Counsellor and Director; C. F. Schwartz, Deputy Director; C. P. Blackwell, G. I. Brown, L. U. Ecevit, M. Goldstein, L. M. Goreux, N. Kaibni, G. M. Khatchadourian, D. Papell, P. Sukachevin. Treasurer's Department: R. J. Familton, Deputy Treasurer; R. W. Ley, A. Watkins. Western Hemisphere Department: J. Del Canto, Director; S. T. Beza. Information Office: I. S. McDonald. Personal Assistant to the Managing Director: D. W. Green. Advisors to Executive Directors: C. Bouchard, J. K. E. Cole, F. K. Hussein. Technical Assistants to Executive Directors: V. Alipui, S. Arancibia, M. Berger, D. Berthet, J.-M. Bisson, I. M. Cobbold, J. M. Cock Londoño, R. De Beckker, G. Heyden Q., E. Leung, C. J. Lohmann, A. G. Morris, A. K. Mullei, K. Nakayama, C. C. Ozumba, S. K. Panya, M. Pietinen, E. Sacerdoti, S. B. Satyal, A. van Dorssen, L. F. Vílches, M. A. Wasfy, P. Zimmer, A. G. Zoccali.

1. APPROVAL OF MINUTES

The draft minutes of Meetings 76/21 and 76/29 were approved.

2. AUSTRALIA - PURCHASE TRANSACTION - COMPENSATORY FINANCING

The Executive Directors considered the staff's analysis and recommendation with respect to a request from Australia for a purchase under paragraphs 2, 3, and 4 of the Decision on Compensatory Financing of Export Fluctuations (EBS/76/288, 6/24/76; and Sup. 1, 7/1/76).

The staff representative from the European Department said that new information had been received on the import and tariff quotas mentioned on page 4 of EBS/76/288. Of the items on which restrictions had been introduced during the period October 1974 to March 1975, the quotas on opthalmic frames, sunglass frames, and sunglasses had already been removed. Those on motor vehicles would lapse at the end of 1976. For all other items, the restrictions were temporary and subject to the completion of reviews by the Industries Assistance Commission, which was responsible for setting tariffs, of the need for long-term protection of the industries concerned. The reviews were expected to be completed within the coming financial year. It should be noted that the restrictions in force applied to only 8 per cent of 1973-74 imports, and not to the entirety of each of the categories. For example, the quota restrictions on textiles applied to only 24 per cent of the value of textile imports.

Mr. Whitelaw commented that the request of his Australian authorities for a drawing under the compensatory financing facility had a certain novelty about it, the Fund having become an institution lending mostly to developing countries with a need for long-term aid resources or to developed countries with poor balance of payments prospects going beyond the short term, as Mr. Kafka had mentioned at a recent meeting (EBM/76/95, 6/30/76). Yet the Fund had been established originally to provide short-term financing to countries whose economies were basically sound. It was not intended to finance development needs, which was the responsibility of the Bank. Its function was to assist those in need of temporary finance and to avoid recourse to other policy measures. While not necessarily objecting to some of those developments, he believed the Fund should not discriminate against countries that happened to fall in neither of the two categories that now tended to benefit the most from the Fund's facilities.

Whatever other questions were raised during the discussion, there would surely be no doubt that Australia's request met the technical requirements of the decision on compensatory financing, Mr. Whitelaw continued. Australia's eligibility was clearly shown in the staff paper. Questions were more likely to concern the general aspect of need and why Australia wanted to borrow from the Fund. It was true that Australia's external prospects, at least in the early medium-term future, were good. Export forecasts showed a substantial improvement, and the upward trend might even be more rapid than that shown in the cautious staff estimates. But it was in the very nature of the compensatory financing facility that an improving export prospect be present if, arithmetically, there was to be an export shortfall. Australia's balance of payments need to draw on the Fund was associated with a wish to avoid a movement in the rate for the Australian dollar that was not justified by the longer-term outlook for the balance of payments. It was even more strongly associated with the present Government's concentrated attack on inflation, as part of which many stern measures had been undertaken in recent months. At the present point of time, a depreciation of the Australian dollar would be anything but helpful in the fight against inflation. The rate of cost and price increase in Australia was at present higher than that in most of its trading partners. That could be dealt with through a movement in the exchange rate, and the Australian Government had not been reluctant in recent years to adjust the rate for the Australian dollar when appropriate. But the attack being made by the Government on its economic problems was based on tackling the fundamental problem that the rate of increase of prices and incomes in Australia was more rapid than that abroad. A number of measures had already been taken, to curb increases in government expenditure, to firm up monetary policy, and to try to diminish the onflow of price increases into wage increases. The Government had had some success in all those fields and it believed that conditions had been created for bringing down inflationary pressures in the economy. But the process would take time, and the authorities were seeking temporary finance to allow the measures which were directed toward correcting the basic economic situation to take effect. To the extent that those measures were successful, the case for an exchange rate adjustment would diminish.

In December 1975, Mr. Whitelaw recalled, there had been a run against the Australian dollar. In that month, Australia had lost $A600 million from its reserves. For many years, Australia had not been a significant borrower overseas on government account, and for the past ten years had steadily paid off foreign debts. In the last few months, however, the Government had made a succession of borrowings overseas, which had helped to check the rundown in reserves that took place at the end of 1975; in the first half of 1976, the reserve situation had held steady. It had been suggested to him that since Australia had shown that its creditworthiness permitted it to raise money in the market relatively easily overseas, recourse to the Fund's resources was not necessary. Yet if Australia had come to the Fund without trying to raise money on its own account, it might have been told to try to borrow abroad in the market first. In his view, a combination of those financing approaches was appropriate.

As for the attitude of his Australian authorities to the proposed drawing under the compensatory financing facility, Mr. Whitelaw explained that if the export outturn in the years ahead proved to be as expected, and if the balance of payments position improved, the Australian authorities would observe the spirit of the compensatory financing decision with respect to the provision of an early repurchase. It was 15 years since Australia had drawn on the Fund. The 1961 drawing had been made at a time when the Australian authorities had abandoned a general policy of using import restrictions for balance of payments reasons. There had been a short run on imports and a fall in reserves as a consequence of that decision. As soon as that position had corrected itself, Australia had repurchased, and had repaid the drawing in full within 12 months. There was explicit reference in the 1975 decision on compensatory financing to repurchase in the event of an improvement in a member's balance of payments and reserve position. The Australian authorities fully supported the principle of the revolving nature of the Fund's resources and recognized that all countries using the Fund's resources should have regard to their obligations to repurchase as the external position improved.

It had also been put to him, Mr. Whitelaw remarked, that even though Australia's request met the technical requirements of the decision, and even though it had a need for temporary financing for a short period of time, other countries' needs were probably greater and their prospects for balance of payments recovery were less good. Also, the Fund was approaching a time when its resources might become scarce. The question that had been raised was whether Australia should not refrain from making a sizable drawing on the Fund at the present time and leave room for those whose needs were greater. His response was that the Fund had originally been conceived as a revolving fund, to work more or less automatically in the sense that surpluses offset deficits, those members in surplus standing ready to make their currencies available to other members in deficit that were in need of temporary assistance. As he had mentioned at the beginning of his statement, the Fund had to some extent moved in a different direction. He did not necessarily object to that but he saw dangers in suggesting that a country should refrain from using the Fund's resources because its economy was not structurally maladjusted and because in the fullness of time it could overcome its difficulties without assistance. First, members could not be expected to agree to the use of their currencies in currency budgets, and to hold SDRs, thus providing finance for countries in deficit, if they themselves were not able to get temporary assistance when they felt they needed it. Second, drawings by countries in a position to repurchase in the foreseeable future would help protect the revolving character of the Fund. To the extent that the Fund became wholly engaged in providing finance where the expectations of repayment were not good, the Fund's resources would not be revolving and the Fund itself would become a weaker institution.

Mr. Kafka commented that in referring at an earlier meeting to the "habitually poor" and the "unfortunate rich" he had had in mind countries, whether rich or poor, with no access to private borrowing. He had been concerned because they represented a group of countries--with the exception of the occasional unfortunate rich country--that was not very important in world trade. Thus, the leverage acquired over those countries by the Fund would not help reach the goal, to which everyone subscribed, of maintaining a liberal trading system.

As for Australia's request, Mr. Kafka said that he had always held that all the Fund's facilities should be available without distinction to all members. A one-world system was not only appropriate because of the way in which the Fund was constituted; it was also in the best interest of all its members, whether they were poor or wealthy, well managed or mismanaged, or somewhere in between. He had examined the Australian request carefully and felt that it was justified on the evidence presented. Therefore, he gave it his strong support.

Mr. Yaméogo considered that Australia's request was justified, under the provisions of the revised compensatory financing decision, because of the nature of the export shortfall. Australia and New Zealand were high-income countries whose economic resources, output, and exports resembled those of developing countries. For instance, one third of Australia's exports were agricultural commodities, one third were minerals, and another 15 per cent of exports consisted of other primary products. Thus, 75 per cent of Australia's exports had their origin in the primary sector where the export shortfall had mainly occurred. In addition, the balance of payments deficit had been SDR 1,350 million in 1974 and SDR 818 million in 1975; it was expected to be SDR 175 million in 1976. Reserves had declined in the shortfall year by SDR 706 million, total reserves being SDR 2,781 million. The rate of growth of exports had fallen from a high level of 27 per cent in 1973 to 5 per cent two years later and was expected to recover to 14 per cent in 1976/77; the developing countries of the Group of Twenty-Four experienced very similar fluctuations in their export receipts.

He wondered whether Australia's exchange rate was being managed in the best way, Mr. Yaméogo continued, because a stable rate based on a basket of currencies was not necessarily an incentive to exports. He recognized that the main cause of the export shortfall was the world recession, but the growth of demand due to the upswing of economic activity in certain countries, which were the main importers of Australian products, might make it advisable for Australia to take advantage of the situation by adjusting its exchange rate so as to make its goods cheaper and thus increase demand for them. Also, Australia's foreign reserves were close to SDR 3 billion, and he wondered how the gold component had been valued. A decision to value its gold holdings on the basis of the market price might increase Australia's creditworthiness and encourage capital inflow, thus compensating the deficit on current account through the capital account.

He questioned the rationale for deducting stocks to the value of SDR 30 million in calculating the shortfall, Mr. Yaméogo said. Those stocks had not yet been sold, and if they were sold, it would be at a price yet to be determined; although in the meantime an amount of SDR 30 million might be entered into national accounts as being receivable, that did not necessarily mean that the stocks were a liquid asset. Many member countries of the Fund had stocks of agricultural commodities or of minerals. His preference was for disregarding those stocks in computing export shortfalls for the purposes of compensatory financing, because deducting the value of stocks from the calculation was tantamount to making an addition to foreign exchange receipts. Until the stocks were sold and the exact export receipts were known, they should be excluded from the calculations.

Mr. Ryrie said there could be no doubt that Australia had met the requirements of the compensatory financing decision, and he had no criticism of the way in which the calculations had been used to arrive at the requested drawing of SDR 332.5 million. Although the facility had not been intended solely for the benefit of developing countries, he believed that it had been in most people's minds that they would be the main users. However, other countries that relied primarily on the export of primary products should not be excluded as users of the facility, provided the conditions were met.

His chair had had certain doubts about the Australian request, Mr. Ryrie added, and one of them concerned whether it was appropriate for a member that had not actually drawn the gold tranche to draw under the compensatory financing facility. Presumably Australia's total reserves figures would not be affected by a drawing of the gold tranche, and he wondered whether it might not have been more seemly for Australia to have drawn the gold tranche and included it in its reserves before considering a drawing under another facility. His second doubt was related to the whole question of balance of payments need. Australia's need would be questionable if looked at solely on the basis of its balance of payments deficits and reserve positions for 1975 and 1976. The requested drawing was almost twice the size of the prospective balance of payments deficit for 1976. Of course, the shortfall had occurred mainly in 1975 when the overall deficit had been considerably higher, at SDR 818 million, but it had masked a large trade surplus of SDR 1,628 million. Much of the reserve loss had been due to the speculation at the end of 1975. In effect, the Fund was being asked to agree to a compensatory finance drawing for essentially capital account reasons. Mr. Whitelaw himself had referred to the need to resist the possibility of any further speculation against the exchange rate. Under the circumstances, it was open to doubt whether use of the compensatory financing facility was necessarily the best technique for a Fund drawing. He sympathized with Mr. Whitelaw in his general comments about the revolving nature of the Fund and about members' needs for funds for short-term purposes. Certainly, a country wishing to maintain a realistic exchange rate and to resist speculation of the kind that Australia had suffered should be given every benefit of the doubt. But, again, the question was whether the technique chosen was necessarily the best one. However, in the tradition of giving members the benefit of the doubt, and attaching much importance to Mr. Whitelaw's statement about the undertaking of early repayment, he gave his full support to the proposal.

Mr. Monday said that on the basis of the evidence provided in the staff paper, and in light of the introductory statement made by Mr. Whitelaw, he could give his support to the request of the Australian authorities to draw an amount equivalent to SDR 332.5 million under the compensatroy financing facility, which was equivalent to 50 per cent of Australia's quota. He noted that the last time Australia had made use of the Fund's resources had been in 1961. Australia's request was being made against a background of a steep decline in the growth of export earnings, due to factors clearly beyond the control of the authorities. External demand for wool, beef, wheat, and sugar had weakened considerably as a result of recessionary conditions in major importing countries. At the same time, the country had been subject to sudden speculative capital outflows amounting to SDR 600 million in December 1975 alone, resulting in a sharp decline in overseas reserves and a further deterioration in the balance of payments position. Fortunately, the outlook for 1976 and beyond appeared better, both for exports and for underlying economic policies in general. Australia already had a diversified export base in primary commodities, and the world economy seemed to be picking up. At home, the authorities had achieved some success in moderating inflationary pressures, mainly through the introduction of "plateau-indexation." However, the continued high rate of increase in domestic demand might well undermine the projected improvement in the balance of payments for 1976 unless the authorities moved quickly to restrain it.

In concluding, Mr. Monday commended the Australian authorities for the relatively generous aid they provided to developing countries and urged them to try to achieve a better geographical distribution.

Mr. Pieske noted that Mr. Whitelaw had rightly referred to Australia's excellent Fund record. It had drawn on the Fund only once, in 1961, and had repurchased that drawing less than a year later. The Australian currency had been used extensively in Fund transactions and it had been revalued several times; for two years the authorities had been able to hold its effective rate stable, a significant achievement in view of developments elsewhere and in Australia itself. In short, the Australian dollar had come to be regarded as a strong currency, notwithstanding the temporary deterioration that had occurred in 1974 and that had been partly related to the increased cost of oil imports. The Fund should be glad to have debtors of such quality, and he agreed that it was appropriate for the Fund to help not only the poorest countries but strong and weak, large and small countries alike, whenever they were in need of temporary assistance. Nevertheless, he had been taken aback at first sight by the size of Australia's requested drawing and the balance of payments forecasts in the staff paper. He had not the slightest doubt about the existence of the export shortfall and its causes, or about the readiness of Australia to cooperate with the Fund. But the fact that the requested drawing was almost twice as large as the projected overall balance of payments deficit for 1976 raised the question of what yardstick was used in assessing members' balance of payments needs.

The requirement of need was a difficult question, Mr. Pieske recognized. The main purpose of Australia's drawing, as Mr. Whitelaw had explained, was not the 1975 balance of payments deficit but the wish to bolster Australia's defenses against unjustifiable runs on its currency and future depreciations. That was not, a priori, an illegitimate use of the Fund's resources, although he agreed with Mr. Ryrie that it could be asked whether it was the purpose of the compensatory financing facility to meet such needs or whether the ordinary resources of the Fund should not have been used. On the other hand, Australia had made the usual representation under Article V that the currencies were presently needed to make payments consistent with the Articles of Agreement. He wondered whether a country with reserves equivalent to four months' imports could make that claim in respect of a drawing that was twice the amount of the current annual balance of payments deficit.

The Fund had never evolved a clearcut policy on what constituted balance of payments need, Mr. Pieske considered. Formulating such a policy was difficult, and, in the past, the need to do so had apparently not been acute. But two elements of the Fund's operations were changing. First, members' drawing rights as a percentage of their quotas had increased considerably. The relationship between the Fund's resources, basically members' quotas, and potential claims was changing rapidly, with the consequence that the liquidity position of the Fund was more precarious than it had been in the past. The second fundamental change was that the level of charges, together with the absence of conditionality for drawings under the compensatory financing facility, made it relatively more attractive to borrow from the Fund than in the market. Those two developments made it increasingly necessary for the Fund to take a prudent approach to the use of its resources, so that it would be able in future to meet all legitimate requests for its assistance. One way to do that was to pay closer attention to the requirement of need. He looked forward to an early completion of the word being done on that problem by the Research Department.

In the meantime, Mr. Pieske concluded, Australia could not be penalized because of the absence of a coherent Fund policy on balance of payments need. He was prepared to give the Australian authorities the benefit of the doubt, particularly in view of Mr. Whitelaw's statement of their intention to repurchase when the balance of payments and the exports situation improved.

Mr. Drabble said that he too was prepared to support the requested drawing. Mr. Whitelaw had ably met the concerns he had originally felt, although from a more general philosophical point of view, the Australian request threw into relief some of the problems faced by the Fund as a result of the decision to modify the compensatory financing facility. His personal preference had always been for a more generous increase in access to the Fund's regular credit tranches, rather than for the course that had in fact been followed, in response to the small size of Fund quotas in relation to most countries' needs. Those underlying problems, which would have to be considered in due course, should not be used to discriminate against Australia. The staff had demonstrated that the request fully met the requirements of the 1975 decision. Part of his concern, like Mr. Pieske's, was the question of balance of payments need. But it was only fair to point out, when looking at the forecast for 1976, that the current account balance was estimated to deteriorate by some SDR 600 million and that in fact the presumed improvement in the overall balance of payments was more than wholly due to a swing of no less than SDR 1.2 billion on nonmonetary capital transactions. The outcome in that connection would of course depend on the maintenance of confidence in the level of the Australian dollar and in the adequacy of Australia's reserves to meet any contingencies. He recognized that the authorities had engaged in external borrowing, which seemed sensible and appropriate, but that was not the only element in the capital account. The forecast net inflow of capital in 1976 was fairly high, viewed over the relatively short span of years covered in Table 1 of EBS/76/288.

However, it should be borne in mind that inflows for direct investment in Australia at the present time were at a low level because investment activity was sluggish. In sum, the overall balance of payments position was more uncertain than it might appear at first glance.

Like others, Mr. Drabble said that he had been encouraged by Mr. Whitelaw's assurances regarding Australia's willingness to cooperate with the Fund and to regard the drawing as a strictly temporary financing requirement, if in fact the balance of payments position improved in the coming year or two. That was a most welcome attitude, and he hoped that other countries that had used the compensatory financing facility would follow suit if their trade and overall balance of payments positions improved, as was usually implicit in the calculations for postshortfall years.

As far as the exchange rate was concerned, Mr. Drabble said that he could understand the high priority being given by the Australian authorities to reducing the rate of inflation and particularly the pressure on the wage side. One of the problems of exchange rate adjustment was the need to keep in mind that the price effect of a downward movement of the rate was felt immediately, but that it took much longer for the benefits to be reflected in improved underlying economic activities. Ultimately, of course, the effect on the level of investment was extremely important in an economy with many resource industries, but only after a long time lag. Once they had achieved a greater degree of price and wage stability, the Australian authorities would no doubt need to consider the competitiveness of their import-competing industries and whether or not they were attracting as much investment in the resource sector as was desirable. In that connection, it was reassuring to know Australia's position with regard to its special trade restrictions. He hoped that approval by the Executive Board of Australia's request for a drawing would encourage the authorities to be more venturesome in the removal of those restrictions.

Finally, Mr. Drabble remarked that he did not agree with Mr. Ryrie that it would have been appropriate for Australia to draw its gold tranche at the same time or perhaps in place of part of the compensatory drawing. One of the advantages of the compensatory financing facility was that it was a floating facility so that Australia was not required to draw its gold tranche. Since the present request was made out of concern for the maintenance of an adequate level of reserves, it might in fact be possible for Australia, if developments turned out as well as expected, to resume its participation in currency budgets even while its drawing under the compensatory financing facility remained outstanding.

Mr. Cross said that he agreed that the Fund should not bail out only the habitually poor and the temporarily unfortunate wealthy, and from that viewpoint he welcomed Australia's participation in the Fund's activities. As Mr. Whitelaw had recalled, the range of those activities was broad and not set in any mold. Also, neither the compensatory financing facility nor any of the Fund's other facilities should be limited to a particular group of members.

It seemed to him from the staff paper and the discussion, Mr. Cross continued, that Australia's request met the requirements for the compensatory financing facility as they had been written in the revised decision. Questions had appropriately been raised about whether the facility had been formulated in the best way. But a particular and reasonable arrangement had been agreed upon, and Australia met the criteria. Questions similar to those that had arisen had been in his mind as well. Australia's total export earnings had continued to rise throughout the period under review. Also, there was the question of whether or not the gold tranche should have been used. Another question was whether Australia's problem was not more a problem of capital flows. Finally, there was the matter of need. Australia's reserves were still quite high, although they were only half the former peak level. On first glance, it might be surprising to see the Fund provide an amount of financing that appeared to be double the balance of payments deficit for the year. Yet it was clear that the figures themselves were fraught with uncertainties. There were many uncertainties, for instance, about the estimates of short-term capital inflows. He doubted whether the staff, if pressed, would want to vouch that the deficit in 1976 would in fact be SDR 175 million.

An important factor to him, Mr. Cross observed, was the prospect of a rapid turnaround in Australia, which seemed to experience them on occasion, and the willingness of the authorities to consider early repurchase in those circumstances. That willingness was important and reassuring not only with respect to Australia's drawing but, as Mr. Whitelaw had said, for the drawings of all countries under the compensatory financing facility. The U.S. authorities had supported the liberalization of the 1975 decision and had expected large drawings during the present period. But those calls should taper off rapidly and almost come to a halt because of the cyclical swing from a strong fall in commodity prices to an equally strong rise. If indeed members' situations did turn round sharply, the Fund should be looking toward the possibility of early repurchase. Perhaps the staff should be prepared to report on the position with respect to outstanding drawings under the facility, to see whether it was appropriate to discuss with individual members the likelihood of repurchase when their reserve positions turned around. Looking further down the road, there was cause for concern about the Fund's liquidity position. The concept of the compensatory financing facility envisaged early repayment, as the decision itself stated, and the Fund should be prepared to apply that provision.

The deduction for stocks was appropriate, Mr. Cross considered. In general, he had always had a question in his mind about which circumstances were beyond the control of a member, and he would be reluctant to have the Fund providing finance to countries that withheld exports from the market and thereby caused a shortfall. As for restrictions, he joined others in encouraging the authorities to reduce and eliminate them as soon as possible. Of course, Australia had not long ago undertaken unilateral tariff cuts, and he hoped that the present restraints would be allowed to lapse as proposed. In the meantime, he welcomed the limited moves made in that direction.

Mr. Suárez considered there was conclusive evidence that Australia's export shortfall was due to circumstances beyond its control, especially the high elasticity of export earnings in relation to the business cycle. However, he shared some of the hesitations that had been expressed by others. Export earnings had been decreasing in relative terms, but not in absolute terms. Although the shortfall was confirmed by both the extrapolation formula and the judgmental forecast, reserves equivalent to four months' imports were comfortable and should provide leeway for a further drawdown. A country in Australia's strong position should certainly be able to make further use of capital markets. In that sense, he did not think that the proposed drawing represented a priority allocation of the Fund's dwindling resources.

Yet he had been convinced by Mr. Whitelaw's arguments in his opening statement, Mr. Suárez added. He had a certain feeling of solidarity with countries that were trying to maintain a stable exchange rate in face of the variability of exports, which posed special problems in terms of reserve management. He was also aware of the adverse market effects of drawings in the gold tranche. One of the advantages of the compensatory financing facility was its floating character. Furthermore, the Fund lacked a mechanism for providing speedy financing--perhaps for shorter periods than was normal for use of the Fund's regular resources--against short-term capital movements of a speculative nature that were not necessarily justified by underlying economic conditions. The Fund should consider embarking into that area of activity.

To conclude, Mr. Suárez said, he believed that Australia met the formal criteria for a drawing under the compensatory financing facility. The Fund could assist the country in overcoming its present balance of payments difficulties, with the safeguard that Australia would repay if the turnaround was significant.

Mr. Kawaguchi commented that Australia seemed to have a clear case for drawing under the compensatory financing facility, its export shortfall having been caused by the world-wide recession. The judgmental forecast of the shortfall for the twelve-month period beginning on March 1, 1975 exceeded 50 per cent of Australia's quota, the maximum it was entitled to draw. Nevertheless, he understood the doubts expressed by previous speakers. There seemed to be no disagreement that members, both poor and rich, should be treated uniformly with respect to use of the Fund's resources under the compensatory financing facility if their balance of payments needs were of the same kind. The crucial question that had arisen was whether or not the requirement of need had been met. As far as Australia's requested drawing was concerned, export prospects seemed bright and an improvement on current account almost certain. Yet according to the formula for determining the existence of an export shortfall, a member could not be shown to have suffered an export shortfall in the shortfall year unless there was expected to be a significant increase in exports in future years. If that was not so, few members would be entitled to a compensatory drawing. Again, as Mr. Ryrie had noted, Australia's need was based on a fall in reserves that had resulted mainly from movements on capital account, and the requested drawing was roughly double the forecast deficit in the balance of payments. Nevertheless, drawing members should be given the overwhelming benefit of the doubt, and, as Mr. Whitelaw had stated, Australia had been making considerable recourse to borrowings in the overseas market before coming to the Fund.

Australia's good performance in the past should also be taken into consideration, Mr. Kawaguchi observed. The Australian Government was determined to curb inflation, a process that might take sometime. He accepted Mr. Whitelaw's argument that Australia was determined to avoid an unjustified depreciation of its currency in the course of the fight against inflation. In that context, the need for temporary financing assistance from the Fund was clear. Moreover, under the 1975 decision the Fund could recommend an early repurchase if the member's position improved significantly. Mr. Whitelaw's statement in that connection was both relevant and reassuring, and he was fully prepared to support the proposed decision.

Mr. Lieftinck said that there was no doubt in his mind that the Australian request met the special requirements attached to the use of the compensatory financing facility. Australia's requested drawing reinforced his opinion that the facility was liberal and would have to be reconsidered at an appropriate time to determine whether it should be continued in its present form. His difficulty in the present case related to the requirement of need. It had been said that a staff paper defining the requirement was under preparation, but there was no excuse for taking it lightly in the meantime. While it might be considered anew in connection with special Fund facilities, a reasonably well considered policy had been established and it should be applied to Australia's situation.

He had great difficulty in coming to the conclusion that Australia met the requirement of need, Mr. Lieftinck continued. If he was not mistaken, it had always been the practice of the Fund to require that a member should have a need at the moment of drawing, taking account of what had happened in the preceding period with respect to the level of reserves, but based more on a look forward than a look backward. It was clear that although Australia had had a considerable overall balance of payments deficit in 1975, albeit with a large trade surplus, the present forecast for 1976 suggested that there would be a minimal reduction of reserves, which were presently at the level of four months' imports. It might be true that the ratio of reserves to imports was lower than it had been since 1971, and the staff had concluded that it was not unduly high, but he wondered whether it was unduly low, which was after all the criterion to be applied. The projected overall balance of payments deficit of SDR 175 million was equivalent to less than 2 per cent of expected export revenues. Taking into account both imports and exports, which was appropriate because the balance of payments improvement could come either from higher exports or from lower imports, the deficit would be less than 1 per cent of the forecast value of imports and exports. If it came to the worst, a country like Australia could bear that slight additional deficit, if indeed it occurred. Therefore, he believed Australia had a weak case for a drawing based on the requirement of need. Philosophically speaking, he wondered whether it was even desirable from a general economic policy point of view to try to compensate fully for a small balance of payments deficit if the objective was to restrain inflation. And Australia's requested drawing would be an overcompensation of its expected overall deficit. A country with a relatively high rate of inflation should have a balance of payments deficit; to offset it fully would defeat domestic anti-inflationary policies.

Another difficulty in the way of his acceptance of Australia's request for a drawing was that the gold tranche had not been drawn, Mr. Lieftinck observed. He recognized that the compensatory financing facility floated, but if Australia had not felt it necessary to draw its gold tranche in 1975, when it had had an overall deficit of SDR 818 million, he failed to understand why it chose to draw under the compensatory financing facility in 1976, while continuing to safeguard its gold tranche. Also, if Australia had made a gold tranche drawing in 1975, it would have had to pay charges on the full amount of the present drawing under the compensatory financing facility, and not only on half of it. It could be argued that a gold tranche drawing would have been made free of charge, because charges fell due only when the Fund's holdings of a member's currency were above 100 per cent of quota. Nevertheless, he felt that drawings under a special facility like the compensatory financing facility, where there was practically no conditionality, should generally be preceded by a gold tranche drawing. The Fund should have the income and the country should pay the charge. It should be noted that the deduction on the calculation of the export shortfall of stocks, which Mr. Cross had welcomed, while it affected the judmental forecast, would not affect the amount of the drawing because of the cutoff of 50 per cent of quota.

In general, Mr. Lieftinck observed, he admired and warmly supported the policies of the Australian Government. As he had already suggested, the authorities' hands could be strengthened in their fight against inflation if they had a small balance of payments deficit. He regretted that the requested drawing by Australia under the compensatory financing facility would not be a fully appropriate use of the Fund's resources, but an overextension by the Fund of its liberal policies. Therefore, he would have to abstain.

Mr. Khonsary recalled that his chair had always been in support of the rule of uniformity of treatment of members. Australia met the requirements for the use of the compensatory financing facility, despite the questions raised on the requirement of balance of payments need and the prior use of the gold tranche. He attached great importance to the statement by Mr. Whitelaw that Australia expected to repurchase immediately if its exports and balance of payments position improved. Therefore, he supported the requested drawing.

Mr. Jagannathan stated that his views were close to those of Mr. Monday. Therefore, he supported Australia's request without reservation. He could agree with Mr. Pieske that the Fund's policy on the requirement of need was not very explicit, but, like Mr. Kawaguchi, he considered that members should be given the benefit of the doubt. He had been intrigued by Australia's decision not to draw its gold tranche, although, as it had been correctly stated, that was not necessary. Presumably, Australia preferred to keep its gold tranche in reserve.

Mr. Yaméogo observed that if Australia had drawn the gold tranche, as suggested by Mr. Lieftinck, it would not have needed to present any case at all to the Executive Board, because a member could draw its gold tranche automatically. The requested compensatory financing would mean not only additional financial resources for Australia but would encourage the inflow of private capital, which was of great importance for a country like Australia with a high potential for private investment. Australia's current account was weak, and the Australian Government had had to compensate for that by increased overseas borrowing. Along with increased confidence on the part of private investors, the proposed drawing by Australia would indicate that the Fund concurred with the authorities' policies in the monetary and fiscal fields to improve their economic situation. The inflow of capital that would be generated would far exceed the amount of the proposed drawing, and Australia might be in a position to repay its borrowing from the Fund within a few months.

Mr. Foglizzo commented that approval of Australia's request for a compensatory drawing, and of similar requests that might later be received by the Fund, drew attention more than ever to the need for a broad and far-reaching review of all aspects of the Fund's liquidity position.

Mr. Malek said that he was in agreement with the staff that Australia's request for a purchase of the equivalent of SDR 332.5 million met the requirements of the decision on compensatory financing. He had taken note of the concerns expressed by some Executive Directors but was prepared to give Australia the benefit of the doubt. As for the adequacy of Australia's reserves, he believed the staff had made a fair judgment, because the export earnings of a country like Australia could swing sharply from one period to another. Also, the maintenance by Australia of a stable exchange rate for its currency posed special problems for reserve management, as the staff had pointed out. Although reserves were equivalent to four months' imports, the Australian Government had had to borrow on the overseas market to maintain the level. As for the valuation of the gold component of Australia's reserves, he doubted whether it was appropriate to raise the question, since it had not been considered in the past in connection with requests for drawings by other members. In light especially of Australia's undertaking to repurchase when its balance of payments and reserve positions improved sufficiently, he was prepared to support the requested drawing.

Mr. de Toledo said that he supported the requested drawing. Mr. Pieske had raised an important point in mentioning the requirement of need for the drawing. But in looking at the figures on Australia's reserve position, attention should be paid to the sharp downward trend, which, if it continued, might lead to renewed speculation against the Australian dollar, especially as the authorities were sustaining the rate of exchange at a rather high level. For that reason, he was satisfied that Australia had a need to defend its currency and avoid a further intensification of the downward trend in the level of reserves.

The Acting Chairman noted that the subject of need, which had been mentioned by several Executive Directors, might better be discussed in general terms when the staff paper on the subject as it related to all the Fund's facilities had been issued. To some extent, the comments that had been made had been unduly influenced by the special approach to the concept of need in connection with the oil facility. The Executive Board had never previously taken the view that need must be established exclusively with reference to looking ahead or with respect to the year in which the drawing was taking place, except under the oil facility. Also, it had never been established that what might be called a relatively high level of reserves should in itself be a reason for not agreeing to a purchase by a member.

The staff representative from the Research Department said that, as many Executive Directors had noted, compensatory drawings floated in the gold tranche. In fact, several members had drawn under the 1966 compensatory financing facility without first drawing their gold tranche. Practically all members that had drawn under the 1975 decision by March 1976 had previously drawn under the oil facility and, as a prerequisite, had already drawn their gold tranche.

As for the balance of payments need, the staff representative continued, it was not easy to define precisely the period over which the requirement of need should be established. Compensatory drawings were made on the occasion of an export shortfall experienced during a 12-month period which was generally in the recent past. The member should normally have had a balance of payments need during the 12-month period associated with the export shortfall, and the member should still have a need at the time the drawing was made. The need could continue during a brief period following the end of the shortfall year and the date of the drawing. It should, however, not last very long, since, in most of the cases dealt with so far, the entitlement to use the facility had been based on the expectation of an upsurge of export earnings during the 24 months following the end of the shortfall year. In the case of Australia, the entitlement to a compensatory drawing was based on the expectation of a strong upsurge in export earnings during the period March 1976 through February 1978. The first ten months of the postshortfall period were part of calendar year 1976.

An additional difficulty arose from the fact that the overall balance of payments deficit was generally available only for calendar years while the shortfall year covered any 12-month period, the staff representative explained. Thus, Australia's requested drawing was less than half of the overall balance of payments deficit estimated for 1975, although it was more than twice the deficit projected for 1976. The reservations expressed by several Executive Directors related to the small size of the deficit projected for calendar year 1976. In view of the SDR 600 million capital outflow during December 1975, however, the projected deficit would have become more than twice as large as the requested drawing if the shortfall had been calculated for the 12-month period December 1976 through November 1977. That such a large difference could occur by shifting the period of calculation by a single month was indicative of the difficulties encountered in projecting net capital inflows and the overall balance of payments deficit.

The staff representative from the European Department noted that the difficulties of making projections about the outlook for private capital movements had been mentioned in the staff paper. The basic assumption had been that the rate of inflow of capital in the first four months of 1976 would continue throughout the year and that the large outflow of December 1975 would be reversed. Although the figure of SDR 175 million for 1976 had been called a forecast, it was based on the limiting assumption regarding the behavior of private capital flows.

As for the level of Australia's reserves, the staff representative continued, it was true that in 1975 it was equivalent to about four months' imports and about 3.5 months of 1976 imports forecast on an f.o.b. basis. Nevertheless, a member's preferences must be taken into account in determining what was a satisfactory level of reserves. During the late 1960s and early 1970s Australia had operated with a reserve level in the range of 7 to 14 months of imports. From 1972 onward, the ratio had declined: to 10.5 months in 1973; 5 months in 1974; 4 months in 1975; and to 3.5 months in 1976. The gold component in Australian reserves was small; at the end of May 1976, it was SDR 258 million, valued at the official price of SDR 42.50, out of total reserves of SDR 2,714 million.

The Acting Chairman recalled that the first amendment of the Articles of Agreement, adopted in 1969, had specified that members could purchase under the compensatory financing facility without making prior use of the gold tranche. Although it was true that the Fund's income might be slightly higher if Australia had first purchased the gold tranche, its liquidity position would be correspondingly reduced.

A staff paper was also under preparation on the matter of stocks, to which Mr. Yaméogo had referred, the Acting Chairman observed. In short, insofar as the creation of a stockpile was within the control of the member, and if it could be seen that exports during the shortfall year were reduced as a result, it might be sensible to make a deduction on the grounds that part of the shortfall was attributable to measures within the control of the member.

The staff representative from the Research Department added that the Australian policy was to reduce stocks during the two postshortfall years. In the projection for earnings from wool exports, account had been taken of sales of existing stocks. As stated on page 11 of the staff paper, the level of stocks had already fallen by the end of May 1976 to slightly below the level at the beginning of the shortfall year. It was therefore legitimate to assume that stocks accumulated during the shortfall year would be sold shortly afterward. Moreover, the accumulation of stocks had been small in relation to the size of the proposed drawing and did not affect the member's entitlement, as Mr. Lieftinck had pointed out.

Mr. Whitelaw said that he had been reassured by the comments of Executive Directors. In response to specific questions, he noted that Australia held only about 10 per cent of its reserves in gold, the percentage normally having been around 5 per cent when reserves had been larger. Australian gold holdings had been constant for about 20 years. As for revaluing those gold holdings, there were certain consequences which might flow from that, and it certainly might be desirable to have a uniform policy on the matter among Fund members. There were risks in being locked into valuing gold at a certain price. Some other countries that had drawn under the modified compensatory financing facility were substantial gold holders.

With regard to the suggestion made by some Directors that Australia might have given thought to first drawing the gold tranche, Mr. Whitelaw noted that that would not help in terms of increasing the country's reserve position. In fact, the Australian authorities placed some value on the fact that the gold tranche remained available if it was needed.

On the question of Australia's need in 1976, Mr. Whitelaw recalled that although he had stated that export prospects were good, there was certainly some doubt about the capital account. In the first quarter of the year Australia had held its own by borrowing overseas, but private capital inflow was not as significant as it had been in earlier years. It was doubtful whether the leads and lags of December 1975 would be fully unwound. It was better for the Fund to help its members when that would serve a useful purpose, rather than waiting until they were in dire straits.

In response to Mr. Lieftinck's observations on Australia's balance of payments position and prospects, Mr. Whitelaw observed that the Board had previously approved purchases under the compensatory financing facility even when members' reserves had, in relative terms, exceeded those of Australia.

The Executive Directors then turned to the proposed decision.

The Acting Chairman noted that, for technical reasons, the formal request from Australia had been received on June 30, 1976 rather than on June 29, 1976 as expected. If Executive Directors agreed, instructions for the transfer of currencies could be dispatched as soon as the decision was adopted, setting aside the provisions of Rule O-3, according to which those instructions would not be dispatched until July 6, 1976.

The Executive Directors agreed with the Acting Chairman's suggestion, and approved the proposed decision, with Mr. Lieftinck abstaining.

The decision was:

> The Fund has received a request from the Government of Australia for a drawing of the equivalent of SDR 332.5 million under paragraphs 2, 3, and 4 of the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 4912-(75/207), adopted December 24, 1975). The Fund agrees to the requested purchase and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii) of the Articles of Agreement on the repurchase terms set forth in the cable to the Fund reproduced in EBS/76/288, Supplement 1.

Decision No. 5131-(76/97), adopted
July 2, 1976

3. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Zulu on conclusion of his service as Alternate Executive Director to Mr. Monday.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 76/147, October 22, 1976

WILLIAM B. DALE
Acting Chairman

JOSEPH W. LANG
Acting Secretary