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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/25

10:00 a.m., February 9, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	S. M. Hassan, Temporary
	Song G., Temporary
	D. C. Templeman, Temporary
	E. L. Walker, Temporary
	G. Seyler, Temporary
	C. A. Salinas, Temporary
	T. Alhaimus
	B. Goos
	J. Reddy
	J. R. N. Almeida, Temporary
	M. Foot
	S. King, Temporary
H. Lundstrom	
	D. McCormack
Mawakani Samba	
	I. A. Al-Assaf
	E. Ayales, Temporary
H. Ploix	
	J. de Beaufort Wijnholds
C. R. Rye	
	R. Msadek, Temporary
A. K. Sengupta	
K. Yamazaki	
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

Working Party on the Statistical Discrepancy in World Current Account Balances: P. Esteva, Chairman; S. Pizer, Director of the Technical Staff. IBRD: F. Vakil, Western Africa Regional Office. African Department: G. E. Gondwe, Deputy Director; E. A. Calamitsis, S. E. Cronquist, M. G. Fiator, M. G. Gilman, J. W. Kratz, I. S. McCarthy, A. Tahari, G. P. Taplin. European Department: P. M. Nagy. Exchange and Trade Relations Department: S. J. Anjaria, V. P. G. Schoofs. External Relations Department: D. M. Cheney. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: M. A. Dessart. Legal Department: J. M. Ogoola, J. K. Oh. Research Department: A. D. Crockett, Deputy Director; M. C. Deppler, S. J. A. Gorne. Bureau of Language Services: R. L. Renfield. Bureau of Statistics: W. Dannemann, Director; J. B. McLenaghan, Deputy Director; A. C. Bouter, M. S. Gill, D. K. McAlister. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: M. B. Chatah, G. D. Hodgson, K. Murakami, A. Ouanes, G. Pineau, N. Toé, A. Vasudevan, K. Yao. Assistants to Executive Directors: A. R. Al-Abdullatif, F. E. R. Alfiler, M. Hepp, A. Iljas, O. Isleifsson, J. M. Jones, K.-H. Kleine, M. A. Kyhlberg, V. K. Malhotra, T. Morita, S. Rebecchini, V. Rousset, D. Saha, G. Schurr.

1. PEOPLE'S REPUBLIC OF THE CONGO - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with the People's Republic of the Congo (SM/87/17, 1/16/87). They also had before them a background paper on recent economic developments in the Congo (SM/87/21, 1/23/87).

The staff representative from the African Department said that since the previous consultation mission, discussions with the authorities had continued with a view to reaching understandings on the requisite adjustment measures for 1987. Progress had been made in those discussions, and the staff had been informed by the authorities of their intention to take the necessary supplementary measures to bring the program back on track. The authorities had requested a mission to complete the discussions on the review under the stand-by arrangement. A mission was scheduled to visit Brazzaville in the second half of February 1987.

Mr. Mawakani made the following statement:

> The economic performance of the People's Republic of the Congo in 1986 was adversely affected by unfavorable developments brought about by the precipitous decline in world oil prices. Real GDP declined, for the second year in a row, by about 2 percent compared with an annual average rate of growth of over 7 percent achieved over the period 1982-84. Largely on account of a 46.5 percent deterioration in the terms of trade, the external current account deficit, including public transfers, rose sharply. Moreover, oil revenues, a major source of government revenue (more than two thirds of total revenue in 1985), fell by 48 percent in 1986. It is against such an extremely difficult background that the Congolese Government developed and strengthened its structural adjustment program, 1985-87, that is being supported by the current stand-by arrangement with the Fund.
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> Although in some instances the performance of some sectors of the economy fell marginally short of the program objectives for 1986, the overall economic performance is nevertheless a source of satisfaction, as it does indicate to the authorities that their efforts are bearing fruit. Indeed, despite a sharp drop in export receipts representing 33 percentage points of the 1986 nominal GDP, the external current account deficit, including public transfers, was contained at 17.5 percent of GDP in 1986. The tight demand-management policy stance adopted in 1986 enabled the Government to reduce the budget deficit on a commitment basis, from 6.3 percent of GDP in 1985 to 5.8 percent in 1986 in spite of a 35 percent decline in total revenue, representing 17.6 percentage points of the 1986 nominal GDP. This policy stance also contributed to an abatement of the inflationary pressures in the economy, with the rate of inflation, as measured by the consumer price index, falling to 5 percent from 6.4 percent in 1985.

The Congolese authorities are determined to continue to pursue their adjustment efforts geared at reducing the internal and external financial imbalances and diversifying the economy to lay the foundation for sustainable noninflationary economic growth over the medium term. To achieve the latter objective, they intend to undertake a further reassessment of their investment strategy with a view to reorienting it toward the most productive sectors of the economy and putting increased emphasis on the development of small and medium-scale enterprises. In this respect, and as a start, the Government trimmed its investment program and scaled down substantially its investment budget from CFAF 162 billion in 1985 to only CFAF 65 billion in 1986. It should be noted that this amount is in excess of the CFAF 50 billion programmed under the revised public investment budget submitted in May 1986 because of difficulties in assessing outlays on ongoing investment projects at the time of the revision of the budget and because of technical and legal problems encountered with contractors. Thus, the overshooting of the program ceiling on public investment commitments should not be construed as a relaxation of the Government's efforts at enhancing the effectiveness of the public investment program. However, while the Congolese authorities remain committed to scaling down or interrupting the implementation of nonpriority projects, they are of the view that the legal, technical, and financial implications of such an undertaking should not be overlooked.

The Government's strategy toward fiscal adjustment is to combine expenditure-reducing with adequate revenue-raising measures in the face of the abrupt decline in oil revenues. On the expenditure side, the Congolese authorities have enacted drastic cuts in current and capital outlays in 1986. In the event, current and capital expenditures were reduced by 16 and 59 percent in nominal terms, respectively. On the revenue side, notwithstanding the adoption of various measures, including, inter alia, a reduction of the number of exemptions from customs duties and domestic taxes, a broadening of the scope of taxes on imported goods, and the introduction of a levy on some items, non-oil revenues declined by 8 percent in 1986. While recognizing that the technically induced delays in the effective implementation of these measures have had and adverse impact on the revenue performance, the Congolese authorities are of the view that the recession in the non-oil sector that was more severe than previously anticipated has had a greater impact on revenue. In the face of such unforeseen developments, the authorities adopted promptly additional revenue-raising measures that were not contemplated under the program. This quick response certainly contributed to containing the decline in non-oil revenues.

The Congolese authorities rocognize that the rehabilitation of the public enterprise sector should be an integral part of their efforts to reduce the internal financial imbalances. They are aware of the main causes of the financial difficulties confronting this sector and are determined to address them in the context of a major reform program. To this end, discussions are under way with the World Bank and bilateral donors to secure adequate financial assistance to implement such a program. In the meantime, the Government has addressed the problems of personnel costs, inadequate pricing policies, and management problems by reducing the wage bill of some key enterprises and limiting recruitment, raising most prices and tariffs of the goods and services provided by the public enterprises, and improving their billing and collection system.

Under the current uncertain conditions of the world oil market, a viable medium-term external position for the Congo can be achieved only through economic diversification away from oil. The Congolese authorities are aware that such a policy redirection is a lengthy process. They hope that the reorientation of their public investment program, the successful completion of the discussion under way with the World Bank on a structural adjustment program, together with the various measures taken with a view to improving the performance of the public enterprises, would go a long way in attaining their objective of economic diversification.

In sum, although the economic performance of the Congo was mixed in 1986, the Congolese authorities are encouraged to pursue their adjustment efforts to arrest the deterioration of the economic and financial situation of their country and lay a sound basis for a durable economic growth. They are looking forward to the next staff mission and hope that they will be able to agree on the measures needed in 1987 to conclude the first review of the stand-by arrangement.

Mrs. Ploix made the following statement:

For the Congo, 1986 has been marked by a sharp fall in oil prices but also by significant efforts to adjust economic policies, stop the continuing deterioration in the public finances, and undertake the structural reforms needed to encourage diversification in the non-oil sector in the medium term. Of course, such an adjustment process naturally involves some difficulties, stemming partly from the speed at which some of the measures have been implemented--for example, the curtailment of several ongoing public investment operations. Difficulties have also resulted from errors and omissions in assessing the stock of arrears. The uncertainty about future oil prices and the dollar exchange rate has made the situation all the more difficult.

In the circumstances, including the ambitious nature of the reform effort, I am not surprised that there have been slippages in the program and that modifications have been required. The difficulties that are mentioned in the staff report must be considered in the light of the magnitude of the reforms that have been formulated and implemented in 1986. Indeed, several steps have been taken in each of the main areas of the Fund-supported program--the reform of marketing and pricing policies, the scaling down of the investment program, the improvement in the performance of some key public enterprises, and the reduction in the overall fiscal deficit.

The authorities are gradually implementing a realistic pricing system aimed at sending the necessary signals and providing the necessary incentives. I am particularly pleased that the agricultural producer prices have been substantially increased to reach the levels of neighboring countries, that the list of products and services that are subject to price regulation has been reduced from 38 products to 20 products, and that the prices of regulated goods have been raised to eliminate all the subsidies on these products. In addition, an important step has been taken in the liberalization of the global economic framework, as the export and marketing monopolies for several entities have been reduced or abolished. Moreover, the public investment program was cut by two thirds in 1986, compared with 1985, and recent tariff increases and wage bill reductions will improve the financial position of six of the public enterprises. The overall fiscal deficit on a commitment basis has been reduced from 6.3 percent of GDP in 1985 to 5.8 percent in 1986. Despite some slippages and delays, which are of course regrettable, the efforts that have been made to reduce government expenditures are clearly significant. In particular, there has been a sharp reduction in new recruitment in the civil service.

It is important to stress that, however commendable and absolutely necessary these efforts may be, they are meaningful only in a medium-term perspective. If the Congo is to achieve viable balance of payments and budgetary positions and to renew sustainable growth, it must make a continued adjustment effort and strive for more complete structural reforms for several more years. It is important to stress also that the structural reforms will continue to be fully warranted even if oil prices were to increase.

Three adjustment areas deserve particular attention. With respect to the public investment program, following the scaling-down phase efforts should focus on the reorientation of the program toward quick-yielding investments. In addition, the authorities should focus on improving management in the public enterprise sector. I noted that the reform of the banking system is expected to be part of the reform of the public enterprise sector. Moreover, the liberalization of pricing and trade policy should be pursued further in order to create an environment that will be more conducive to the needed diversification of the economy. The World Bank has the expertise and the resources to play a key role in all these areas, and I am therefore pleased that sectoral and structural operations are being studied. I hope that these operations will be undertaken quickly.

While attempting to implement these structural reforms, the authorities should continue to focus on the fiscal area in order to keep the deficit within a manageable limit through adequate expenditure and revenue measures.

The Congo's track record in 1986 shows the commitment of the authorities to this program. I have no doubt that they will maintain their commitment in 1987, and that the review will be completed soon.

Mrs. Walker made the following statement:

I welcome the information provided by the staff at the beginning of this discussion on the status of relations between the Congo and the Fund. It is disappointing that the program went off track so soon after the Executive Board's approval of it. The slippages in the fiscal area, together with the lower than expected oil prices, caused the overall balance of payments outcome to be considerably worse than was programmed, and caused several of the performance criteria for September and December to be missed. The economic outlook for the Congo has been extremely difficult, and the slippages have set back progress under the economic adjustment program. However, the information given by the staff representative in his opening statement is encouraging; the authorities are clearly committed to bringing the program back on track. They should introduce the needed measures on the fiscal front that they have discussed with the staff; this should enable the staff to complete the review under the stand-by arrangement. Furthermore, I attach importance to strengthening the adjustment effort in the coming year in order to avoid slippages owing to other than such exogenous factors as oil prices, in order to keep the program on track.

In a number of areas the authorities have made commendable progress in implementing the program. The measures to liberalize marketing and pricing policies and to increase producer and consumer prices are substantial and should contribute to the efforts to diversify the economy, increase domestic production, raise exports, and decrease the reliance on imports. The reduction in subsidies on the remaining controlled prices is certainly a step in the right direction. Increased economic activity outside the oil sector will require continued market-related pricing and marketing policies, and I hope that these policies will be included in the rest of the program. I am pleased that progress has been made in formulating a comprehensive public enterprise reform in conjunction with the World Bank. I agree with the staff that rehabilitation of the public enterprise sector is a critical element of the adjustment program, and the authorities should tackle this reform with determination and a sense of urgency.

It appears that a majority of the slippages in 1986 consisted of overspending in the investment program. Any attempt to cut public investment obviously involves difficult decisions, and I hope that the authorities and the World Bank can agree on a program that can be justified on the basis of budgetary limitations as well as of contributions to productivity. The adoption of and adherence to a sound investment policy are essential to keeping the program on track. I hope that there will be an agreement with the World Bank on this issue by the time that the review is discussed by the Executive Board.

The balance of payments position deteriorated considerably in 1986 and is projected to worsen again in 1987. Even after including already agreed debt rescheduling, there is a financing gap of SDR 52 million. The staff should comment on the possibilities for filling this gap.

It is clear that the authorities must strengthen their adjustment efforts, particularly in the fiscal area, even if this scenario is to occur. For the improvement projected in 1987, however, I assume that the staff has a certain set of fiscal criteria that must be met and that these will be the basis for negotiating with the authorities the targets for the program in 1987. The authorities should carefully consider the staff's proposals and follow a conservative approach in their investment program in particular in 1987. Even if oil prices increase in 1987, a continued appreciation of the CFA franc could wipe out the benefit; the authorities have no choice but to maintain a strong adjustment effort. The debt service ratio is high, and debt will be difficult to service in the absence of continued reforms. Furthermore, both domestic and external arrears should be eliminated as soon as possible.

The authorities have made progress under their adjustment program. They should not let this progress slip by, and I hope that the results of the next staff mission to the Congo will be positive.

Mr. King made the following statement:

The staff report clearly shows that the situation facing the authorities has sharply worsened over the past few years, due partly to the continuing dependence upon the oil sector, which accounts for nearly 45 percent of GDP and 70 percent of exports. The weakening of the oil market, coming as it did on top of the problems resulting from the earlier rapid increase in public expenditure associated with the authorities' ambitious development plans and the recent real appreciation of the CFA franc, has added to the strains on the economy. With external debt equivalent to about 130 percent of GDP and substantial internal and external arrears, the position of the Congo is far from comfortable. It is clear that the economic situation is not only exceptionally difficult, but is likely to remain so over the medium term. Resolute measures will be needed if a viable balance of payments position is to be achieved in the coming years. This will require, as the authorities recognize, both firm demand-management policies and structural reforms to promote the expansion of the non-oil sector.

The stand-by arrangement that was approved in July 1986 represented a major and commendable effort at implementing the measures required to meet this objective. On the demand-management side, the program envisaged a sharp reduction in public sector demand. Substantial progress toward this goal was achieved, although some slippages occurred on both the expenditure and revenue sides, which led to the program going off track. Mr. Mawakani noted in his opening statement that these problems reflected in part legal and other technical difficulties. Nevertheless, the staff believes that the authorities' draft budget proposals would be financeable only by a further significant accumulation of arrears. I am pleased that progress has been made in the discussion between the authorities and the staff on the additional measures that are required to bring the program back on track, and I hope that these issues can be resolved during the coming mission.

While tight demand-management policies will be essential over the medium term, they will need to be supported by structural measures to improve growth prospects and to help to diversify the export base. Important steps in this direction have already been taken, and the staff report gives grounds for believing that there is considerable scope for further rapid progress.

The staff notes that both the agricultural and forestry sectors appear to have great potential for expansion. For example, the sustainable yield of timber production is thought to be about three times the current level of output. The relatively disappointing performance of the agricultural sector in recent years appears to have been due partly to the weaknesses in the management of the state farms and partly to inappropriate producer prices. These have resulted in it being more economical to import frozen meat than to rely upon domestic production. Therefore, it is encouraging to see that considerable progress has been made in tackling these problems and that producer prices have been increased to the levels in neighboring countries. While these steps should help to reduce the incentives for smuggling of agricultural products, they might not ensure that prices are appropriate in comparison with those on world markets. A further comment on this matter will be helpful. A table in the background paper providing this information would also have been useful.

Structural policies also have an important role to play in promoting non-oil exports, particularly in view of the limitations on the use of the exchange rate as a policy tool. The recent rise in the real value of the CFA franc adds to the importance of rapid action in this area. If the exchange rate is effectively not available as a way in which to change relative prices, other instruments will obviously have to be used to achieve that objective. I wonder whether there might not be a case for further relaxation in the system of price controls. At present, a significant number of prices appear to be determined by a system of controlled markups. Relaxation of these controls should contribute to improving resource allocation.

As a part of the process of attempting to shift resources within the economy, it will be important to ensure that the areas of the public sector that are least closely involved with productive activities do not absorb an excessive amount of resources. Central government employment appears to have grown strongly in recent years, owing partly to the employment guarantees given to some groups. At the same time, average salaries have risen rapidly, owing to wage drift, despite the absence of general salary increases. Therefore, it is encouraging that the authorities have already achieved a significant slowing in the rate of growth of public sector employment. While this is undoubtedly a step in the right direction, I wonder whether a more fundamental examination of employment levels might not be worthwhile.

Mr. Hassan made the following statement:

The Congo, like other oil dependent countries, has been facing serious economic and financial problems as a result of the sharp drop in oil prices, the deceleration in output expansion, and the recent appreciation of the CFA franc in relation to the U.S. dollar. Real GDP is estimated to have declined by about 2 percent in 1986--the second year of decline in a row--reflecting a sharp curtailment of development expenditure and the shrinking of the oil sector; a further decline of 3 percent is projected for 1987.

In an effort to improve the situation, the authorities adopted a comprehensive adjustment policy that is being supported by a stand-by arrangement. I note from the staff report and Mr. Mawakani's opening statement that the authorities succeeded in implementing most of the measures under the program. These included substantial increases in producer prices for a large number of commodities, an upward adjustment in tariffs for services provided by public entities, liberalization of prices through substantial reductions in price and profit controls, the elimination and reduction of subsidies for a number of commodities, and the abolition of export and marketing monopolies. In addition, the authorities implemented the agreed public sector recruitment policies and the specific measures envisaged to improve the financial situation of six key public enterprises and made progress in formulating a comprehensive reform of the parastatal sector with the assistance of the World Bank.

It is regrettable that despite this commendable effort by the authorities to implement the measures under the program, the first scheduled review was not completed because of slippages in the implementation of a number of measures and the nonobservance of some of the performance criteria for end-September 1986. The authorities should reach the understandings needed to complete the review and bring the program back on track. At the same time, the staff and the Fund should show reasonable flexibility in monitoring the program, taking into consideration the difficult situation facing the authorities in their efforts to meet some of the performance criteria, particularly when factors beyond their control are involved--for example, the legal, technical, and financial difficulties that the authorities indicated are facing them in canceling and scaling down certain projects. I am pleased that, according to the latest information reported by the staff, progress has been made in reaching an understanding on the needed measures, and that a mission will be visiting Brazzaville soon.

The staff report indicates that the prospects for the Congolese economy for 1987 and the medium term remain difficult. They include heavy external debt servicing and a large financing gap and will require a strengthening and effective implementation of the adjustment policies. The staff noted that the authorities' budgetary proposal for 1987 will fall short of achieving the program's original targets. However, I agree with the authorities that substantial adjustment efforts were made, and I have noted their commitment and determination to undertake the measures necessary to bring the program back on track. They should strengthen their efforts to achieve viable balance of payments and budgetary positions over the medium term and to re-establish sustainable economic growth.

The staff representative from the African Department remarked that the authorities had made commendable adjustment efforts in 1986, particularly in response to the sharp decline in oil exports and oil fiscal receipts. In 1986, the investment program was reduced by nearly 60 percent, and current expenditure was reduced by about 20 percent compared with 1985. However, there were slippages in the implementation of the adjustment program, especially with respect to the investment effort. Only a few years previously, the investment program had involved expenditure of CFAF 200 billion, and the authorities had subsequently succeeded in the difficult task of reducing investment expenditure to about CFAF 65 billion. The slippages in the investment program had been due partly to the contractors having continued work on some of the projects that had been stopped. However, the slippages had also been due partly to the difficulty the authorities had had in closely following the implementation of investment projects. The authorities had explained that the delays in implementing the planned tax policies had been due to technical problems, but the staff felt that, since the relevant measures had been announced in the budget in May, they should have been implemented at that time.

At the time of the formulation of the adjustment program, information provided by the authorities showed that domestic arrears were estimated at CFAF 75.8 billion, the staff representative said. Further analysis by the authorities, following a survey taken by them, showed that the outstanding arrears at the end of 1985 were CFAF 94.3 billion.

After producer prices had stagnated for a number of years, the authorities had raised the prices of coffee and cocoa by almost 100 percent under the adjustment program, bringing producer prices for those products to almost the same level as in neighboring countries and to about 66 percent of world prices, the staff representative explained. Given the very high costs of transportation in the Congo, the staff considered that the current producer prices were appropriate. If world prices for coffee and cocoa were to decline, producer prices in the Congo would be even higher than world prices, thereby creating difficulties for the marketing agencies, which could record losses. In any event, the authorities had indicated that they were determined to maintain flexible producer prices in order to encourage local production.

The authorities had significantly altered their employment policy, the staff representative said. In the past, and particularly during boom years, all graduates had been assured employment with the Government. Accordingly, while the total population of the country was just about 2 million persons, government recruitment had averaged about 5,000 persons a year in recent years. That level had been reduced to about 2,500 persons in 1986, when net recruitment was only some 400 persons compared with 4,000 persons in 1986 and a target of about 700 persons under the program.

The projections for 1987 in the staff report took into account the proposals that the staff had made to the authorities with a view to achieving the required adjustment, the staff representative from the African Department explained. Even if the price of oil were to rise to about $16-18, the positive effect would be virtually offset by the exchange rate; accordingly, the authorities would have to make strong adjustment efforts in 1987 as well as over the medium term.

Mr. Mawakani said that the interruption of certain projects in the public investment program had legal implications for contractors and was costing the Government more financial resources than it was saving. At least five cases involving disputes with contractors were still pending.

It would therefore be necessary to make provision in the 1987 budget for the resources required to complete those projects, thereby avoiding lengthy legal procedures. The Congo's situation with respect to the exchange rate was the same as that of Senegal and Côte d'Ivoire, which were recently discussed by the Executive Board.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the views expressed in the staff appraisal in the report for the 1986 Article IV consultation with the People's Republic of the Congo.

Directors welcomed the efforts which the authorities had made in 1986 under the program supported by the stand-by arrangement. While some speakers stressed the very difficult conditions under which the adjustment efforts were being made, others underscored that the imbalances in the economy and the need for further adjustment remain substantial. On balance, Directors remarked that the authorities had clearly made strenuous adjustment efforts in the course of 1986 despite the increasingly difficult situation, which had been exacerbated by the precipitous decline in oil revenues stemming from falling oil prices. They noted that the Congo had satisfactorily implemented the measures envisaged under the program in the areas of pricing, marketing, reduction of subsidies, reforms in certain public enterprises, and recruitment policy, although they regretted the slippages in the implementation of other elements of the program. In particular, there were delays in the implementation of tax measures, and public investment and non-interest current outlays exceeded the programmed amounts. These slippages had resulted in the failure to meet the end-September performance criteria under the program with the Fund.

Directors noted with concern that the authorities' 1987 budget did not conform to the original program objectives, and that it had not so far proved possible to complete the review of the program. They welcomed the recent indications on the part of the authorities of their intention to take the requisite adjustment measures to put the program back on track, and their request for a Fund mission to resume discussions on the review. They hoped that the staff and the authorities will reach appropriate understandings on these policies and complete the review as expeditiously as possible.

Directors remarked that the Congo's economic outlook for 1987 and the medium term remains very difficult and requires that the adjustment efforts be strengthened and implemented effectively--even if oil price developments and prospects become more favorable--if the Congo is to reach viable balance of payments and budgetary positions over the medium term so as to re-establish sustainable economic growth. For 1987 in particular there is a need for additional measures to reduce current expenditure, including further restraint on public sector recruitment and wages, and an appropriate and sustainable investment level. At the same time, it is essential that investment be oriented toward quick-yielding projects and the directly productive sectors. In this context, they welcomed the authorities' efforts to diversify exports, stimulate agriculture, and encourage small and medium-scale enterprises. In view of the less than encouraging prospects for the oil sector, the necessity for diversification of the economy was particularly pressing, and Directors welcomed the involvement of the World Bank in the reform of the public enterprises and the formulation of a structural adjustment program.

Finally, Directors encouraged the authorities to continue their efforts to eliminate existing arrears--with special emphasis on the public sector arrears--and to close the remaining balance of payments gap for 1987.

It is expected that the next Article IV consultation with the People's Republic of the Congo will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with the People's Republic of the Congo, in the light of the 1986 Article IV consultation with the People's Republic of the Congo conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that the People's Republic of the Congo continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

Decision No. 8522-(87/25), adopted
February 9, 1987

2. STATISTICAL DISCREPANCY IN WORLD CURRENT ACCOUNT BALANCES - FINAL REPORT OF WORKING PARTY

The Executive Directors considered the Final Report of the Working Party on Statistical Discrepancy in World Current Account Balances (SM/87/13, 1/12/87; and Sup. 1, 1/30/87).

Mr. Esteva, Chairman of the Working Party, made the following statement:

At the end of 1984, the Working Party was asked to investigate the sources of the large discrepancy that had developed since the late 1970s and to suggest measures--mainly in the statistical field--that should be taken to cope with that problem. At the end of 1985, the Working Party produced an interim report that was devoted primarily to giving a first idea of the sources of the discrepancy and to describing the strategy that was to be used to complete the project. The Final Report analyzes the sources of the discrepancy, proposes adjustment to data for 1983 and preceding years, and makes a number of other recommendations.

The discussion in the report on the sources of the discrepancy is relatively short, because the sources are clear. The main source is the emergence of large flows of cross-border assets recognized by debtor countries but not by creditor countries in the period 1979-83. The emergence of this trend was coupled with rising interest rates. The excess of reported capital inflows over capital outflows in 1977-83 was approximately $300 billion. The statistical adjustments for direct investment income that are proposed for 1983 include reinvested earnings, for which a positive discrepancy of $11 billion can be fully explained. As to other direct investment income, adjustments are proposed to eliminate half of the discrepancy--around $12 billion. The rest of the discrepancy is traceable to a limited number of creditor and debtor countries, giving a focus for the work in this area that remains to be done. The discrepancy for portfolio investment income has been reduced for 1984 as well as 1983 and preceding years to minor amounts by adjustments that are well founded. In addition, some work has been done on the shipping and other transportation items of the current account balance of payments and on official and private transfers. Extensive suggestions are made for further work in these areas as well.

The report assesses these adjustments and recommends measures for coping with the situation in the future. The root causes of the overall discrepancies in the past are likely to exist in the future, and there are some signs that the large discrepancy in portfolio investment is continuing to grow. This problem must be solved, and there is a wide range of possible solutions. The report makes specific recommendations for dealing with the various kinds of discrepancies in direct investment income, portfolio income, shipping and transportation, and unrequited transfers.

The report contains some general recommendations to national compilers that the Fund would have to endorse first. There are also some general recommendations directed to the Fund itself.

These recommendations encompass inquiries that are still to be conducted to fill in gaps--relations with member countries, a review of the Balance of Payments Manual and other publications, a plan of action prepared by the Bureau of Statistics, and some further analysis by the Research Department.

Mr. Ayales made the following statement:

The Working Party's report provides an in-depth analysis of the factors explaining the quantitatively most significant discrepancies in the balance of payments. The report provides a set of recommendations aimed at improving the statistical compilation techniques, thereby reducing the magnitude of the discrepancies over time.

Among the recommendations that are made to national authorities, the report suggests that national statistical agencies should make improvements in the methods of data collection on investment income flows. In particular, it is suggested that surveys should be undertaken in collecting data on direct income investment and associated capital flows in recognition of the fact that systems based on the exchange record do not fully capture the relevant flows, especially those that are routed outside the banking system. In addition, it is suggested that data should be compiled on the stocks of portfolio capital and that these data should be used in calculating the relevant income flows.

While the survey technique in assembling data on international investment and related capital flows has its merit, it should be recognized that for each country any major changes in existing national statistical systems have implications in terms of the possible need for additional resources to introduce these changes. Given the budget cuts in statistical programs in many countries, I wonder whether it is realistic to expect national authorities, especially those in developing countries, to provide the kind of resources that will be needed to make modifications in and/or expand the range of statistical programs.

Several of the Working Party's recommendations involve follow-up actions by the Fund, especially the Bureau of Statistics. The Bureau has prepared a preliminary program of action to implement those recommendations. As an integral part of this program, the Fund is sponsoring a group meeting of experts on balance of payments and national accounts in March 1987, and one of the objectives is the harmonization of guidelines contained in the Fund's Balance of Payments Manual and the UN System of National Accounts.

In addition, a meeting of national balance of payments compilers is planned for late 1987 to address the issues that are raised in the Working Party's report. My authorities support these initiatives, as the joint meeting of national accounts and balance of payments experts would promote harmonization between related bodies of economic statistics, thereby reducing the reporting burden on countries. In addition, both of the planned meetings would provide valuable information for the revision of the Balance of Payments Manual that is planned to be undertaken in the coming few years.

The statistical discrepancies in the balance of payments accounts occurred as a result of the distortions that are characteristic of an inflationary environment, such as capital flow controls and trade barriers. Undesirable trade practices, such as misreporting of data or outright tax avoidance, are the result of these distortions.

Over the previous several years, however, as inflationary pressures have receded in the major financial centers, these distortions have become less acute. This trend explains the fall in the size and relative importance of the statistical discrepancies. In the light of the probable international financial stability in the foreseeable future, it would be convenient to reconsider the importance of this problem, both in terms of accurate measurement of the problem and of its implications for policy design. This does not mean that I dispute the usefulness of improving world data on current account transactions as well as individual countries' balance of payments accounts. I endorse the report's recommendations that are applicable at the national level. They are steps in the right direction, although there are serious constraints on their implementation.

As to the implementation of the Working Party's recommendations for the Fund--including the estimation of data on nonreporting entities, the analysis and calculation of missing credits on investment income, their incorporation in Part 2 of Balance of Payments Statistics, and work on the analysis of shipping and tranportation accounts and official transfers--they would certainly impinge on the activity of the Bureau of Statistics and its existing resources. Implementation of recommendations in this area will require that adequate account be taken of the need to augment the existing resources of the Bureau of Statistics in the budget proposals for FY 1988.

While I acknowledge the importance of the Working Party's study, I would not wish to have the implementation of its recommendations inpinge on the development of the existing training and technical assistance programs on the Bureau of Statistics, which are contributing significantly to improving the quality and the currentness of the economic data in an increasing number of member countries, and which many countries perceive as being one of the major benefits of membership. The Bureau's technical assistance activities in recent years have been directed to a large extent to helping countries to improve the statistical basis for monitoring economic and financial developments, particularly in the context of Fund-supported adjustment programs. The technical assistance activities, which are playing a growing role in the performance of the area departments, should be preserved and encouraged.

Mr. Rye made the following statement:

I welcome the report, which provides a sturdy foundation for the correction of a problem that casts a shadow over the analysis of world economic trends. As the report notes, that problem relates not merely--not even mainly--to the size of the discrepancy in world current account balances but to its extreme volatility. As the report suggests, this problem clearly does not invalidate the Fund's world economic outlook analysis, but it certainly vitiates it.

My authorities have no reason to doubt that the Working Party has correctly identified the main causes of this discrepancy, although one would need virtually to replicate the study to be able seriously to question its conclusions.

While I accept the view of the Working Party that substantial improvements in the compilation of balance of payments figures will result from the implementation of the report's recommendations, I also agree that, over the longer run, improving the world's data on current account transactions will not be an easy task. For many countries, particularly those using data collections based on exchange transactions records, the recommendations seek major changes in collection and compilation procedures. Such an effort would be required at a time when the process of statistical measurement is increasingly complex as a result of rapid changes in the technology and forms of international transactions and at a time of tighter budgetary constraints on statistical agencies. The report's recommendations would require considerable investment by individual countries in personnel, time, and computer equipment. In addition, the process does not stop at balance of payments statistics; in all likelihood, a general review of foreign exchange transactions would trigger a re-examination of the system of national accounts and all other statistical areas that bear any relation to a country's external balance sheet. It may also be found that the countries that require a more thorough review of their statistical systems are the countries that can least afford it. In this connection, the staff could usefully comment on how the technical assistance extended by the Fund on statistical matters has helped or can help to improve coordination between national compilers and the Fund at minimal cost to the individual members. If I have a criticism of this report, it is that I would have liked to see more explicit recognition given to the high costs of the proposed reforms--costs that must be weighed carefully against the undoubted benefits for policy analysis.

My authorities fully support the recommendation for closer cooperation and effective interchange of views and information between the Fund and national compilers of balance of payments statistics and they will cooperate in such endeavors in the future, as they have in the past. My authorities broadly support the main recommendations of the report, on pages 11-13, and intend, as resources permit, to implement them. My authorities expect that, whenever it is relevant to do so, as under recommendation (a), there would be appropriate consultation with, and agreement to changes by, the relevant national statistical agencies before the Fund makes such changes. In addition, my authorities fully support the proposal to review and update the Fund's Balance of Payments Manual, which should remain the key source of international recommendations in the balance of payments field. Since balance of payments statistics are part of the national accounting framework, the recommendations contained in the manual should be harmonized with the UN System of National Accounts. That system is presently under review, and it is appropriate that the manual should be updated and reviewed in parallel with the UN system. While it might be difficult to simplify the contents of the manual itself, it would be useful to prepare an associated handbook, along the lines of the existing textbook, containing practical examples of the principles provided in the manual.

My authorities are willing to cooperate in any review of the process by which Australian data are reported to the Fund and recast into global aggregates.

I support all the proposals for follow-up action on page 2 of the supplement to the main report. However, I would like to have more information on the fourth proposal. There is no doubt that the new balance of payments series should be used only to supplement, rather than replace, the existing world economic outlook series as long as the Working Party's efforts are the sole source of revised data, and then only in aggregated form. However, I assume that, if the revised data are clearly superior to the existing series, they will replace those series as soon as possible.

Mr. Reddy made the following statement:

The Working Party has identified the major sources of the statistical discrepancies. I have no major difficulty in accepting the report's main conclusions and recommendations. I will comment on technical aspects of the analysis and on the recommendations for follow-up action.

There is a major discrepancy in the investment income account, which includes reinvested earnings and portfolio income. The discrepancy in reinvested earnings has been reduced by the Working Party by using information from the credit side of the consolidated balance of payments accounts rather than from the debit side; it is argued that debtors do not compile this information and, therefore, that it is better to use the more complete information from the credit side. I have no difficulty with this approach, but I wish to pose a question. The focus of the report is the discrepancies in the current account. However, the change in the method used for estimating reinvested earnings has direct implications for the capital account, because if we change figures on reinvested earnings, we invariably have to make identical changes in the capital account. Therefore, it is conceivable that, while the changes suggested by the Working Party would reduce discrepancies in the current account, they could accentuate discrepancies in the capital account. The staff should comment on how the suggested adjustments in the estimates on reinvested earnings will affect discrepancies in the capital account.

A question has been raised whether reinvested earnings should be dropped altogether from the consolidated balance of payments accounts. The omission of reinvested earnings will raise serious conceptual problems and impair our outstanding of an important avenue through which capital flows take place. Therefore, reinvested earnings should be retained as an item in the current account. Information compiled for this purpose can also be extremely useful for estimating investment flows in the capital account.

A major achievement of the Working Party is the identification and estimation of the large discrepancy in the portfolio income accounts. I can go along with the view that the portfolio income debits reported to the Fund have been fairly accurate. The technique suggested by the Working Party for estimating portfolio income is broadly acceptable, although I have some doubts about the reliability of the method.

Further work needs to be done in reducing the discrepancies in the shipping and transportation accounts. The widespread use of leasing arrangements for moving stocks such as ships and aircrafts, the importance of Eastern Bloc countries in providing shipping services, and the problem of what the report calls "missing fleets," are some of the reasons for the discrepancy, and further work needs to be done to compile more complete data.

Many recording difficulties exist for the recipients of unrequited transfers. In many developing countries, there is little coordination of aid flows to a large number of agencies in a single country, thereby making it difficult to compile accurate data. In addition, aid-in-kind and technical assistance have become more important forms of unrequited transfers, and a number of difficulties often arise in valuing and recording these transfers. The methodology of the Working Party is basically sound, although more work needs to be done in this area.

As to the follow-up actions to encourage the implementation of the report's recommendations, I would support such action in three areas. First, since the primary source of discrepancies is the national balance of payments estimates, the focus of any work must be on improving the national balance of payments accounts. In order to improve national statistics and to ensure that a uniform methodology is used internationally, priority should be given to the planned revisions of the Balance of Payments Manual, the work of the IMF Institute in training balance of payments statisticians, and Fund technical assistance. Second, increased collaboration among members, the Fund, and other international agencies in reducing the discrepancy will produce positive results. I endorse some of the more specific recommendations of the Working Party on this matter. Third, it would be appropriate for the Bureau of Statistics to prepare a realistic plan of action--not one that is excessively ambitious--to implement the Working Party's recommendations and to bring the plan to the Executive Board for its consideration in the coming months.

Statistics must reflect reality; in a sense, the statistical discrepancies in the global balance of payments are part of that reality. I would be concerned and, indeed, worried if there were no statistical discrepancies in the global balance of payments statistics. There are at least three reasons why we must learn to accept statistical discrepancies as an integral part of the balance of payments and learn to live with them. First, we cannot and should not ignore the fact that there is an intense worldwide desire for secrecy among a very large number of individuals, corporations, and, above all, governments. In recent months the term "covert action" has come into vogue, and there is no doubt that this dramatically describes many of the secret activities of governments in many industrial and developing countries. One need not examine the motivation behind this desire for secrecy, but it is important for the Fund to be realistic and to recognize that there are many individuals, corporations, and governments that expend large amounts of resources to ensure that secrecy is maintained with respect to a significant part of international transactions--both current and capital--and that these resources can never be matched by what the Fund can provide in estimating transactions that are intended to be secret.

Second, the Soviet Union and other nonmembers of the Fund have significant cross-border transactions with Fund members. Unless all these countries are adequately brought within the ambit of the Fund's statistics, there will continue to be large discrepancies in the global balance of payments accounts.

Third, there are many practical difficulties in bringing about complete uniformity in the methodology used by different countries. The methodology in each country will have to be adapted to available information systems, which may be geared to other objectives.

Given these considerations, it would be realistic to expect continued substantial discrepancies in the consolidated global balance of payments accounts. In addition, the Fund's plan of action and the amount of resources that are to be devoted to solving the problem must remain modest.

Mr. Goos made the following statement:

I agree with Mr. Reddy that, by definition, there are transactions that will be difficult to discover and take into account. Nevertheless, the consistency of the data on which we base our analysis and conclusions is so important that we should at least try to minimize the discrepancies. The Working Party's report is an important contribution to clarifying the increasing statistical discrepancies in the reported global current account. At the same time, the report's results and recommendations are clearly a valuable framework in which to make substantial improvements in the data base of world balance of payments statistics.

Against the background of the original concern that prompted the initiation of the study, it is certainly reassuring that the sources of the identified discrepancies are not concentrated in only a few countries and therefore do not invalidate the Fund's analysis of world economic developments and the corresponding policy conclusions and recommendations. However, a closer look at the study's findings clearly reveals that in many respects the Working Party's work is only a first, although very important, step toward the final solution of the problem. This certainly applies, to a smaller extent, to the discrepancies in the investment income account. However, apparently there are still a host of unanswered questions, such as the identification and compilation of transactions related to international ship operators, development assistance, international organizations, and certain offshore and financial centers. The uncertainties remaining in these and other areas, which are clearly described in the report, continue to call for caution in assessing the Fund's economic analysis both on a global and a country-specific scale. Therefore, there is ample scope and, indeed, a definite need to extend the work done by the Working Group with a view to substantiating its assumptions and approximate calculations, especially in the transportation and transfers accounts.

The implementation of the Working Group's recommendations should concentrate on inducing member countries to correct the shortcomings in their national current account statistics that lie behind the global gap. In that context, the report contains a number of suggestions that warrant early implementation. However, the Fund should not undertake unilateral corrections of balance of payments statistics without the consent of the members concerned. Such corrections would threaten to undermine the acceptance by national authorities of the revised statistics as an appropriate instrument for analyzing global economic developments and for conducting consultations with individual members. Accordingly, unilateral corrections by the Fund have to be restricted to nonmembers and other countries that do not provide balance of payments statistics to the Fund. Of course, this should not prevent the Fund, in its work on the world economic outlook, from calculating alternative summaries of current accounts that draw upon the recommendations of the Working Group and the results of subsequent work.

I agree that the report should be made available as widely as possible, and I have no difficulty with the proposals to include a reference in the Interim Committee's documentation to the Working Group's conclusions and recommendations and to suggest that the Committee should include a reference to them in its communiqué. I also support the outline of the future work of the Bureau of Statistics to implement the recommendations. However, the need for additional resources in support of the Bureau's work should be contained as much as possible. The staff could usefully provide an indication of the potential budgetary costs. The Fund should explore all possible ways in which to share to the extent feasible the burden of the additional costs with other international organizations.

My authorities are willing to support all the staff's efforts to implement the recommendations in the report. Those efforts should be pursued in the framework of well-established and proven means of cooperation with other international organizations. In response to the Working Group's recommendations, my authorities have already decided to adjust in the near future Germany's external current accounts for the missing interest receipts on bank deposits that are being held abroad by German nonbanks, which are estimated to have reached some $600 million in 1983.

Mr. Wijnholds made the following statement:

Mr. Esteva is already well known for, inter alia, his work on the so-called multilateral surveillance exercise within the Group of Ten. I am pleased to welcome the important statistical work that he has produced for the Working Party, whose recommendations deserve our full support. The suggestions for specific improvements in the investment income accounts and the more general recommendations in the areas of shipping, transportation, and unrequited transfers are valuable and worthy of a vigorous follow-up effort.

Before commenting on the follow-up effort, I will address the possible consequences of the changes envisaged in reporting transactions that now give rise to large global statistical discrepancies. As to current transactions on a global basis and as distributed across major country groups, the tables in the report show some substantial adjustments in current account balances, which would greatly reduce the overall statistical discrepancy, including the reduction to a small amount for investment income. The adjustments affect all country groups, although not to the same degree. The overall adjustment for 1983 is more than twice as large for the developing countries as for the industrial countries. If one were to assume that the adjustments were of the same order of magnitude in the years following 1983, there would have been a surplus in the current account for the developing countries in 1985, instead of a deficit of $19 billion. The envisaged adjustments will therefore make the current account balances look somewhat different, although the changes in the balances from year to year probably will not be greatly affected.

The Working Party states that the adjustments are "not so concentrated in any single country or group of countries as to invalidate the basic thrust of analyses drawn from the uncorrected figures." The staff has emphasized that the corrections "do not invalidate the analyses of world economic developments that have been prepared by the staff." This is reassuring, as is the suggestion, which I fully support, to insert the corrected figures, while maintaining--at least for the time being--the uncorrected figures in world economic outlook papers. However, this matter may need somewhat more explanation, especially for those outside the Fund whose cooperation we will seek in carrying out the necessary tasks. After all, the origin of the Working Party's activities was the concern that the global current account discrepancy could lead to inappropriate policy reactions. The knowledge gained by being able to explain and largely allocate the world current account discrepancy should provide a valuable contribution to an important exercise that we have been discussing in the Executive Board, namely, the indicator approach, at the center of which are sustainable balance of payments positions.

In order to take up the report's recommendations concerning follow-up actions comprehensively and with sufficient energy, "senior policymakers must express their interest and their strong support for these recommendations." For this to happen, policymakers must be convinced that the exercise is urgently needed. Otherwise, they may be reluctant to commit the resources needed to implement the recommendations. In this context, Mr. Reddy's remarks may indicate that problems will be encountered. In this respect, the Working Party's report is perhaps not as convincing as it might have been to ensure the requisite broad cooperation of national authorities. This is actually a public relations matter--selling a product that we believe is a good and necessary one--and the presentation of the report should therefore be accompanied by appropriate advertising. Care should be taken not to convey the impression that while it would be appropriate, generally speaking, to have better balance of payments statistics, we can make do with the existing current account figures. The Managing Director could state in a covering letter presenting the report to national authorities and other international organizations the necessity of full cooperation by member countries to make the effort successful and the reasons why the exercise is important.

A reference to the Working Party's recommendations in the documentation for the next Interim Committee meeting could be useful, as the staff has suggested. The plan of action prepared by the Bureau of Statistics, including the envisaged review of the Balance of Payments Manual, is welcome. Article IV consultations could be an avenue for raising matters relating to the recommendations of the Working Party in particular countries.

I hope that the Working Party's valuable work will bear fruit and that we can look forward to more reliable current account data in the future, thereby facilitating the analysis of balance of payments positions. I endorse the Working Party's final suggestion--to review at some point the discrepancies and asymmetries in global capital accounts and to assess their relationship to the global current account discrepancy.

Mr. Zecchini made the following statement:

Before commenting on the main issues under discussion, I would like to raise a point of order. This discussion must be seen as a preliminary one. Less than four weeks have lapsed between the circulation of the more than 300-page report and the Executive Board's consideration of the report. This is not enough time to allow national authorities to reach definitive conclusions on the analysis and recommendations. In the case of Italy, several public institutions are involved in the statistical issue and would have a role to play in the implementation of any change in the compilation of the balance of payments statistics. Consequently, it will be necessary to convene another Executive Board meeting at a later stage to decide which suggestions the Executive Board should present to Ministers and the format in which they should be presented.

The Working Party has addressed an issue that is important for our understanding of the external adjustment and financing patterns of the world economy. The Working Party has prepared a good report, which is well organized and covers all the various aspects of the mandate that the Working Party was given. The methodology used and the recommendations are interesting and deserve careful consideration.

Before commenting on the specific sources of the balance of payments discrepancy, I will make some general remarks, prefaced by the warning that only at a later stage will my authorities reach their final position on the several specific questions and suggestions raised in the report. It is encouraging to see that the adjustments that are dictated by the newly available information do not alter the essence of the external positions of the main groups of countries as they are generally perceived; at the same time, they reduce the distance between the position of industrial countries, which is expected to be basically strong, and the deficit position of the developing countries, which are expected to sustain their growth through a net inflow of real and financial resources from the industrial countries.

After assessing the extent of the feasible adjustment and the gap that still remains to be explained, the Fund has to face a basic question, namely, is the benefit to be gained from this new information or estimation of the balance of payments sufficient to justify the extensive costs involving money as well as institutional reforms? At present, it is difficult to give a definitive answer to this question. The changes and costs that are required to improve our information on the balance of payments are undoubtedly extensive and far reaching and seem to exceed the value of the possible findings. Therefore, a delicate balance has to be struck between proposed changes and costs, on the one hand, and the expected gain in our understanding of the balance of payments on the other hand, before we embark on such an ambitious project.

The implementation of the proposed changes requires not only endorsement at the government level, but also the cooperation of national institutions that would actually implement the recommendations. In Italy, and perhaps other countries, some of the recommendations cannot be implemented without first introducing new legislation. Therefore, it is essential that, in presenting the proposals to the authorities for their final approval, their legislative implications are spelled out.

Moreover, any improvement in balance of payments statistics necessarily depends on the cooperation of the Fund staff, particularly the Bureau of Statistics, as well as of other international institutions, such as the OECD and the BIS. The Fund needs to revise its Balance of Payments Manual on the basis of both the staff recommendations and national authorities' suggestions. The Fund also should provide assistance to members in improving their statistical base. However, any decisions in these areas will have to be based on the estimates of the likely cost to the Fund.

I will now comment on the specific sources of discrepancy in some balance of payments entries, bearing in mind that the real crux of the problem is to ensure that agreed rules are applied by all members in a uniform manner.

I agree that the Fund should continue to work with reporting countries to improve data on investment income accounts and reinvested earnings. The suggestion to establish a compilation mechanism based on questionnaires given to local enterprises for countries that do not record reinvested earnings is interesting. Nevertheless, the experience in Italy in this respect suggests that the effective enforcement of such a mechanism will require ad hoc legislation; thus far, the results, based on voluntary efforts, have been very disappointing. I am more skeptical about the suggestion to eliminate the reinvested earnings from the global summation, pending significant results of these actions. Suppressing these data might give the impression that the problem has been solved. It is more appropriate to continue to show the discrepancy until it can be effectively corrected; an explanatory note can be given, indicating the possible incompleteness of the data.

As to other direct investment income, the only viable solution seems to be to take advantage of the excellent statistics provided by four major creditor countries--the United States, the United Kingdom, Germany, and the Netherlands--in order to infer the corresponding data for other countries. To this end, I welcome the efforts that these four countries are making to provide the disaggregated data within the limits of confidentiality. Other creditor countries could also contribute to such statistics in order to widen the scope of these bilateral comparisons.

In the area of income on portfolio investments, I can go along with the procedure proposed by the Working Party for estimating income flows from cross-border banking assets. In theory, the procedure is correct; in fact, the resulting adjustment could be less satisfactory for two reasons. First, the comprehensiveness of data in International Banking Statistics compiled by the BIS and the Fund is somewhat questionable, as even the data for industrial countries are not complete. Efforts to improve that data base should therefore be considered. Second, the determination of the appropriate interest rates is an open question.

In all cases, the estimation should be on the basis of the quarterly stocks of assets and of interest rates, rather than on yearly figures. In addition, I suggest a modification of the procedure. The calculation of the bank rate applied to claims and liabilities of banks versus nonbanks is obtained by adding, respectively, a fixed spread of 1-1.5 percentage points to the interbank rate, as is explained on page 102 of the report. The spread, which represents a large part of the banking profit margin, will therefore be falling in percentage terms when interest rates are rising, and vice versa. A more realistic assumption would be to apply a percentage spread that could be determined according to prevailing market conditions.

I have several reservations about the Working Party's proposal concerning shipping and other transportation and would like to see more analysis of the problem in conjunction with the authorities of the countries that are mainly affected by this adjustment. The procedure suggested by the Working Party for allocating port and shipping expenditure strongly relies on some questionable assumptions, such as the definition of "true management" of the shipping fleet or the proportion of port expenditure in total earnings. The report itself notes some important reservations, which I fully share. The key difficulty is that in many cases it is impossible to single out the country whose balance of payments benefits from shipping transactions. Moreover, for some relatively small countries, such as Greece, Liberia, and Panama, the amounts of the corrections involved are very large relative to their current accounts. As a result, an inappropriate correction might give a very distorted macroeconomic picture of the country's external position. Given the difficulty in approaching this issue, it might be better to make only those adjustments that can be worked out with national authorities; any further adjustments should be avoided.

I share the Working Party's concern about potential discrepancies owing to the fact that some of the financial centers do not provide balance of payments accounts to the Fund. Although the actual discrepancies are still relatively small, I support the recommendation to encourage international financial centers and other important intermediaries to compile such accounts. Meanwhile, I agree, the Fund should use the adjustment procedures described in the report. As to the impact of financial innovations on the quality of international financial statistics, it is necessary to promptly address this issue and devise the most appropriate measures to deal with it. The quality of this data base is of the greatest importance, especially in estimating portfolio income flows. To this end, further action by the Fund, the BIS, and the Committee on International Banking Supervision could be considered.

As to the geographic distribution of the adjustments, I have misgivings about the feasibility of allocating several items linked to investment income and shipping to specific countries. Given the possibility of unrecorded transfers of these financial resources, it is very doubtful that the proposed criteria for the purpose of allocation will be able to provide a better picture of the balance of payments of groups of countries.

More extensive discussions between the Fund and national authorities are clearly needed before an appropriate final decision on the set of proposals included in the supplementary paper can be taken. I agree on the general thrust of the proposed plan for adjustment, but I have several reservations about the specific methods to be used. These points must be clarified before this plan can reach the operational stage. Meanwhile, I can go along with the third, fourth, and fifth proposals in order to make progress in the analysis, but it is not appropriate at this stage to ask the authorities concerned to carry through the Working Party's recommended changes in the areas that are the responsibility of those authorities.

Mrs. Ploix made the following statement:

The Working Party's report is a remarkable achievement. As a result of the thorough analysis of the major items of the current account, it has been possible to correct, to a large extent, the statistical discrepancy that has emerged since the late 1970s. In practical terms, the discrepancy has not been overly misleading in the conduct of economic policy. It has probably led only to policies that were slightly more cautious than warranted. However, the underlying causes of the discrepancy still exist, and new discrepancies could be generated in the future. The Working Party's recommendations are designed precisely to prevent such an outcome. My authorities are prepared to cooperate actively with other members and multilateral institutions to follow up on the report as efficiently as possible.

The report correctly stresses the need to intensify the exchange of data among industrial countries that share a major responsibility for the statistical discrepancy. In this connection, all the relevant multilateral institutions, beginning with the Fund, should be urged to play an essential role in coordinating the efforts of the various countries concerned.

This approach should yield positive results in at least three areas. The first is data on the income from direct investments, particulary reinvested income. All the primary data collected at the national level could be centralized by the Fund and provided to each participating country after being processed to ensure global consistency. In the broader area of capital flows, further methodological studies could usefully be undertaken by the Research Department in collaboration with the Bureau of Statistics to facilitate the reconciliation of data from various sources.

Another category of transactions that can be usefully considered is unrequited transfers. In the case of France, a workable solution in the area of public transfers probably has to be sought within the EEC, which should be prepared to establish a data base that could be fed by member countries and supplemented by additional information from the EEC in order to produce a more complete and accurate picture. A similar solution could perhaps be explored for workers' remittances, with the collaboration of partner countries in the Mediterranean region.

A third area where some improvements are likely to result from a better pooling of information is offshore centers, the international organizations, and a number of centrally planned economies. Those entities have in common the fact that they do not supply any consistent set of information on their international transactions. This missing element generates a significant bias, and the Fund should stand ready to prepare balance of payments documents for this category of operations.

A word of caution is warranted: some data, which ideally should be circulated widely in order to promote greater consistency on an aggregate level, are sensitive. Specific rules should therefore be defined and followed to protect the confidential nature of some data, especially data on portfolio or direct investments.

In discussing various methodological issues, the Working Party refers to the so-called comparative method. This method could be developed on a bilateral basis, between countries that maintain strong trade relations. In this connection, a very promising joint study on the bilateral current account balance between Germany and France has recently been completed.

Attention should also be given to the promotion of closer collaboration among the various entities that may have to deal with balance of payments questions inside a given country. This avenue is certainly worth exploring, but some serious difficulties are likely to emerge. For example, the time frame, periodicity or availability of data are bound to vary considerably from one institution to another.

The current form of the Fund's Balance of Payments Manual dates back to 1977 and could probably be improved. A major innovation would be the development of a specific framework in which to take more accurately into account the growing number of financial innovations. It would also be interesting to adapt the presentation of the manual to enhance its practical utility for member countries. The scope and timing of possible reforms in the manual would have to be assessed carefully. In particular, achieving the desirable harmonization of balance of payments and national accounting concepts does not mean that one of those concepts should prevail over the other. In this connection, the report referred to PIFS/85/2, which was issued by the Fund on October 10, 1985 and should remain the basis for further study.

I hope that the staff will monitor the follow-up actions in response to the Working Party's recommendations.

Mr. Templeman made the following statement:

The Working Party's report is a remarkable achievement. It has substantial value both for the improvement of statistical collection and estimating techniques and for the analysis of world economic developments.

My authorities were among the earliest and strongest supporters of the study. This reflected their concern that inadequacies in world current account data might threaten to undermine the statistical basis for analysis of world current account developments to such an extent as to have an adverse effect on policy formulation. As Mr. Wijnholds has noted, this has become particularly relevant in the context of the Fund's work on economic indicators. Of course, it is hard to say whether perceptible policy distortions have actually occurred. However, distortions of this magnitude in such important international statistics certainly impede good economic analysis and sound policy formation in the Fund and in member countries.

In general, the report's findings are comforting. Apparently, there is not a secular rise in the size of the discrepancy, and the Working Party has been able to identify and recommend corrective action with respect to a substantial part of the discrepancy. In addition, the adjusted data do not importantly undercut the credibility of past Fund assessments of the world economic outlook, and there does not seem to be any significant concentration of the discrepancy in any one country that would call into question the Fund's assessments under Article IV consultations and other surveillance procedures. Finally, the discrepancy problem seems amenable to at least a partial solution through the rather prompt implementation of measures by the Fund and member countries.

In a practical sense, the concentration of the discrepancy in three major current account categories--investment income, shipping and transportation, and official transfer payments--considerably facilitates a solution; important adjustments in the data could be made by concentrating on a relatively few. These would consist of some estimated adjustments for missing investment income credits based on available data from some major industrial countries, better national accounting of fleet transportation together with some expansion of the coverage of maritime countries, and continued cooperation with other international institutions to fill some gaps in official transfers. One point worth stressing is that the discrepancy is likely to continue and parts of it, such as unrecorded investment income, could increase owing to expanding world capital markets.

I will now comment on the four major areas where the staff seeks guidance. The first concerns the adoption by national compilers of the suggestions made by the Working Party. National statistical authorities should study these findings carefully and on the presumption that, even if all the recommendations cannot be adopted, significant improvement should be made in the authorities' submissions to the Fund. There may be difficulties, and Mr. Reddy has reminded us that we live in an imperfect world, but the potential payoff is worth the effort. My authorities, in addition to conveying to the appropriate U.S. Government agencies the findings and recommendations of the Working Party, will seek to reinforce the follow-up effort with encouragement at a high policy level. As to the cost of the Working Party's recommendations, it is not clear to me that the additional cost will be as large as suggested by some Executive Directors, since data collectors would presumably need to make significant expenditures, in any event, in coming years in order to maintain and improve the reliability of their own statistics.

Let me give some of the specific reactions to the report from U.S. Government agencies. We agree with the report on the utility of many members taking advantage of data already compiled by international institutions and by major creditor countries as a means of making prompt improvements in their statistics on investment income flows. However, this should not interfere with member countries' efforts to improve their own national data. We place considerable stress on the utility of including estimates of reinvested direct investment income in the accounts of developing countries, because this would give a much more complete measure of the impact of direct investment than does the net flow of new capital. After all, such reinvestments can have important effects on the host country's investment, growth, and job creation performance. In addition, inclusion on an accrual basis in the accounts of developing countries of investment income from portfolio investments of their residents is a useful way in which to demonstrate the actual, or at least potential, benefits to their economies of maintaining an attractive economic climate, and the cost--in terms of capital flight and lost foreign exchange income--of failing to do so.

With respect to the shipping and transportation category, and especially the geographic allocation of the proposed adjustment, my authorities feel that such adjustments are not particularly reliable, as the report itself recognizes. To the extent that missing data seem to be attributable partly to Fund members, those countries should make a special effort to cooperate with the Fund. On a related matter, my authorities have noted that the Fund already calculates a global adjustment to the trade account for timing asymmetries. For example, this appeared as a memorandum item and footnote to Table A30 in the October 1986 World Economic Outlook Report. If adjustments are to be made to some service and transfer items in the current account data in future world economic outlook papers, my authorities wonder whether a similar adjustment could not be incorporated in the merchandise trade account as well.

Improved data on official transfers would have some special significance, as analysts often consider this item to be a source of financing of current account deficits, where the current account is calculated to include only goods and services and private transfers. It is somewhat surprising that part of the official transfer discrepancy can be traced to inadequacies in the data of international institutions. However, this should make the solution of the problem somewhat easier through closer cooperation.

We expect to see some improvement in data on offshore centers and on financial innovations, as the geographical coverage of the Fund's own international banking data broadens. The effects on current account data of innovations in financial markets is likely to be of increasing importance, as international capital markets evolve and expand. Presumably the ongoing work of the Fund, the BIS, the OECD, and others on international capital markets could contribute importantly to the task of capturing statistical data on these new forms of transactions in a more comprehensive and reliable way.

My authorities have noted the comments in paragraph (e) on page 221 on problems that were not investigated by the Working Party but which merit review by the Fund. One of these concerns the continued utility of publishing balance of payments statistics in the Balance of Payments Yearbook in SDR terms rather than in dollars. Our analysts find the SDR data cumbersome because of the difficulty in converting and reconverting data that are not originally denominated in SDRs. A staff comment on this matter would be welcome.

Part of the present discrepancy is the result of Fund practices, particularly the omission of data or estimates for nonmember countries and entities. There is a strong analytical case for including such information, and the Working Party makes a recommendation in this respect on page 224 of the report. While we recognize that there are certain sensitivities in this area, we would hope that a way could be found to fill this gap.

On the question of the geographic distribution of the adjustments, my authorities were somewhat surprised to learn that the discrepancy was as widespread as the report suggests, although there is some degree of concentration of the missing credits with the non-oil developing countries. It would be interesting to know the extent to which the data compiled by the Working Party could be further disaggregated to show some individual industrial countries, such as the G-7 countries, in a table like Table IV on page 16 of the report. It would also be interesting to know whether the staff is in a position to reconstruct the adjusted data--along the lines of that table--for years prior to or after 1983.

I have already expressed my satisfaction that the results of the study do not invalidate the analysis prepared by the Fund of the world economic outlook.

In discussing possible follow-up work, the Working Group usefully suggests that the report should be circulated to member countries with a covering letter from the Managing Director. It will be at least equally important to have a high-level official in each member country lend his authority in encouraging coordinated follow-up action in that country. Whether or not the report is published by the Fund, it should be widely distributed to working-level statisticians and analysts.

We have an open mind on the idea of including a reference to the report in the next Interim Committee communiqué. However, it is more important to draw the attention of the members of the Interim Committee to the report during the Committee's deliberations.

We support the idea of a coordinated action plan within the Fund under the direction of the Bureau of Statistics. After all, the Fund is the leading authority on the proper and internationally consistent method of recording balance of payments data. It can have an important influence on follow-up action by setting revised standards through an updated Balance of Payments Manual, periodic meetings with national and other experts, and other activities.

The treatment of adjusted current account data in future world economic outlook papers and in other Fund publications will need to evolve gradually. Initially, presentation of adjusted current account data as a supplement to official figures would seem to be useful. The degree of disaggregation of data for individual countries or country groups may be inherently limited by the statistical difficulties in making adjustments to the official data. On the other hand, to the extent that official data begin to be adjusted in line with the Working Party's recommendations, this constraint may be relaxed.

Since it is already established practice for Fund staff missions to consider the adequacy of each country's statistics as part of the Article IV consultation procedures, examination of the extent to which countries have adopted the Working Party's suggestions should become a natural part of these discussions.

I would expect to see some evidence of the outcome of the report in future work programs and in the FY 1988 Administrative Budget. However, it is not my impression that major additional resources should be needed, and we will examine any specific proposals on their merits, within the overall budgetary constraints.

Mr. Foot made the following statement:

My authorities were pleased to be represented on the Working Group and hope that the report will be published soon. If the report is to have a lasting influence, the Fund, other international institutions, and member governments must give a high priority to implementing its recommendations. My authorities will be reviewing their existing balance of payments methodology in light of the report and will be pleased to cooperate with the Fund and member governments--for example, through bilateral data exchange arrangements--in order to implement the report's recommendations. The value of the report also will be enhanced by making an appropriate reference to it in the documentation for the next Interim Committee meeting.

I strongly endorse the staff's proposed plan of action. The staff should strengthen the cooperative links with other international bodies, particularly the BIS and the OECD, in order to harmonize methodologies and the data collection arrangements. It should also make a greater effort to verify and cross-check data received from member countries. It is clear from the report that this is an important way in which to improve the quality of data without the need for actually collecting new data. The Fund can also enhance the quality of data by improving internal communications between the Bureau of Statistics and country officer desks, a point that this chair has made during previous discussions on the Fund's statistics. Of course, the Fund can help by continuing to provide practical advice to members on data collection and related problems based on this report. In addition, I agree that the time has come to review and update the Fund's Balance of Payments Manual.

It would be appropriate for the next world economic outlook paper not only to allocate the discrepancy among country groups and regions, as mentioned in the report, but also to attempt to adjust the balance of payments positions of individual countries--at least the seven major countries. It is virtually certain that once the report we are considering today is widely available, this is precisely what private commentators will be rushing to do--unfortunately in a much more rough and ready fashion than the Fund staff. Therefore, there is value in the staff making the first effort in this area.

As to direct investment data, we would encourage other members to adopt the U.K. practice of collecting information on reinvested earnings by means of a survey, although survey work admittedly is not easy and may take a number of years before confidence and confidentiality in the uses of the surveys become appreciated. In the area of shipping, it is clear that much additional work needs to be done in cooperation with the OECD and the member countries involved, and the Fund can make a major contribution by establishing a data base on world shipping.

Mr. McCormack made the following statement:

My authorities feel that the Working Party has provided an extensive and highly valuable analysis of the various factors that have given rise to global current account discrepancies. They expect that it will be useful in strengthening their own domestic accounting practices. I fully support the proposal to prepare the report for as wide a circulation as possible. In addition, the Managing Director should make note of the report's findings at the next Interim Committee meeting. The Bureau of Statistics should proceed on the basis of the report's recommendations by strengthening the operations of the Balance of Payments Division and reviewing the Balance of Payments Manual with a view to increasing the emphasis on practical problems of implementation. I wonder whether the staff has a view on the possible timing of the completion of the latter exercise.

The themes of the Working Party's recommendations--namely, to make maximum use of existing data and to make further efforts to achieve international consistency in balance of payments data--are familiar but are clearly worth supporting. My Canadian authorities have noted that recommendation No. 5 on page 217, encouraging bilateral comparisons of major transaction categories, cites the efforts of the United States and Canada to share data on various components of their current accounts. However, my Canadian authorities are somewhat hesitant, given the fiscal restraints and competing demands for a limited supply of statistical resources, to support at this stage the full range of the Working Party's recommendations, which potentially involve substantial additional resources. Each recommendation will need to be weighed carefully by both the Fund and national authorities against competing demands, although there may be cases in which the need for better data for other purposes could also lead to improvements in balance of payments data. The staff should comment on the extent to which the Working Party's recommendations might be implemented by using existing resources and practices, such as Article IV consultations and the world economic outlook exercise.

A central issue is the geographic distribution of the current account discrepancy and its possible impact on analyzing economic developments in individual countries. As the Working Party has noted, the negative discrepancy in the world current account is not concentrated in any individual country or group of countries to such an extent that the interpretation of basic economic problems has been distorted; Table 78 tends to support this view. However, it should be stressed that a number of uncertainties persist, as a significant amount of the adjustments could not be allocated geographically. Moreover, the allocations are judgmental; their basis is admittedly imperfect in the areas of shipping, transportation, and transfers. This observation is not intended as a criticism of the report's findings, but it does suggest that follow-up work in this area might be useful, particularly with respect to transfers, where improvements should be possible over the coming years. There would seem to be merit in following up on the report's recommendation on page 206 that the regional allocations of discrepancies could be refined and extended to additional categories of transactions.

Of related interest are the recognized weaknesses in fully assessing the allocation of adjustments on a country-by-country basis. I am particularly interested in this point in the context of the indicators exercise. While the report indicates that the direction of change is fairly clear for individual countries, it is important to emphasize that better assessements of the magnitude of the change are clearly required. This is especially true because, despite the report's general assessment, the suggested balance of payments adjustments may cause some reappraisal of economic policies in a few cases. Further work to strengthen the statistical coverage in individual countries might be facilitated through Article IV consultations.

My authorities are also interested in the possible role of the Fund staff in improving the statistics on portfolio income. Neither the identification of portfolio investment income as "the fastest growing and now the largest of all individual current account discrepancies" nor the approach taken to adjust the reported data are surprising. They were essentially dictated by a positive capital flow discrepancy and the high and rising interest rates in the early 1980s. In that connection, the recent estimated reduction in the statistical discrepancy from its high levels in 1982-84 has occurred together with the downward adjustment of interest rates. The evidence in the report and the implications of subsequent developments are indications that a great bulk of the discrepancy and movements is attributable to portfolio income.

A cost-effective way in which to reduce the discrepancy and its movements is to use more effectively available information on cross-border assets and liabilities. This will involve essentially a reorientation of the work of national compilers and the Fund staff rather than a significant expansion of effort. I also assume that current efforts by various international organizations and national authorities to improve available information on cross-border flows and outstanding external debt will continue and will be helpful.

At the same time, some of my authorities question the added benefits of the involvement of the staff and national compilers in extended efforts to deal with all the other possible sources of the statistical discrepancy. They feel that, to the extent that the statistical discrepancy can be stabilized by initiatives with respect to portfolio flows and the results of the report can be taken as an indication of the remaining problem areas, reasonable analyses can be made and policy decisions can be taken.

It is fair to say that users of statistics always want better data. However, it must be recognized that all members face budgetary constraints that require trade-offs to be made. The report is useful both in providing greater insight into the sources of the discrepancy and, more important, in confirming earlier impressions that, despite a large statistical discrepancy, the trends indicated by uncorrected figures are broadly correct. In light of this, I prefer to pursue what are perceived to be the least costly approaches to further narrowing the discrepancy and to do so by reallocating existing resources where possible, rather than by making a major new investment in this area.

Mr. Almeida made the following statement:

In a relatively short time the Working Party was able to arrive at important conclusions and to clarify sensitive matters that have been worrying economists since the problem of the discrepancy was brought to public attention in the May 1983 World Economic Outlook Report.

I am pleased that the corrections of balance of payments statistics by the Working Party will not invalidate the conclusions of the staff's analysis. However, this leads me to wonder about the necessity of undertaking further work in the area of the statistical discrepancy until we have a better idea of the cost of the work that would have to be done in the Fund and in member countries. If we know that no significant statistical and analytical results will be gained from work in this field, it might be best to proceed only with the greatest caution.

In saying this, I do not mean that we should not go ahead with some follow-up actions as suggested on page 4 of the supplementary paper, since some of these actions are not related to the study of the discrepancy per se. It is clear that we should proceed immediately to revise the Balance of Payments Manual, as the present one is obviously outdated, particularly as it does not take into account the series of financial innovations of the previous decade. We should make these changes with existing manpower, and the staff should not forget that modifications of the manual will have cost implications for the statistical offices of member countries. The financing for the planned meeting of balance of payments statisticians in late 1987 still needs to be clarified. This matter is not of concern exclusively to the Fund; it is of interest to several institutions. In general, the cost of discrepancy projects should be shared by the interested public, which might well include not only the World Bank and the United Nations, but also regional international organizations, such as the Asian and African Development Banks.

I do not believe that the discrepancy should be the subject of Article IV consultation discussions between the staff and national authorities. Such consultations should be reserved for policy discussions. In any event, there is not much time during an Article IV mission for either the staff or the authorities to discuss subjects other than policy items. It might be preferable to discuss the subject of discrepancy in meetings between the staff and a country's delegation during the Annual Meetings or during visits by the Fund's statistical staff to countries where large discrepancies are known to exist.

Mr. Song made the following statement:

The report shows the great success that the Working Party had investigating the main sources of discrepancy in world current account balances and exploring ways in which to improve current statistical practices in order to reduce the discrepancy and to prevent its recurrence.

Obviously, it is important to improve world data on current account transactions, as these data are the basis for analyzing the major problems of the world economy, especially the debt situation in developing countries and the external positions of the major industrial countries, which will be the core of the indicator analysis used in Fund surveillance.

I agree with most of the major conclusions on the causes of discrepancies in the global investment income accounts, the global shipping accounts, and official unrequited transfers. However, I have difficulty in accepting the major conclusion on page 4 that the indicated adjustments--adding net credits to the current accounts--are not so heavily concentrated in a single country or group of countries as to invalidate the basic thrust of the analyses based on uncorrected figures. The words "basic thrust" can undoubtedly be interpreted broadly. Nevertheless, the conclusion is inconsistent with some of the findings on the investment income accounts mentioned on pages 8 and 9--for example, "it seems reasonably firm that most of the missing income credit can be assigned to industrial countries, and lesser amounts to most other country groups," and after adjustment "the industrial countries are shown to have considerably larger net investment incomes...and the other developing countries are shown as large net payers of income...." This picture is drawn more clearly by Table III on page 8. It shows that the adjustment of investment income in 1983 for industrial countries alone was $18.3 billion, which would result in an adverse change from a negative $1.7 billion, as reported, to $16.6 billion--the adjusted figure for this group of countries. On the basis of these figures it is difficult to feel convinced that the basic thrust of analysis based on the uncorrected figures will be as valid as the Working Party's report claims, especially in the context of net transfers of resources between industrial countries and developing countries, which is a major factor in the growth of developing countries and in the world debt situation.

The main causes of the emergence and growth of the global discrepancy in current account balances suggest that there are at least three shortfalls in current statistical practices. First, those practices lag significantly behind continuing changes in the international financial markets in which the integration of the major financial centers and the innovation of financial instruments have become irreversible trends. Second, there are some relatively specific and persistent statistical deficiencies, as reflected in the accounts for shipping and other transportation. Third, some economic entities are in a position in which they do not have to submit data on international transactions.

Against this background, I agree that improving the world's data on current account transactions is a formidable task--one that will be time consuming and difficult. However, it can be successful if the Fund and other international institutions give it a high priority and if national statistical offices implement the recommendations in the report.

In the light of those factors, I can go along with the main thrust of the report. In general, the contents of the report are useful and appropriate, although some modifications may be necessary after the Executive Board's discussion. Many of the recommendations are valuable and will help to improve the quality of data and to reduce potential discrepancies.

I fully endorse the five suggested follow-up actions mentioned on page 2 of the supplementary paper and I attach great importance to the plan of action prepared by the Bureau of Statistics for playing a central role in implementing the report's recommendations. Effective improvement in statistical methods and practices to reduce discrepancies in the world's current account balances will depend to a great extent on increasing and enhancing the activities of the Bureau of Statistics, as suggested in recommendations 9(a)-(e) on pages 220-222. These recommendations include, inter alia, a review and updating of the Balance of Payments Manual in order to take into account new developments in international transactions since the previous review of that publication in 1977, and the suggestion to issue a companion to the manual that would present a simplified set of basic accounts, principles, and definitions. The Bureau of Statistics could also play a significant role by providing technical assistance, especially to developing countries. To these ends, providing additional resources for the Bureau of Statistics seems inevitable. This matter should be considered in the context of the allocation of the Fund's resources; the aim should be to implement the report's recommendations in a way that would minimize the amount of resources required while maximizing their usefulness.

It is indispensable to intensify cooperation between the Fund and other international agencies, such as the BIS, the OECD, and the World Bank, in order to produce accurate statistics on international banking positions, the debt of developing countries, and other international financial transactions and resource transfers. Special attention should be paid to the suggestion to prepare a broader handbook that would bring together such diverse data and explain their similarities and differences.

In light of the huge amount--nearly $300 billion--in the discrepancies in the world's capital flows in 1977-83, as shown in Table 5 on page 17, it may be necessary to trace the principal sources of this discrepancy and to devise ways in which to avoid such discrepancies in the future.

Mr. Lundstrom made the following statement:

The Working Party's report is comprehensive and illuminating. I am pleased that the Fund is now dealing systematically with the problem of the discrepancy in global current account balances. In the long run, imperfections in the statistics on the external balance of individual countries may hamper international economic policy coordination and economic cooperation in general. The report is the result of a thorough examination of the problem and includes many valuable proposals. I agree with Mr. Wijnholds that every effort should be made in effect to sell the report to those whose attention is required in order to implement the report's recommendations.

One way in which to improve significantly the quality of data reported to the Fund is to increase the contacts between the Bureau of Statistics and current account statisticians in member countries. Such contacts might deal with quality improvements and changed data collection routines as well as requirements for data collection methods and definitions applied to individual countries by the rest of the world. More frequent contacts might also prove to be helpful in facilitating the avoidance of errors in standard routine reporting and in detecting emerging errors. Hence, the Fund might well make greater use of the expertise of individual countries in this area. I support the proposals to establish a group of consultants to follow and deal with questions on balance of payments statistics arising from the rapid developments in international financing. This group should consist of a small number of experts in order to ensure its effectiveness. Such methods might also be useful in other areas. The Fund must take the lead in working toward reducing the discrepancy in world current account balances. To this end, the Fund should initiate and support individual country studies and projects in individual countries aimed at improving the areas that are highlighted in the Working Party's report. In general, the Fund needs to take the initiative in making definitions and in improving the quality and fostering the development of statistics in the balance of payments field. This conclusion is applicable to the ongoing review of the classification of services, where there is some risk of developing different regional standards.

As to methods for reducing the global deficit, the main effort should be to improve the quality of data and the coverage of balance of payments statistics in countries and by international organizations. In making these efforts, standard routines for adjustment should be seen mainly as emergency solutions.

I will now comment on the section on recommendations that begins on page 212. As to recommendation 1, the use of rough and ready adjustment routines to improve statistics requires caution. The solution should primarily be sought in improved statistics at the national level, including coordination of statistical definitions and methods of data collection.

Given the experience with the comparison of balance of payments data for different countries, the method of historical comparisons of bilateral data to identify differences in the statistics seems worth pursuing. To remove these differences, one has to go further and to compare definitions and methods of different countries and, if possible, to replace national material.

This approach also applies to recommendation 5, regarding systematic programs for bilateral comparisons of major transaction categories between the most important countries.

As to recommendation 2(b), in order to record accurately the international flows of interest and dividends, it would seem to be far from optimal to calculate these flows by applying a certain interest rate to the stocks of assets and liabilities. On the national level, corrections emanating from such calculations may be seen as unreliable and difficult to analyze. Instead, we should try to improve the quality of the data collected from individual countries.

I agree that offshore financial centers should be urged to produce relevant balance of payments data, as suggested in recommendation 2(c). I also agree that national authorities should require all their agencies to coordinate and share relevant information, as suggested in recommendation 3. However, certain details may be restricted for security reasons.

Mr. Vasudevan made the following statement:

The Working Party's recommendations have far-reaching implications. Before dealing with some of them,' I will make several general remarks. 'First, the Balance of Payments Manual is a reference book for most national compilers and is the essence of the IMF Institute's balance of payments course, which has benefitted many of those compilers. The manual helps to ensure maximum inter-country comparability; therefore, it is essential for the manual to be given priority in our efforts to rectify the discrepancies in the world current account balances. I am not suggesting that there is no scope for improving the manual or that adjustments should not be made in the present compilation and presentation of data. I wish to stress that the adjustments should be consistent with the manual, so that there will not be even an appearance that our efforts to present more reliable data are ad hoc rather than carefully considered. Indeed, given the large-scale financial innovations and the financial integration of the previous decade or so, there is a need to update and revise the manual, as the Working Party has recommended. In addition, while the Working Party has stressed that the Fund will need to consider how best to incorporate the adjustment suggested in the report, the addendum to Chapter I shows that the 1986 edition of the Balance of Payments Statistics Yearbook includes revised data for 1979-83. It also states that the Bureau of Statistics will "presumably review the nature of the changes published in 1983 and 1984, some of which may reflect reactions to the results of the Working Party while others may be rather random changes in the assembled statistics."

The meaning of this statement is unclear to me. The adjustments to the global data imply that adjustments are also made at the regional level and perhaps at the national level. As I understand it, adjustments are now made in Part II of the Balance of Payments Statistics Yearbook, while Part I consists of data largely as reported by member countries themselves. Questions naturally arise about the meaning and appropriateness of this procedure.

The Working Party's report should have been analyzed and commented upon by the Research Department. The staff's comments, together with those of the BIS and the OECD, would have increased our understanding of the various implications of the report.

Recommendation 2 is that each country should conduct a reappraisal of its methodology in the light of the findings of the report and in conformity with the Balance of Payments Manual. The Working Party has also recommended that the standard survey--or questionnaire--technique should be used in the collection of information on international transactions of direct investment enterprises. While the merit of the suggestion is clear, the experience of some countries suggests that the response by multinational entities would not be encouraging. In fact, there is a danger that the finalization of balance of payments data might be delayed for a long period if one had to wait for information on direct investment enterprises. The Working Party's suggestions--such as inviting countries to initiate comparisons of bilateral data on direct investments with partner countries that produce detailed statistics, or asking offshore financial centers to produce data for those sectors of their balance of payments accounts that have a significant counterpart in the international accounts of other countries--would be difficult to implement, time consuming, and may prove to be frustrating, thereby resulting in avoidable delays in the compilation of balance of payments data. Similarly, while the suggestion that national authorities should require all their agencies to coordinate and share their relevant information with balance of payments compilers is laudable, progress in that area will probably be gradual.

Recommendation 5 is that national compilers should develop systematic programs for bilateral comparisons of major transaction categories with their most important partner countries. The report suggests that countries that do not have data on reinvested earnings may be induced by the Fund to accept the figures produced by the partner countries. This would not be a good practice, especially in cases in which the Fund has leverage with which to influence the country that does not maintain the data concerned. This recommendation should be in the same spirit as recommendation 7, which seeks to improve the data on the basis of which members cooperate with one another.

As for the general recommendation to make early improvements in data, instead of asking each country to follow the suggestions of the Working Party, the major industrial countries, particularly the United States, could be asked to tighten their balance of payments data compiling machinery. This seems advisable since at present the United States has been running, on average, a positive errors and omissions item of $24 billion per year for the previous seven years or so, while the comparable figure for Japan is $2 billion and for Germany and Switzerland $1 billion each. These countries must determine whether the direction of the errors and omissions item is changing. Once the source of this balance is found by these large industrial countries, the global statistical discrepancy in current account balances will be reduced considerably. Basically the Working Party relied on the questionnaire method or on what might be called indirect inference, based on the data of main partner countries, where such data existed, in making the necessary adjustments. In the present circumstances, while these methods appear to be a reasonable way in which to start reconstructing the world current account position for a given year in the past, they might not give the best results for current accounts in the present and future.

The Working Party's report notes that the statistical discrepancies could give rise to distortions in the analysis of the developments in world output. On page 24, it is noted that the serious world recession in 1980-82 coincided with a sharp discrepancy, which implied that about $95 billion of income growth was not accounted for in member countries' national statistics. This in turn implies that the severity of the recession was overstated and that world savings were understated. Year-to-year assessments in world economic outlook papers might not be much affected by statistical discrepancies if they are moderate in size, but if one were to make an assessment over the medium term, the analysis could well be found to be unsatisfactory. Moreover, given the recent agreement to use the saving/investment framework to judge the sustainability of external positions, the need for consistency of data on payments is particularly great, especially in the case of major industrial countries. The only way in which to improve the analysis is to urge members to compile and provide high-quality data in a systematic and uniform manner.

The Fund will need to give priority to balance of payments statistics because it is intimately concerned with surveillance and has the task of bringing about durable and sustainable balance of payments positions in member countries. While I have no particular difficulty with the idea of having the Managing Director write to national authorities about the Working Party's report, it would be premature to give the report an important place in the deliberations of the Interim Committee. Improving the statistical data is desirable for better policy formulation but it is not in itself a policy matter that should be discussed by the Interim Committee, unless we intend to convey the impression that the analyses of world economic developments are being severely constrained by the quality of data that are currently available to the Fund. The recommended adjustments to data could be made in the Fund after considerable study and discussions with national compilers. Therefore, I endorse the suggestion to convene a meeting by the Fund of balance of payments statisticians late in 1987.

Mr. Alhaimus made the following statement:

I join other Executive Directors in commending the Working Party for its excellent work in analyzing the intricacies of the discrepancy and, even more significant, in suggesting a set of methods that go a long way toward reducing the discrepancy. I particularly welcome the Working Party's ability to identify the sources of the discrepancy in investment income and to make suggestions to reduce it, as well as the suggestions to reduce the other discrepancies in shipping and transfers. The estimating techniques that the Working Party used to reduce some of the discrepancies and the numerous suggestions that are made to tackle them in the coming period should of course be carefully considered by the competent statistical agencies in member countries. Unfortunately, as Mr. Zecchini correctly observed, insufficient time has been allowed for our national authorities, or at least some of them, to react adequately to the analysis and conclusions of this comprehensive report and, consequently, it will be difficult for me to offer specific responses to the issues raised in the supplementary paper prepared by the staff. I will, therefore, confine my intervention to a few remarks of a general nature.

The new data on the magnitude of the discrepancy, as shown in the 1986 edition of the Balance of Payments Statistics Yearbook, indicated a small discrepancy for some of the recent years and a clear decline in 1985, bringing the discrepancy to nearly one half of its 1982 level. This tendency should not, of course, lead to complacency in efforts to eliminate the discrepancy, but it does indicate that the discrepancy is not as staggering as it was three years ago. The gravity of concern about the policy implications of the discrepancy is also expected to recede somewhat in light of the Working Party's conclusion that the discrepancy is not concentrated in any individual country or group of countries to such an extent as to distort the interpretation of basic economic problems.

The Working Group correctly paid considerable attention to the income discrepancy, in keeping with its mandate. An interesting major conclusion of the Working Group in this respect is that in investigating the possible sources of the income discrepancy--in the wide swings of exchange rates and the effects of the large rise in oil prices after 1979--the Working Group could not find any systematic statistical bias that can be traced to these developments. Geographically, the discrepancy seems to be widely spread, but, as is shown in the case of income, the bulk of the adjustments have to be made in industrial country accounts; in portfolio investment income, in fact, almost half of the discrepancy is attributed to industrial countries and 20 percent to developing countries--other than offshore centers.

The Working Group has developed an interesting set of procedures to reduce the discrepancy. These procedures need to be pursued with national compilers, and the staff's supplementary paper suggests that, following the Executive Board's discussion, national authorities will be asked to make the general and specific improvements suggested by the Working Group. However, if a large number of national authorities have not had sufficient time to study the recommendations, it may be appropriate initially to solicit the widest possible comments on the suggestions before requiring national authorities to comply with them. After giving the national authorities sufficient opportunity to respond, the staff could, as Mr. Reddy suggested, draw up a realistic plan, taking into consideration the feasibility and cost of implementing the plan. Notwithstanding this effort, the Fund can embark on the tasks that have been assigned to it in the report; in so doing, the Fund would assume a central responsibility in the exercise.

Although the task of eliminating the discrepancy is of considerable importance and could be reported to the Interim Committee, as the staff has suggested, I doubt whether we need at this stage to recommend that a specific reference to the report should be made in the Committee's communiqué.

Mr. Yamazaki made the following statement:

The Working Party's report is highly commendable. I welcome its conclusions that considerable gains could be made by implementing the recommendations in the report. Serious consideration should be given to those recommendations, so that they can be implemented without undue delay.

The analysis in the report is appropriate. I am pleased that the distribution of the needed adjustments is not concentrated in any single country or group of countries so as to invalidate the analyses that had been made on the basis of the uncorrected figures. These results underscore the consistency of the Fund's surveillance activities.

Nevertheless, we should not be complacent about the conclusions of the Working Party. Much remains to be done concerning the discrepancy and lack of transparency in certain areas, such as shipping and transportation services, and unrequited transfers. Furthermore, there is still a possible considerable discrepancy in international financing transactions, particularly in light of the recent rapid financial innovations. In this connection, my authorities are especially interested in two areas where improvement is needed. One is the breakdown of balance of payments data by individual countries and regions, and the other is the treatment of investment earnings on direct investment, the needed improvement in which Mr. Foot has already stressed.

The balance of payments statistics for Japan are based mainly on data provided by intermediaries--in other words, on exchange records of foreign exchange banks. That approach has the merit of accuracy, low costs, and the rapid availability of information, but one deficiency is that reinvested earnings that do not accompany the international flow of funds cannot be captured. For this particular problem, my authorities are now studying the method for estimating reinvested earnings, taking into account experiences of other countries with the statistical methods for incorporating such earnings in the United States, the United Kingdom, and Germany. However, our information on these practices is fairly limited. Therefore, my authorities would welcome at a later stage information on the treatment of reinvested earnings.

I generally support the recommendations in the Working Party's report. The Fund should play the central role in implementing those recommendations. Therefore, the Bureau of Statistics and the Research Department should make a greater effort to make the improvements and the adjustments suggested by the Working Party. The Balance of Payments Manual, which is the cornerstone of the established accounting principles in this field, should be comprehensively reviewed and updated. However, further efforts to improve statistics at the national level are equally important. Indeed, any single entity's negligence will impair the quality of global statistics as a whole. The efforts of all national agencies concerned are clearly required. In particular, countries that have data deficiencies or do not report data should not see the Fund as a substitute or a supplement to their own institutions; the efforts of those institutions are essential. As to the particular statistical issues concerning individual countries mentioned in the report, they can be taken up during the Article IV consultations with those countries.

In view of the important implications of the Working Party's report, it should be made available to a wide range of people. Therefore, I welcome the suggestion that the report should be prepared in order to enjoy as wide a circulation as possible. I also agree that the documentation for the Interim Committee should include a reference to the Working Party's conclusions and recommendations.

The Working Party's report has provided a clear view of the problem of discrepancy and insights into the direction that should be followed in making the needed adjustments. Those concerned should make the best possible use of the report and should cooperate in the effort to make progress toward solving the problem of the statistical discrepancy.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/24 (2/6/87) and EBM/87/25 (2/9/87).

3. SFF SUBSIDY ACCOUNT - AMENDMENT OF SUBSIDY ACCOUNT INSTRUMENT, AND SUBSIDY PAYMENTS FOR JULY 1, 1985 THROUGH JUNE 30, 1986

1. The following sentence shall be added at the end of Section 10 of the Subsidy Account Instrument as a separate paragraph: "For the purpose of the calculation of charges under (a) and (b), any adjustment in the rate of charge referred to in Rule I-6(4) that may be made under Section V, paragraph 2(b) of Decision No. 8348-(86/122), adopted July 25, 1986, shall not be taken into consideration."

2. In accordance with Section 10 of the Instrument establishing the Supplementary Financing Facility Subsidy Account, as amended, additional subsidy payments shall be made with respect to charges paid on holdings of currency referred to in Section 7 of the Instrument for the period July 1, 1985 through June 30, 1986, in the amount indicated to each of the eligible members as listed in column 3 of the table attached to EBS/87/22.

3. The subsidy payment shall be made to each eligible member on February 9, 1987, or as soon thereafter as the member has paid all overdue charges, if any, on balances eligible for the subsidy. (EBS/87/22, 2/4/87)

Decision No. 8523-(87/25), adopted
February 6, 1987

4. CHILE - EXTENDED ARRANGEMENT - MODIFICATION

Paragraph 4 of Decision No. 8342-(86/120), adopted July 21, 1986, is amended by substituting "February 12, 1987" for "February 13, 1987." (EBS/87/25, 2/5/87)

Decision No. 8524-(87/25), adopted
February 6, 1987

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/86 and 86/87 are approved. (EBD/87/31, 2/2/87)

Adopted February 6, 1987

APPROVED: September 15, 1987

JOSEPH W. LANG, JR.
Acting Secretary