10/8/50

NOTE OF THE NETHERLANDS DELEGATION 6295/50 2x.

Schematic analysis of the financial consequences of the proposed integration of a certain branch of industry. 10/8/50.

Before giving a schematic analysis of the financial consequences of the proposed integration of a certain branch of industry, the Netherlands Delegation wishes to make it clear that applications for assistance from the European Integration Fund by member countries can only be taken into consideration if the assistance applied for bears directly on the financing of specific measures to be taken in the country concerned to enable this country to participate in the integration of a certain branch of industry.

As will appear hereafter, under certain circumstances, the E.I.F. when judging the application will take into consideration the effect, if any, of the specific measures concerned on the countries position vis-à-vis E.P.U.

General effects to be expected from liberalisation on a country's position vis-à-vis E.P.U., e.g. an increased deficit as a result of higher consumption of liberalised products will by themselves not justify an application for assistance from the E.I.F. Such consequences should be financed out of the E.P.U. quota of the member country.

In the following it is assumed that a Technical Committee after having reviewed the situation in the branch of industry for which it was appointed, is of the opinion that it has been proved to its satisfaction that in a certain country this branch should be modernised. It is also assumed that the total costs of this modernisation are $ 5 million, of which $ 1 million would be spent in the country concerned, whereas $ 4 million would have to be spent in other member countries. Thus the project would have to be effectuated in $ 1 million local currency and $ 4 million EPU-units.

In this context the following schematic possibilities present themselves.

A. The $ 5 million needed can be obtained in local currency on the home capital market. This case should be subdivided as follows:

1. the position of the country concerned in E.P.U. is such that through E.P.U. the necessary equipment can be imported from member countries with the aid of $ 4 million local currency without serious consequences for the country's E.P.U. position.

   In this case no action or aid from the E.I.F. would be needed.

2. the position of the country concerned in E.P.U. is such that the $ 4 million imports of necessary equipment from member countries would cause difficulties to this country. 1)

   In this case two possibilities arise, viz.:

   a) the country concerned might call upon the E.I.F. to act as intermediary in finding the $ 4 million abroad; if necessary the E.I.F. might strengthen its intermediary action by offering a guarantee;

   b) if, even with the aid of a guarantee, the funds cannot be found in this way, the E.I.F. itself might give a loan of $ 4 million.

B. The $ 5 million needed cannot be found in local currency on the home capital market because the modernisation project is considered to be too risky.

In this case a solution might be found if the E.I.F. would give a guarantee to the Government concerned up to $ 5 million

1) The criteria for judging whether this would be the case might either be objective (e.g. the surpassing of a certain percentage of the country's deficit quota) or be left to the discretion of the E.I.F. in consultation with the EPU-management.

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so as to onable this Government to give, in its turn, a guarantoo to those nationals or national institutions, that might provide the funds. In this connection, however, two cases should be distinguished:

1. the position of the country concerned in E.P.U. is such that with the aid of $ 4 million local currency the necessary equipment can be imported from member countries without serious consequences.
   In this case the procedure described above would suffice.
2. The position of the country concerned in E.P.U. is such that importing the necessary equipment from member countries to an amount of $ 4 million would cause difficulties. 2)
   In this case the country concerned might call upon the E.I.F. to act as an intermediary in finding the $ 4 million abroad. In this situation, it might be expected that the intermediary function of the E.I.F. would have to be supplemented by a guarantee, in order to enable the Government concerned to give, in its turn, a guarantee to an amount of $ 4 million to the foreign lenders. If the funds could not be found in this way, the E.I.F. itself might give a loan amounting to $ 4 million, while guaranteeing the $ 1 million, to be found on the home capital market.

C. <u>The $ 5 million needed cannot be found in local currency on the home capital market because there is a shortage of capital.</u>
   In this case the E.I.F. should act as an intermediary, regardless of the position of the country concerned vis-à-vis the E.P.U. If the intermediary function were insufficient, the E.I.F. might strengthen its action by offering a guarantee. If also this would prove to be insufficient, the E.I.F. itself should give a loan to a maximum amount of $ 5 million.
   This case might present itself as well for a country which is a creditor in E.P.U. as for a debtor country in E.P.U. Although under certain circumstances tightness of the capital market of a creditor country might be an indication that the internal financial policy of that country should be questioned, the Netherlands Delegation is of the opinion that unless the Organisation has taken an explicite attitude towards the policy concerned, the Fund should not give an unfavourable advise for this reason only. The proper occasion to judge the financial policy pursued is when studying the internal financial stability of member countries. We should also wish to refer to para. 27 of the Stikker-plan (C(50)159).

From a bookkeeping point of view the above mentioned cases would lead to the following manipulations.

A. <u>Guarantee</u>. The providing of a guarantee by the E.I.F. should be established in the books of the E.I.F. as a possible obligation to the Government of the country concerned.
   In the above mentioned example the country concerned will import the capital equipment needed, either by means of funds obtained from abroad or for its own account.
   In the first case the exercise might run according to the rules set out in E.P.U. (compare par. 27 of C(50)190).
   In the second case the E.P.U. account of the country concerned will in due course be debited for an amount of $ 4 million.
   The account of E.I.F. with E.P.U. will remain unchanged, unless the country would call for the amount guaranteed.
   In this latter case the account of the E.I.F. with E.P.U. would be debited for the amount called whereas the account of the country concerned would be credited.

2) vide footnote 1.

B. Loan provided by the E.I.F.
If the E.I.F. would provide a loan to the country concerned, it would credit the country in its books for the amount of the loan. After being notified of a payments obligation becoming due, the E.I.F. would in its own books debit the account of the country concerned, whereas the account of the **E.I.F. with E.P.U.** would be debited and the E.P.U. account of the supplying country would be credited. The E.P.U. account of the favoured country would remain unchanged.

An example of the payment of a contribution to the E.I.F. has been given in the workingpaper submitted by the Netherlands Delegation, C(50)197 Annex I.

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