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April 8, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Review of the Decision on Compensatory Financing of
Fluctuations in the Cost of Cereal Imports

There is attached for consideration by the Executive Directors a paper on the review of the decision on compensatory financing of fluctuations in the cost of cereal imports, which is proposed to be scheduled for discussion on Wednesday, May 6, 1987. A draft decision appears on page 11.

Mr. Kaibni (ext. 7721) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Review of the Decision on Compensatory Financing
of Fluctuations in the Cost of Cereal Imports

Prepared by the Research Department

(In consultation with other Departments)

Approved by Jacob A. Frenkel

April 7, 1987

I. Introduction

On May 13, 1981, the Executive Board adopted, for a period of four years ending May 13, 1985, Decision No. 6860-(81/81)--"Compensatory Financing of Fluctuations in the Cost of Cereal Imports." The decision was reviewed by the Executive Board on July 18, 1983 (SM/83/131 and Cor. 1, 6/16/83) after the first two years of operation, and was retained without modification. 1/ The decision was again reviewed on May 3, 1985 (SM/85/98, 4/5/85), and the Executive Board decided to extend it without modification for a further four-year period until May 13, 1989. 2/ Paragraph 17 of the decision provides that a review should be completed not later than May 13, 1987.

The purpose of this paper is to report on developments under the cereal decision in order to assist the Executive Board in its review of the decision. The review is presented in four sections and two annexes: the following section outlines the main features of the cereal decision; the third section examines developments in the world food situation and outlook, and reviews the operations under the decision; and the final section contains a summary appraisal and the staff's recommendations. The purchases under the cereal decision since the 1985 Executive Board review are summarized in Annex I, and the decision is reproduced in Annex II.

II. Main Features of the Cereal Decision

The decision enables members in balance of payments need to obtain assistance related to temporary increases in the costs of commercial cereal imports which are caused by factors largely beyond their control. An excess in cereal import costs is calculated as the c.i.f. cost of cereal imports (excluding concessional imports) in a given 12-month period (the excess year) less the arithmetic average cost of these imports

1/ Decision No. 7490-(83/105), adopted July 18, 1983.

2/ Decision No. 7967-(85/69), adopted May 3, 1985.

for the 5-year period centered on the excess year (paragraph 6). 1/ The financing of cereal excesses is integrated with the financing of export shortfalls under the compensatory financing facility (CFF); thus, compensation is provided for the net shortfall defined as the sum of the excess in cereal import costs and the shortfall in merchandise export earnings (paragraph 4). Repurchases are made in equal quarterly installments during the fourth and fifth years following the drawing, unless the Executive Board approves a different schedule. A member may use the CFF to finance export shortfalls alone 2/ or may, at any time, choose to use the integrated scheme. Having opted for the cereal decision, however, any CFF requests during the following three years must be made under this decision (paragraph 2). Compensation is subject to separate limits on outstanding purchases relating to the cereal component and the export component, each 83 percent of quota, and to a joint limit on both components of 105 percent of quota (paragraph 9). 3/ To permit compensation on a timely basis, data for cereal imports may be estimated for up to 12 months of the excess year (paragraph 5). Data for merchandise exports may be estimated for up to six months of the same year. To the extent that subsequent calculations based on actual data indicate that the member was overcompensated, the member will be expected to make a prompt repurchase of the amount of overcompensation (paragraph 12). Finally, as under the CFF, the request must meet the requirement that the net shortfall is largely attributable to factors beyond the control of the member, as well as the test of cooperation with the Fund (paragraph 3). In practice, the cooperation requirement has been applied in accordance with the guidelines adopted by the Executive Board at EBM/83/140, 9/14/83. 4/

III. World Food Situation and Outlook, and Operations under the Cereal Decision

1. World food situation and outlook

During the six years of operation of the cereals decision, the average annual rate of growth of world production of cereals (3.3 percent) has exceeded that of world cereal utilization (2.2 percent). Factors contributing to the growth of output over this period include generally favorable weather conditions in major producing areas, increased use of high yielding seed varieties and fertilizers, and government policies designed to protect farm incomes in a number of developed countries, and to raise self-sufficiency in developing countries. World cereal production has exceeded cereal consumption each year since 1981/82 except in 1983/84 when production declined by 4 percent due to widespread drought (Table 1).

1/ Cereals covered by the scheme are those designated by SITC 041-047: wheat, rice, and coarse grains including maize, barley, sorghum and millet, and the flour from these grains.

2/ Under Decision No. 6224-(79/135), adopted August 2, 1979, as amended.

3/ From the inception of the scheme until January 6, 1984 the separate and joint quota limits were, respectively, 100 percent and 125 percent of quota.

4/ The guidelines are contained in EBS/83/171, Supplement 1 (Selected Decisions, Twelfth Issue, p. 87).

Table 1. World Cereal Situation, 1971/72-1986/87 ^{1/}

(In millions of metric tons)

Year ^{2/}	Production ^{3/}		Utilization		Imports		Food Aid in Cereals	Stocks/ consumption	Export Prices (US\$/ton) ^{5/}		
	World	Developing countries	World	Ending stocks ^{4/}	World	Developing countries			Wheat	Rice	Maize
1971/72	1,206	503	1,269	217	108	43	12.6	.17	61	136	51
1972/73	1,273	586	1,318	172	133	50	10.0	.13	92	192	71
1973/74	1,375	621	1,361	186	135	60	5.6	.14	178	485	116
1974/75	1,338	633	1,348	176	134	62	8.4	.13	162	439	132
1975/76	1,372	682	1,354	194	150	56	6.8	.14	151	295	116
1976/77	1,481	683	1,421	254	148	58	9.0	.18	112	257	108
1977/78	1,472	700	1,477	249	162	72	9.2	.17	116	337	96
1978/79	1,604	751	1,567	286	170	82	9.5	.18	141	330	103
1979/80	1,556	750	1,571	271	197	90	8.9	.17	175	387	115
1980/81	1,567	770	1,590	248	206	97	8.9	.16	190	477	142
1981/82	1,652	813	1,604	296	212	97	9.1	.18	170	390	118
1982/83	1,702	833	1,671	336	197	106	9.2	.20	158	273	114
1983/84	1,641	891	1,702	275	204	110	9.8	.16	153	268	146
1984/85	1,804	919	1,757	322	219	109	12.5	.18	148	236	123
1985/86	1,845	927	1,769	398	178	95	9.6	.22	128	214	105
1986/87 ^{6/}	1,859	945	1,804	453	171	97	10.2	.25	104 ^{7/}	201 ^{7/}	70 ^{7/}

Source: FAO, Food Outlook, various issues.^{1/} Cereals comprise wheat, rice, and coarse grains.^{2/} Data refer to July/June year unless otherwise indicated.^{3/} Data refer to calendar year of first year shown.^{4/} Stock data are based on an aggregate of national carryover levels at the end of national crop years.^{5/} Average spot quotations for July-June. Wheat = U.S. No. 2, Hard Red Winter, Ordinary Protein, f.o.b., Gulf ports; Rice = Thai, White, 5 percent broken, f.o.b., Bangkok; Maize = U.S. No. 2 Yellow, f.o.b., Gulf ports.^{6/} Projection.^{7/} July 1986-February 1987.

Although cereal production in developing countries rose on an aggregate basis in 1983/84, drought conditions were severe in certain regions, and many countries, particularly in sub-Saharan Africa, experienced abnormal food shortages in 1984 and the first half of 1985. In mid-1985, 27 countries were identified by FAO as experiencing abnormal food shortages. 1/ The availability of large surpluses in developed countries facilitated a response to the food crisis in sub-Saharan Africa, as shipments of food aid in cereals reached a record 12.5 million tons in 1984/85, compared with an average of 9.4 million tons per year during the preceding three years.

In the past two years, the world food security situation has improved significantly. World cereals production recovered by 10 percent in 1984/85 to a record 1.8 billion tons. Output rose by a further 2 percent in 1985/86, and an additional 1 percent increase is expected for 1986/87. More importantly, output in developing countries continued to increase, by 3 percent in 1984/85 and by a further 1 percent in 1985/86. This enabled cereal imports by developing countries to decline marginally in 1984/85 for the first time since the mid-1970s, and to fall by an additional 13 percent in 1985/86. Due to the recovery in output, the number of countries experiencing abnormal food shortages declined from 27 to 11 by end-1985 and was reduced further to 9 by end-1986. 2/ World food security is further enhanced by the ready availability of food aid, as evidenced by the contribution of cereals to the International Emergency Food Reserve administered by the World Food Program. These contributions are targeted at 500 thousand tons per year, but reached 747 thousand tons in 1985 and again exceeded the target by 32 thousand tons in 1986.

With world output at record levels, world cereal stocks rose by 24 percent in 1985/86 and are expected to increase by a further 14 percent in 1986/87. World cereal stocks at end-1985/86 were 22 percent of annual world consumption, the highest level reached since the 1960s, and the outlook is for a further substantial increase in this share by end-1986/87. The ratio of stocks to consumption is now well above the 18 percent threshold considered by the FAO as a minimum level for world food security.

The ample world supply situation has been accompanied by an intensification of competition amongst the major grain exporters resulting in lower prices. Under the 1985 Food Security Act, loan rates in the United

1/ These countries were Angola, Botswana, Burkina Faso, Burundi, Cape Verde, Chad, Ethiopia, Kenya, Lesotho, Mali, Mauritania, Morocco, Mozambique, Niger, Rwanda, Senegal, Somalia, Sudan, Tanzania, Zambia, Bangladesh, Kampuchea, Laos, Lebanon, Viet Nam, El Salvador, and Nicaragua.

2/ The countries so identified by FAO at end-1985 were Angola, Botswana, Cape Verde, Ethiopia, Lesotho, Mozambique, Sudan, Bangladesh, Kampuchea, Lebanon, and Viet Nam. By end-1986, Cape Verde and Sudan had been removed from the list, and exceptional surpluses of cereals in 10 sub-Saharan African countries, which in 1984/85 had been cereal importers, were expected for the 1986/87 crop year.

States, which in the past have provided a floor to market prices, were reduced sharply for 1985/86 and 1986/87, and government-owned grain stocks have been provided as a bonus to exporters to assist in regaining export markets. These actions have forced competitors to lower their selling prices, and the world market prices of cereals have fallen sharply; the average prices of maize, wheat, and rice in 1985/86 and the first seven months of 1986/87 were, respectively, 29 percent, 22 percent, and 12 percent below their prices in 1984/85. At the end of 1986, cereals prices were at their lowest levels since 1972/73 (Chart 1).

Little change in the market situation for cereals is expected during the next two years. Although some decline in cereals output is expected to occur in response to low prices, a rapid adjustment of world supply is not likely due to the existence of producer support mechanisms in the United States, the European Communities, and Japan whereby producer prices are maintained well above world market prices. 1/ Moreover, productivity gains in importing countries may be expected to continue. In the absence of any weather-related production shortfall on a global scale, cereals prices are projected to remain at or near their current levels in 1987 and to rise only moderately in 1988-89. Consequently, no deterioration in the world food security situation is anticipated. However, individual countries may be expected to continue to experience a need to increase cereal imports because of variations in weather.

2. Use of Fund resources under the cereal decision

Thirteen purchases by seven members have been made for a total amount of SDR 1,116 million since the approval of the decision by the Executive Board in May 1981. Of these purchases, ten were in respect of excesses in cereal imports in a total amount of SDR 505 million (Table 2). 2/ Over the same six-year period, 89 compensatory financing purchases have been made under Decision No. 6224-(79/135) in a total amount of SDR 8.2 billion. 3/ Therefore, the SDR 505 million purchased with respect to cereal import excesses represents 6 percent of combined purchases under the two decisions since May 1981. Of the ten purchases which relate to an excess in cereal imports, eight were made in the first four years of the decision's operations; only two purchases have been made since the last review of the decision by the Executive Board in May 1985, and none has been made over the past 16 months.

1/ Preliminary indications from negotiations in the GATT are that an agreement on a coordinated multilateral reduction in agricultural protection will take some time.

2/ Three purchases--two by Malawi in 1983 and 1984 and one by Korea in 1984--were based entirely on shortfalls in merchandise exports, but were made under the cereal decision because they occurred within three years of the member's initial purchase under the decision.

3/ Including the approval-in-principle in February 1987 of a purchase by Argentina of SDR 388.7 million.

Table 2. Purchases Under the Cereal Decision, 1981/82-1986/87

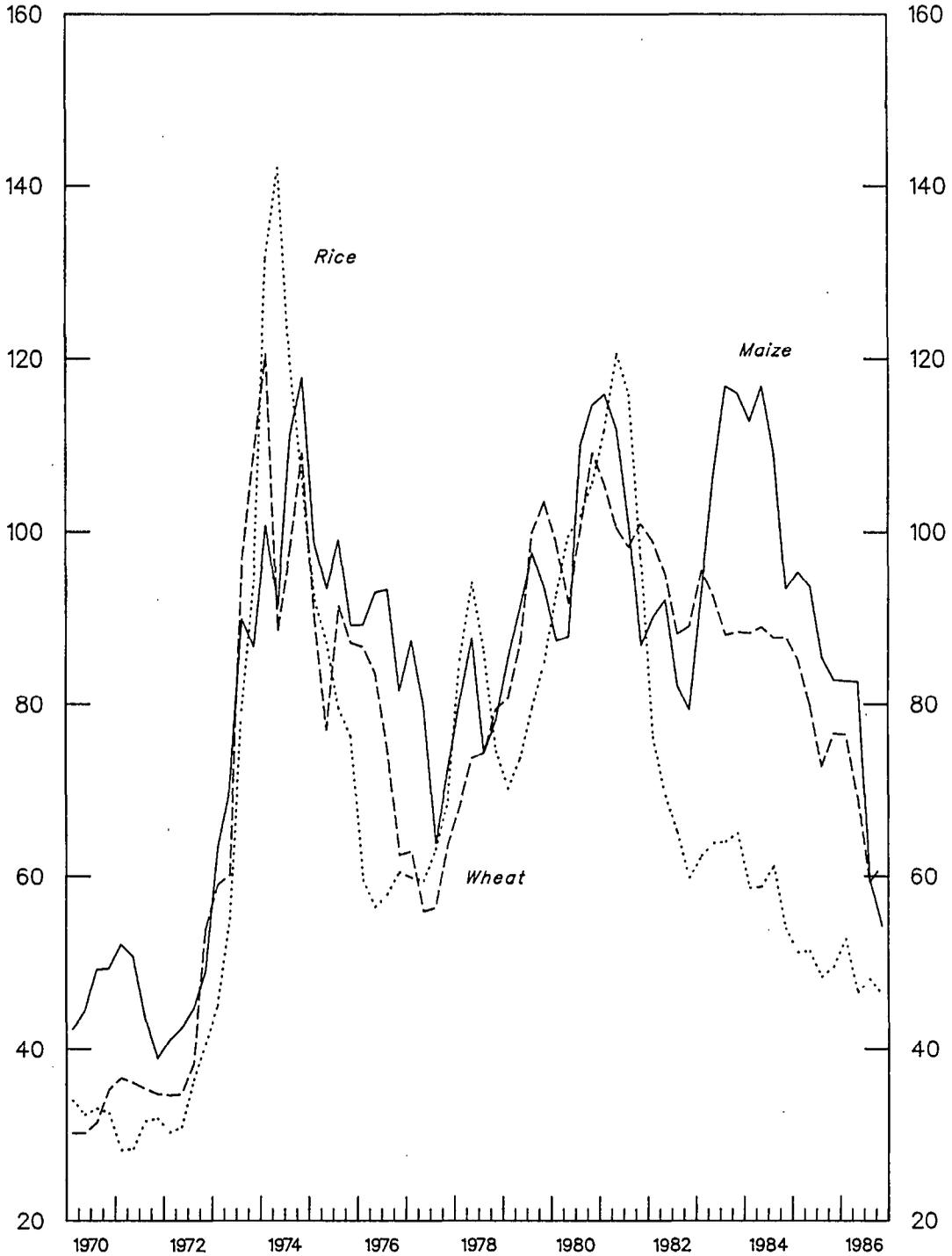
Country	Date of Purchase	Amount of Purchase by Component			Purchase			Outstanding After Purchase		
		Purchase (1)	Export component (2)	Cereal component (3)	Total CFF (4)	Export component (5)	Cereal component (6)	Total CFF (7)	Export component (8)	Cereal component (9)
		--(In millions of SDRs)--			----- (In percent of quota) 1/ -----					
Total 2/		1,115.5	610.4	505.1	(47)	(25)	(22)	(91)	(63)	(27)
First year (1981/82)		354.6	113.0	241.6	(63)	(17)	(46)	(112)	(66)	(46)
1. Malawi 3/	9/81	12.0	--	12.0	42	--	42	109	67	42
2. Korea	1/82	106.2	--	106.2	42	--	42	104	62	42
3. Morocco 3/	4/82	236.4	113.0	123.4	105	50	55	124	69	55
Second year (1982/83)		143.8	78.6	65.2	(44)	(29)	(15)	(92)	(75)	(17)
1. Kenya 3/	6/82	60.4	28.8	31.6	58	28	30	125	94	31
2. Bangladesh 3/	8/82	71.2	37.6	33.6	31	16	15	47	33	15
3. Malawi	3/83	12.2	12.2	--	43	43	--	103	98	5
Third year (1983/84)		--	--	--	--	--	--	--	--	--
Fourth year (1984/85)		464.1	377.1	87.0	(44)	(34)	(11)	(81)	(63)	(18)
1. Korea	6/84	279.7	279.7	--	60	60	--	105	82	23
2. Malawi	8/84	13.8	13.8	--	37	37	--	78	74	4
3. Ghana	12/84	58.2	49.2	9.0	28	24	4	87	83	4
4. Jordan	1/85	57.4	34.4	23.0	78	47	31	78	47	31
5. Bangladesh	4/85	55.0	--	55.0	19	--	19	50	23	27
Fifth year (1985/86)		153.0	41.7	111.3	(32)	(7)	(26)	(84)	(27)	(57)
1. Morocco	9/85	115.1	41.7	73.4	38	14	24	105	46	59
2. Kenya	12/85	37.9	--	37.9	27	--	27	64	46	18
Sixth year (1986/87)		--	--	--	--	--	--	--	--	--

1/ The figures in parentheses are unweighted averages.

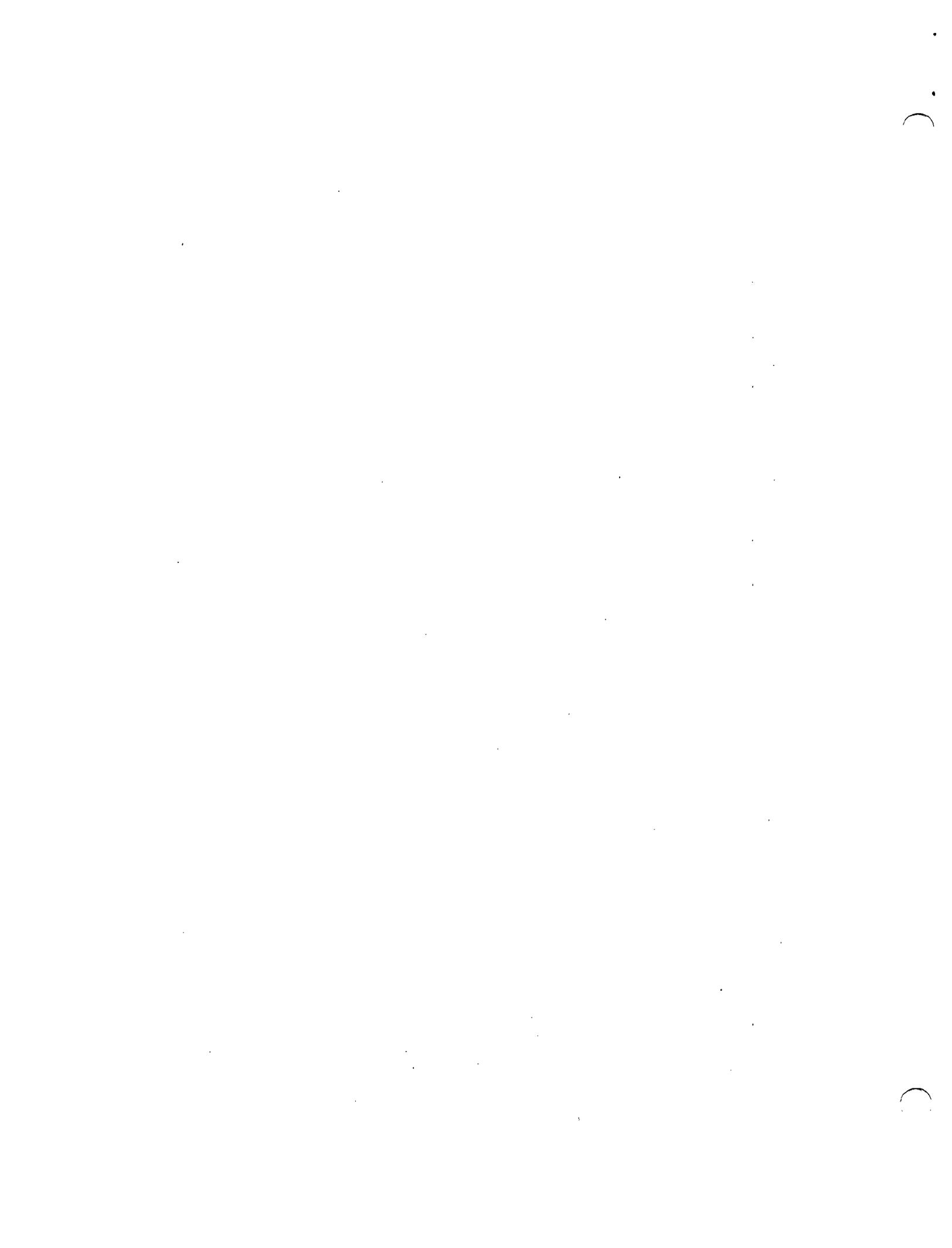
2/ Total purchases under the Decision, after reversal of overcompensation associated with the early drawings by Malawi and Bangladesh, amounted to SDR 1056.1 million, consisting of SDR 562.2 million in relation to export shortfalls, and SDR 493.9 million in relation to the cereal excesses.

3/ Early drawing. Final calculations based on actual data for the shortfall year indicated that two purchases were overcompensated--Malawi by SDR 10.5 million and Bangladesh by SDR 19.3 million. Malawi reversed the overcompensation in two installments, SDR 3.8 million in March 1982 and SDR 6.7 million in April 1982. Bangladesh reversed the overcompensation of SDR 19.3 million (SDR 8.1 million in relation to the export component and SDR 11.2 million in relation to the cereal component in March 1983.

CHART 1
PRICES FOR MAJOR CEREALS¹
(1980=100; in terms of U.S. dollars)



¹ Maize: U.S. No. 2 yellow, f.o.b. Gulf ports; Wheat: U.S. No. 1 hard red winter, f.o.b. Gulf ports; Rice: Thailand, white milled 5 percent broken, f.o.b. Bangkok.



The reasons for the low usage of the cereal option, which were examined in the previous Executive Board reviews, remain essentially the same. It was suggested that members may have preferred to meet their cereal import needs by food aid rather than commercial imports, especially when this aid was readily available. In addition, members may not have been able to satisfy some of the requirements of the decision; for example, there may have been difficulties in compiling the necessary data; difficulties in meeting the requirement of cooperation with the Fund; or the existence of adverse production conditions over many years, especially in a number of African countries, may have resulted in cereal excesses which were long-term in nature. In addition, members may have chosen not to use the facility because of the potential reduction of future net shortfalls if future CF requests had to be made under the cereal decision. 1/

The number of purchases under the cereal decision is basically influenced by fluctuations in the cereal import requirements of the low-income food-deficit countries (LIFDCs). 2/ The three purchases in 1984/85 and the two purchases in 1985/86 were related to the widespread drought in sub-Saharan Africa and regional food shortages in Asia. The import requirements of the African LIFDCs (excluding Egypt) rose by 6 million tons in 1983/84 to 12.4 million tons, and increased by a further 4.5 million tons in 1984/85 (Table 3). Due largely to the ending of drought and the recovery of cereals output, the cereal import requirements of the sub-Saharan African countries declined by 7.7 million tons in 1985/86. This development, combined with the general improvement in the world food security, are the main reasons why there have been no purchases under the facility since December 1985.

Few problems have been encountered in the implementation of the decision. As required under paragraph 4, compensation was provided on a net, rather than a gross, basis in that a cereal import excess was partly offset by an export excess in four cases (the initial purchases by Malawi and Korea and the second purchases by Bangladesh and Kenya), and an export shortfall was partly offset by a cereal import shortfall in the second and third purchases by Malawi and the second purchase by Korea referred to above. In the other six cases, a cereal import excess was combined with an export shortfall. Adequate data to identify commercial cereal imports separately from concessional imports were available in all cases.

1/ An examination of the three cases (two by Malawi and one by Korea) where subsequent CF purchases were made under the cereals decision because of the three-year rule, and where export shortfalls were partly offset by cereal import excesses, showed that largely because of an early repurchase, the total compensation to Malawi from its three drawings was slightly smaller than if the cereal decision had not been used. Total compensation to Korea was significantly larger under the cereal decision.

2/ These import requirements are estimated by FAO for 65 developing countries.

Table 3. Estimated Cereal Import Requirements of Low-Income Food-Deficit Countries, 1981/82-1986/87

(In millions of tons)

Region	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
Total	<u>37.2</u>	<u>44.0</u>	<u>46.2</u>	<u>47.6</u>	<u>34.4</u>	<u>32.7</u>
Africa	12.6	13.8	21.1	25.6	17.9	16.4
Of which:						
Egypt	(6.9)	(7.4)	(8.7)	(8.7)	(8.7)	(9.0)
Asia	23.6	28.7	23.7	20.7	15.4	15.2
Other	1.0	1.5	1.4	1.2	1.0	1.1
Memorandum item:						
Actual cereal imports	<u>37.0</u>	<u>40.4</u>	<u>42.9</u>	<u>40.0</u>	<u>33.1</u>	<u>...</u>

Source: FAO, Foodcrops and Shortages, various issues.

With respect to the impact of quota limits, in no case was the amount of purchase constrained by the separate quota limit relating to cereal import excesses; outstanding purchases for cereal excesses were raised to more than half the separate quota limit in effect at the time of purchase in only two cases (both purchases by Morocco). Two purchases (the second purchases by Korea and Morocco) were, however, constrained by the joint limit on outstanding purchases of 105 percent of quota, and one purchase (Ghana) was constrained by the separate limit on export shortfalls of 83 percent of quota.

Four cases used the early drawing procedure, of which, two (the first purchases by Morocco and Bangladesh) involved estimated cereal data. The period of estimation in these two cases did not exceed four months, well within the 12-month limit. Final calculations indicated that two cases involved overcompensation, including one case where cereal import costs were overestimated. A prompt repurchase was made in each case.

With respect to over or undercompensation on account of differences between projected and actual data, information is available on the actual cost of cereal imports for six cases (Table 4). ^{1/} Ex post calculations

^{1/} Although the projection period has now ended for the five purchases made in 1984/85 (Table 2), actual cereal import data for these cases are not available in sufficient detail to enable ex post calculations to be made.

using actual data indicate that there was significant overcompensation in the four cases other than the two purchases by Malawi. The overcompensation was due mainly to the overestimation of export earnings; projected cereal import costs proved to be fairly accurate in all cases except for the 1982 purchase by Bangladesh where cereal imports were underestimated because floods, which reduced food production sharply in 1984, were not foreseen. Actual export earnings were much lower than projected in the purchases by Korea, Morocco, and Kenya, largely because of the unforeseen impact of the 1982-83 international recession.

Table 4. Purchases Under the Cereal Decision: Ex Post Calculations

Country	Short- fall year ending	Estimated Net Shortfall 1/			Ex Post Compensable Amount		
		Net short- fall	Export short- fall	Cereal import excess	Net short- fall	Export short- fall	Cereal import excess
1. Malawi <u>2/</u>	6/81	1.5	-17.2	18.7	--	-19.9	6.5
2. Korea	9/81	106.2	-464.0	570.2	--	-1,248.1	584.4 <u>3/</u>
3. Morocco <u>2/</u>	3/82	236.4	113.0	123.4	123.8	-45.8	169.6
4. Bangladesh <u>2/</u>	9/82	51.9 <u>4/</u>	47.9	22.4	12.2	45.0	-32.8
5. Kenya	12/81	61.5	29.9	31.6	16.5	-36.9	53.4
6. Malawi	9/82	12.2	16.3	-4.1	13.3	15.6	-2.3 <u>3/</u>

1/ In the case of purchases under the early drawing procedure the amounts shown are the net amounts after repurchases, if any.

2/ Purchase was made under the early drawing procedure.

3/ Partly estimated.

4/ Excludes an adjustment for double compensation in respect of export shortfalls of SDR 18.4 million.

In all ten cases with a cereal import excess, the cause of the excess was the impact of adverse weather on domestic cereal production, clearly a factor beyond the control of the member. Purchases were made in the lower tranche in two cases, both by Bangladesh. In all but one upper tranche purchase (Jordan) cooperation with the Fund was met by a satisfactory performance under an existing stand-by arrangement, or the concurrent approval by the Executive Board of a new stand-by arrangement. In the case of Jordan, the member's current and prospective policies were considered adequate to satisfy the test of cooperation.

Purchases under the cereal decision averaged SDR 77 million per year during the past two years of operation of the facility. Assuming that the world food security situation remains favorable, a sharp increase in the use of the facility is not likely to materialize over the next two years.

V. Staff Appraisal and Recommendations

The use of the cereal decision by members has been quite limited since the approval of the decision by the Executive Board in May 1981. A total of 13 purchases by seven members have been approved for a total amount of SDR 1,116 million. Six purchases were made in the first and second years of operation of the scheme, none in the third year, and seven in the fourth and fifth years. Only two purchases have been made since the cereal decision was last reviewed by the Executive Board in May 1985, and none have occurred during the past 16 months. The main reason for the limited use of the scheme in the past two years is the recovery in cereals production in many low-income food deficit countries, especially in sub-Saharan Africa. Since mid-1985 there has been a significant improvement in world food security; world cereals production and stocks have reached record levels in each of the last two crop years, and prices have fallen to their lowest level since the early 1970s. Cereal importers now face a very favorable situation in terms of the availability of food aid and the price of commercial imports.

No serious problems have arisen in the implementation of the provisions of the cereal decision. The option to use the cereal decision in case of need is open to all members, and two members (Morocco and Kenya) have now chosen to exercise the option a second time. No purchases have been constrained by the separate limit on outstanding purchases relating to a cereal excess (83 percent of quota), although two purchases have been constrained by the joint limit (105 percent of quota), and one purchase by the separate limit relating to export shortfalls. The expectation with respect to reversal of overcompensation in early drawings was fulfilled, and no unusual difficulties were encountered concerning the requirements relating to "beyond the control", and cooperation with the Fund.

The staff considers that the cereal decision continues to serve the purpose for which it was intended; although the favorable world food security situation is expected to continue on a global basis for the next two years, individual members may require assistance to finance the cost of non-concessional food imports necessitated by adverse weather conditions or natural disaster. The staff recommends that no modifications be made to the provisions of the decision, and that the decision be reviewed again after two years, that is, before it lapses on May 13, 1989. Certain aspects of the decision may also need to be reviewed in the context of the ongoing review of the CFF.

Accordingly, the following decision is proposed for adoption by the Executive Board:

Review of Decision on Compensatory Financing of
Fluctuations in the Cost of Cereal Imports

The Executive Board has reviewed Decision No. 6860-81/81, adopted May 13, 1981, as amended, on Compensatory Financing of Fluctuations in the Cost of Cereal Imports, as required by paragraph 17 of that decision. The next review of the decision shall be conducted not later than May 13, 1989.

Summary of Recent Purchases Under the Cereal Decision
(Executive Board Decision No. 6860-(81/81))

This annex summarizes the calculations underlying the two purchases made since the review of the cereal decision by the Executive Board in May 1985 (SM/85/98), and indicates the cause of the cereal excess, and how the member was able to satisfy the test of cooperation with the Fund. A summary of all previous purchases under the decision is contained in Annex II of SM/85/98 (4/5/85).

1. Morocco (EBS/85/159, 6/25/85 and Supplement 1, 9/6/85)

Morocco made a second purchase under the cereal decision in September 1985. A compensable amount of SDR 130.3 million was calculated as the sum of an excess of SDR 73.4 million in cereal import costs and a short-fall of SDR 56.9 million in merchandise export earnings for the 12 months ended June 1985 (Table 5). However, the purchase was constrained to SDR 115.1 million by the joint limit on outstanding purchases under the cereal decision of 105 percent of quota. The purchase raised outstanding purchases relating to the cereal component to 59 percent of quota and those relating to the export component to 46 percent of quota. The cereal excess mainly reflected an increased volume of cereal imports in the

Table 5. Morocco: Second Purchase Under the Cereal Decision--
Determination of the Amount of Compensation

(In millions of SDRs)

	Years Ending June				
	1983	1984	1985	<u>Projected</u>	
				1986	1987
1. Cereal imports	158.4	276.1	323.3	219.0	272.5
2. Merchandise exports	1,941.6	2,024.3	2,113.7	2,320.0	2,500.0
3. Compensable amount			<u>130.3</u>		
(3.1)+(3.2)					
3.1 Cereal import excess			73.4		
3.2 Export shortfall			56.9		
4. Purchase (4.1)+(4.2)			<u>115.1</u>		
4.1 Cereal component			73.4		
4.2 Export component			41.7		

excess year, necessitated by a sharp reduction of domestic production in two successive crop years on account of drought. Higher prices for cereal imports also contributed to the excess. Food aid accounted for 19 percent of cereal import needs in the excess year. The export shortfall was due both to the effects of drought on agricultural exports and weak external demand for mineral exports. Morocco met the test of cooperation for an upper tranche purchase through the approval by the Executive Board, concurrently with the CF request, of a 17-month stand-by arrangement.

2. Kenya (EBS/85/250, 11/8/85)

Kenya made its second purchase under the cereal decision in December 1985. The purchase of SDR 37.5 million represented a cereal import excess of SDR 63.1 million, partly offset by an export excess of SDR 25.2 million estimated for the 12 months ended June 1985 (Table 6). The purchase raised outstanding CF purchases to 63.9 percent of quota. The excess cost of cereal imports reflected the necessity to resume commercial imports of wheat and maize after two years of self-sufficiency, as domestic production in the 1984/85 crop year was sharply reduced by drought. Food aid provided 55 percent of Kenya's cereal import needs in the excess year. The stricter test of cooperation was met by Kenya's satisfactory performance under a one-year stand-by arrangement approved in February 1985.

Table 6. Kenya: Second Purchase Under the Cereal Decision--
Determination of Amount of Compensation

(In millions of SDRs)

	Years Ending June				
	1983	1984	1985	Projected	
				1986	1987
1. Cereal imports	12.1	2.3	86.7	11.4	5.6
2. Merchandise exports	840.0	1,003.2	964.7	915.0	984.0
3. Net shortfall (3.1)+(3.2)			37.9		
3.1 Cereal import excess			63.1		
3.2 Export shortfall			-25.2	<u>1/</u>	
4. Purchase			37.9		

1/ Excess.

INTERNATIONAL MONETARY FUND

Compensatory Financing of Fluctuations in the
Cost of Cereal Imports

I. Executive Board Decision No. 6860-(81/81), adopted May 13, 1981, as amended by Decisions Nos. 7602-(84/3), adopted January 6, 1984 and 7967-(85/69), adopted May 3, 1985

1. For a period of eight years from May 13, 1981, the Fund will be prepared to extend financial assistance in accordance with the terms of this Decision to members that encounter a balance of payments difficulty produced by an excess in the cost of their cereal imports. The amount of this financial assistance will be determined in accordance with this Decision, which integrates this assistance with that available in accordance with the facility established by the Decision on the Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135)).

2. For a period of three years from the date of a member's first request for a purchase under this Decision, any purchases by the member in respect of its export shortfalls shall be made under this Decision instead of under Decision No. 6224.

3. A member with balance of payments difficulties may expect that its request for a purchase under this Decision will be met if the Fund is satisfied that

(a) any shortfall in exports and any excess costs of cereal imports that result in a net shortfall in the member's exports are of a short-term character and are largely attributable to circumstances beyond the control of the member; and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

4. (a) Subject to the limits specified in paragraph 9, a member may request a purchase under this Decision for an amount equal to the net shortfall in its exports calculated as the sum of its export shortfall and the excess in its cereal import costs.

(b) (i) For the calculation of the net shortfall in exports, an excess in exports shall be considered a negative shortfall in exports and a shortfall in cereal import costs shall be considered a negative excess in cereal import costs.

- (ii) An export shortfall shall be determined in accordance with Decision No. 6224.
- (iii) An excess in cereal import costs shall be determined in accordance with paragraphs 5 and 6.

5. The existence and amount of an excess in the cost of cereal imports shall be determined, for the purpose of purchases under this Decision, with respect to the latest twelve-month period preceding the request for which the Fund has sufficient statistical data, provided that the Fund may allow a member to make a purchase on the basis of estimated data in respect of a twelve-month period ending not later than twelve months after the latest month for which the Fund has sufficient statistical data on the members' cereal import costs. The estimates used for this purpose shall be made in consultation with the member. The calculation of a member's shortfall or excess in exports and its excess or shortfall in the cost of its cereal imports shall be made for the same twelve-month period.

6. In order to identify more clearly what are to be regarded as excess costs of cereal imports of a short-term character, the Fund, in consultation with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's cereal import costs. For the purposes of this Decision, the excess in a member's cereal imports for the twelve-month period referred to in paragraph 5 shall be the amount by which the member's cereal imports in that twelve-month period are more than the arithmetic average of the member's cereal imports for the five-year period centered on that twelve-month period.

7. The amount of a purchase under this Decision, as defined in paragraph 4, may be either in relation to an export shortfall or to an excess in cereal import costs, or the amount may consist of two components, one relating to an export shortfall and the other relating to an excess in cereal import costs. The total amount of the purchase and the amount of each component are subject to the limits specified in paragraph 9.

- 8. (a) The part of a purchase relating to an export shortfall, subject to the limit in paragraph 9(b), shall not exceed the lesser of the export shortfall defined in paragraph 4(b)(ii) and the net shortfall in exports defined in paragraph 4(a).
- (b) The amount of a purchase relating to an excess in cereal import costs, subject to the limit in paragraph 9(c), shall not exceed the lesser of the excess in cereal import costs defined in paragraph 4(b)(iii) and the net shortfall in exports defined in paragraph 4(a).
- 9. (a) The total amount of a member's purchases outstanding under this Decision and Decision No. 6224 shall not exceed an amount equal to 105 per cent of quota, 1/

1/ Changed from 125 percent of quota on January 6, 1984 (Decision No. 7602-(84/3)).

provided that a request for a purchase that would increase the total amount of the member's purchases outstanding under this Decision and Decision No. 6224 beyond 50 per cent of the quota will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

- (b) The total amount of a member's purchases outstanding under Decision No. 6224 and this Decision that are related to export shortfalls shall not exceed 83 per cent of quota. 1/
- (c) The total amount of a member's purchases outstanding under this Decision that are related to the excess in cereal import costs shall not exceed 83 per cent of quota. 1/

10. Where the sum of the export shortfall and cereal import components, as limited by paragraph 9(b) and paragraph 9(c), exceeds the limit specified in paragraph 9(a), the member shall allocate the amount of its purchase as between the two components.

11. Purchases under this Decision and holdings resulting from such purchases shall be excluded pursuant to Article XXX(c) for the purpose of the definition of "reserve tranche purchase." For the purpose of applying the Fund's policies on the use of its resources, holdings resulting from the use of the Fund's resources under the policy set forth in this Decision shall be considered to be separate from the holdings resulting from the use of the Fund's resources under any other policy, except the policy set forth in Decision No. 6224.

12. When a member requests a purchase on the basis of estimated statistical data the member will be expected to represent that, if the amount of the purchase exceeds the amount that could have been purchased on the basis of actual statistical data, the member will make a prompt repurchase in an amount equivalent to the overcompensation.

- 13. (a) Subject to paragraph 12, when a reduction in the Fund's holdings of a member's currency is attributed to a purchase under this Decision the member shall attribute that reduction between the outstanding cereal import component and export shortfall component of the purchase.
- (b) When the Fund's holdings of a member's currency resulting from a purchase under this Decision or Decision No. 6224 are reduced by the member's repurchase or otherwise, the

1/ Changed from 100 percent of quota on January 6, 1984 (Decision No. 7602-(84/3)).

member's access to the Fund's resources under this Decision will be restored pro tanto, subject to the limits in paragraph 9.

14. (a) After the expiration of the period referred to in paragraph 2, the total amount of the export shortfall components of a member's purchases outstanding under this Decision shall be counted as having been purchased under Decision No. 6224, and the resulting total of the amounts outstanding under Decision No. 6224 and the cereal import components outstanding under this Decision shall not exceed 105 per cent of quota. 1/
- (b) The provisions of Decision No. 6224 shall continue to apply to the export shortfall component of a purchase under this Decision after the expiration of the period referred to in paragraph 2 or the expiration of this Decision.

15. In order to implement the Fund's policies in connection with the financing of members' cereal import costs and the compensatory financing of export shortfalls, the Fund will be prepared to waive the limit on the Fund's holdings of 200 percent of quota, (i) when necessary to permit purchases to be made under this Decision or (ii) to the extent that purchases are outstanding under this Decision.

16. The Fund will indicate in an appropriate manner which purchases by a member are made pursuant to this Decision, and the export shortfall component and the cereal import component of each.

17. The Executive Board will review this Decision not later than May 13, 1987.

II. Executive Board Decision No 7490-(83/105), adopted July 18, 1983

1. The Executive Board has concluded a review in accordance with paragraph 17 of Decision No. 6860-(81/81), adopted May 13, 1981, "Compensatory Financing of Fluctuations in the Cost of Cereal Imports," and decides to maintain the Decision unchanged.

2. A further review of the Decision at the time when quota increases under the Eighth General Review of Quotas become effective is not called for, but the Decision shall be reviewed prior to its expiration on May 13, 1985.

1/ Changed from 125 percent of quota on January 6, 1984 (Decision No. 7602-(84/3)).

