March 28, 1985

SECRETARY'S CIRCULAR NO. 85/40

To: Members of the Executive Board

From: The Acting Secretary

Subject: Report on Seminar in Portugal

There is attached for the information of the Executive Directors a report on a seminar co-sponsored by the Fund and the Bank of Portugal, held in Estoril, Portugal, January 16-19, 1985.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Report on Seminar in Portugal January 16-19, 1985

Prepared by the External Relations Department

Approved by A.F. Mohammed

March 28, 1985

1. Introduction

A seminar on "Adjustment and Growth in the Current World Economic Environment", the first conducted in the Portuguese language, took place in Estoril, Portugal from January 16 to 19, 1985, under the joint sponsorship of the Bank of Portugal and the Fund. There were 45 participants selected jointly by the co-sponsoring institutions, which included academicians, bankers and journalists; government officials from Brazil, Cape Verde, Guinea-Bissau, Mozambique, Portugal, and Sao Tomé and Principe also participated in the seminar. The seminar moderator was Dr. José da Silva Lopes, professor at the Portuguese Catholic University, former Minister of Finance, and former Governor of the Bank of Portugal.

The seminar consisted of seven sessions in which six papers were presented by Fund staff members and by outside authors; the final session was dedicated to summing up of the proceedings by the moderator (see Attachment). There were two designated discussants for each paper, and their comments were followed by a general discussion and a summing up by the author. The papers and proceedings, of which the salient aspects are summarized below, are to be published in Portuguese.

2. The Proceedings

A discussion of recent developments, the short-term outlook and critical policy areas of the world economy was introduced by Horst Struckmeyer (ADM). The paper provided general background for the ensuing papers and discussions, and was based on the latest World Economic Outlook exercise conducted by the Fund. Among the issues raised by participants were the adverse impact that a possible future adjustment of the U.S. economy might have on the world economy and, consequently, on growth prospects for developing countries; the related risk of an intensification of protectionist pressures; the implausibility of Europe and Japan assuming a "locomotive" role; and efforts to strengthen the surveillance process by overcoming present weaknesses in the system.

A paper on the challenge to the Fund's conditionality posed by the adjustment process within an interdependent system was presented by Manuel Guitián (ETR). After analyzing briefly the evolution of conditionality, the author argued that the accumulation of external debt combined with the intensification of protectionist pressures impose constraints on the resumption of sound economic growth rates in the international economy. Therefore, it is important now, even more than in the past, that the Fund in its exercise of conditionality, promote broad consistency among members' economic policies. Furthermore, given the nature of the imbalances that still remain in the international economy, the conditionality practices of the Fund need to be set in, and maintained over, a medium-term framework. Apart from the implications for the formulation of policy objectives and instruments, this approach links the exercise of conditionality with the general surveillance responsibilities of the Fund and calls for close institutional links between the Fund, the World Bank, and the GATT to provide support for members' adjustment from their respective complementary perspectives.

In the discussion of conditionality, the difficulties involved in its application were recognized, but some participants questioned the Fund's neutrality, given differences in economic size, importance, and nature of the problems faced by a variety of countries. Some observed that Fund programs provide for an adjustment period that is too short to address all the sources of balance of payments problems; in their view, programs were biased toward excessive reliance on demand management measures which yield faster results, but which do not always address fundamental causes of disequilibria. Programs may thus give rise to "stop-go" processes which may, in turn, aggravate structural distortions in the economy, requiring further adjustment efforts. It was noted that these limitations, to the extent that they exist, and the relatively limited financing that can be provided by the Fund, could be partly neutralized by cooperation with the World Bank in the framework of structural adjustment loans. It was also noted that, in the design of adjustment programs, the Fund should duly consider the difficulties presented by the need for constitutional or institutional modifications in the implementation of certain economic policy measures which not only called for a significant measure of consensus but also took time to yield results.

Professor Jorge Braga de Macedo (Princeton University) introduced a paper on anti-inflationary policies in the adjustment process. Fund programs, he observed, are seen to be fundamentally addressing balance of payments deficits and, although a reduction in the rate of inflation is also an important objective of stabilization arrangements, its priority is lower as reflected in the fact that it does not constitute a performance criterion, thus showing what the author termed the Fund's attitude of "benign neglect" vis-à-vis inflation. The author argued that an additional reason for the Fund's relative tolerance of inflation ma be justified, as a dynamic analysis suggests that flexible exchange rate arrangements carry a deflationary bias under a system characterized by lack of international cooperation on economic policies among countries. On the other hand, the Fund's attitude may reduce governments' resolve, for domestic reasons, to adopt anti-inflationary policies which in most cases can lead to the authorities' losing credibility.

Participants addressed the difficulties involved in reducing inflation rates in economies when widespread price rigidities or indexation mechanisms prevail. These factors must be tackled as part and parcel of the implementation of a credible economic plan to significantly affect inflationary expectations, but certain costs in terms of production and employment were seen as unavoidable. Some participants agreed with the author that Fund adjustment programs give the objective of reducing inflation a lower priority than that of reducing external imbalances. Experience with some programs seems to show that underlying inflation rates are underestimated, at times by not taking sufficient account of the impact of adjustments in the exchange rate and in administered prices on the price level. Accordingly, compliance with increasingly restrictive nominal credit ceilings may yield better than projected results in the external sector, but possibly at the cost of adverse output effects. The Fund's waivers and modifications of nominal performance criteria, which are numerous under some adjustment programs (e.g., Brazil) in situations where inflation was higher than projected, lent credibility, in the view of some participants, to the concept of "benign neglect" with respect to the inflation objective under Fund programs.

A paper on fiscal policy in an economy characterized by high inflation and high debt was jointly authored by Vito Tanzi and Mario Blejer (FAD) and presented by Mr. Tanzi. While recognizing that inflation may be caused by a variety of factors, there is a degree of fiscal deterioration in countries with high inflation, the authors observed. The relationship between inflation and fiscal deficits was analyzed as a symbiotic one where high fiscal deficits may cause inflation but where inflation also contributes to fiscal deficits. The authors discussed how implementation of fiscal policy in a high inflation context can be constrained by the presence of a high stock of public debt, particularly when indexation of debt servicing is practiced. The authors discussed the distinction between the conventional and the inflation-adjusted deficit of the public sector, and concluded that it is not easy to provide general answers regarding the appropriateness of using one or the other concept. A high level of public foreign debt in the view of the authors can impose budgetary constraints on exchange rate policy and limit fiscal policy as public sector price adjustments require devaluations which in turn increase debt service requirements.

Some participants pointed out that the Fund's concern over the reduction in the fiscal deficit, rather than the way in which such a reduction is attained, is indicative of the short-term framework of adjustment programs. However, the nature of revenue measures and of cuts in expenditure outlays (e.g. current versus capital) have medium- and long-term implications for savings, investment, and growth. Participants also discussed some difficulties in establishing and monitoring fiscal objectives in terms of deficit reduction. The relevant definition of the fiscal deficit must be adapted to the economic cycle and, some argued, it needs to be adjusted for inflation. In this regard, it was pointed out that while the inflation-adjusted deficit may be relevant in its impact on domestic demand, the nominal deficit is more relevant in terms of an assessment of financing needs. With respect to monitoring, difficulties arise as there are ways of statistically altering the actual deficit such as by the incurrence of arrears, sales of assets, advance tax receipts, etc., in order to show compliance with fiscal ceilings under adjustment programs.

A paper on the role of public enterprises in the adjustment process in Portugal was presented by Teodora Cardoso (Bank of Portugal). Her analysis concentrated on the explanation of fiscal disequilibria during 1980-82 which were financed by substantial foreign borrowing on the part of public sector enterprises. Such financing contributed to conceal price subsidies and exchange rate losses which should have been paid by the central administration and which gave rise to payments arrears with public enterprises. The latter incurred financial deficits largely arising from a pricing policy which did not adjust for rising costs, particularly those associated with imports of petroleum products, cereals, oil seeds and sugar. Detection of the problem was impaired by the fact that the budget of the central administration is administered on a cash basis, and by the lack of timely and comprehensive external debt statistics. The author argued that the use of a comprehensive concept of public sector finances to make explicit the deficits of the general government and public enterprises would help to avoid past difficulties, but it needs to be accompanied by a modification in the view that the economic performance of the public enterprises need not be subject to the same performance criteria as private enterprises.

Participants agreed with the need to improve the control system over the operations of public enterprises in Portugal, as it is currently divided among several authorities and is applied in an uncoordinated manner. Some pointed to the absence of evaluation criteria with respect to management of public enterprises and to the fact that managers are independent of administrative supervision and are not held accountable for the outcome of their work. Participants recognized that excessive financing needs may also arise, to a significant degree, from ambitious investment programs, as has frequently been the case in Brazil and in Portugal, and adjustment efforts are bound to require curtailment or cuts in public enterprise investment programs. In this sense, several participants pointed to the need to use adequate selection criteria in investment-reduction decisions.

Newly appointed Central Bank Governor, Antonio Carlos Lemgruber (then, Banco Boa Vista, Brazil), introduced a paper on external debt and economic growth. He analyzed the dynamics of external indebtedness, focusing on the impact of export growth and international interest rate developments on a country's import and growth capacity. Different options for a long-term solution to the external debt problem of developing countries were discussed. The author stated the nonviability of debt repudiation or unilateral capitalization of interest payments, and questioned the probability of a quick return to voluntary lending in order to finance interest payments. Among the drawbacks of the "case-by-case" approach from the debtor's viewpoint, Mr. Lemgruber listed the assymetry involved in the fact that while the flow of new money may be interrupted in the face of poor economic management (measured by noncompliance with IMF ceilings), that flow is fixed and cannot be increased to respond to serious external shocks such as a rise in interest rates, a deterioration in terms of trade, or a world recession. The author proposed an interest capitalization scheme with some debt relief elements to be negotiated between debtors and creditors. The scheme would be predicated on the need to maintain an acceptable ratio of interest payments to exports over time. The determination of the corresponding ratio would yield the basic interest rate consistent with its maintenance, given a certain export growth. The fraction of interest rates above the basic interest rate (LIBOR or prime rate) would be capitalized and, at rising interest rate levels above the basic rate, spreads would be first capitalized, then reduced, and finally eliminated. Should there be a reduction in export earnings related to a world recession or a drop in export prices, the basic rate might have to be reduced in order to maintain the ratio of interest payments to exports.

In the discussion of the external debt problem, extreme solutions such as the formation of a debt cartel or debt repudiation found no echo among participants. Mr. Lemgruber's proposal for an interest capitalization scheme was considered imaginative, but some participants found it deficient in failing to distinguish and reward different adjustment efforts among debtor countries. This weakness led some to question the proposal's acceptability among debtors and creditors alike under current and prospective conditions in financial markets. Some participants felt that solutions to the debt problem must consider the problem of capital flight, particularly in its relation to interest and exchange rate policy. Participants recognized the crucial role of the Fund in contributing to the resolution of the external debt problem, particularly its catalytic role in generating new bank loans and in the structuring of refinancing packages between debtor countries and foreign creditors.

The seminar took place in a cordial atmosphere, with widespread participation by those present. Participants expressed their appreciation for the opportunity to discuss adjustment problems and policies with Fund staff, and welcomed what they perceived as a timely institutional effort to explain the Fund and its policies to the outside world.

Attachments

ADJUSTMENT AND GROWTH IN THE CURRENT WORLD ECONOMIC ENVIRONMENT

Seminar Sponsored by the
Bank of Portugal and the
International Monetary Fund

Estoril, Portugal
January 16-19, 1985

List of Participants

Brazil

João Batista de Abreu **	Planning Secretariat of the Presidency of the Republic
Paulo Nogueira Batista Junior **	Getulio Vargas Foundation
Antônio Carlos Lemgruber *	Banco Boa Vista
Antônio Pimenta Neves	O Estado de Sao Paulo and Jornal da Tarde
Celso de Campos Pinto	Gazeta Mercantil

Cape Verde

Amaro da Luz	Bank of Cape Verde

Guinea-Bissau

Manuel Santos	Ministry for Social Equipment
Vitor Mandinga	National Bank of Guinea-Bissau

Mozambique

Marcelo Andrade	National Planning Commission

Portugal

Carlos Alcobia **	Secretariat of Planning
João Ferreira do Amaral	General Planning Office
Paulo Ernesto Carvalho Amorim	Bank of Portugal
Antônio S. Pinto Barbosa	Universidade Nova of Lisbon
Manuel Pinto Barbosa **	Universidade Nova of Lisbon
Maria Teodora Pereira Cardoso *	Bank of Portugal
Rui Carp	Ministry of Finance
Maria José Constâncio	General Directorate of Industry
João Cravinho	Basic Studies on Industrial Economics Group
Paulo Pitta e Cunha **	Universidade Clásica of Lisbon
Antônio Sousa Franco **	Universidade Clásica of Lisbon
José Emîlio Amaral Gomes	Graduate Institute of Economics
Jorge Braga de Macedo *	Princeton University and Universidade Nova of Lisbon
Walter Pego Marques	Bank of Portugal
Maria Manuela Morgado	Brisa
Manuel Antônio Pinho **	Portuguese Catholic University
João da Costa Pinto**	Bank of Portugal
Antônio José Mendonça Pinto	Bank of Portugal
Manuel Lopes Porto	Coordinating Commission of the Regional Center
Virgîlio José Rapaz	Bank of Portugal
Alberto José dos Santos Ramalheira	Bank of Portugal

João Pinto Ribeiro **	Bank of Portugal
Maria Manuela Silva	Graduate Institute of Economics
Aníbal Cavaco Silva **	Bank of Portugal
Alfredo de Sousa **	Universidade Nova of Lisbon and Portuguese Catholic University
Carlos Saldanha do Valle	Bank of Portugal
Jorge Wemans	Expresso

Sao Tomé and Príncipe

Manuel da Trindade Lombá	National Bank of Sao Tomé and Principe
Moreno dos Santos Pequeno	National Bank of Sao Tomé and Principe
Hildeberto Mário do Nascimento Séca	National Bank of Sao Tomé and Principe

Moderator

José da Silva Lopes	Caixa Geral de Depósitos

International Monetary Fund

Horst Struckmeyer *	Administration Department
Vito Tanzi *	Fiscal Affairs Department
Manuel Guitián *	Exchange and Trade Relations Department
Hernán Puentes	External Relations Department

World Bank

Roberto Fernândes ** — Department 1 - Country Programs (Europe, Middle East and North Africa)

* Authors

** Discussants

ADJUSTMENT AND GROWTH IN THE CURRENT WORLD ECONOMIC ENVIRONMENT

Seminar Sponsored by the
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Estoril, Portugal
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Program

January 16, 1985

6:00 p.m.	Reception

January 17, 1985

9:30-11:30 a.m.	1. Recent Developments, Short-Term Outlook, and Critical Policy Areas of the World Economy Speaker: Horst Struckmeyer (IMF) Discussants: João Da Costa Pinto (Portugal) João Baptista de Abreu (Brazil)
3:00-5:00 p.m.	2. Adjustment and Interdependence: The Challenge to Conditionality Speaker: Manuel Guitián (IMF) Discussants: Paulo Nogueira Baptista Júnior (Brazil) João Pinto Ribeiro (Portugal)
5:30-7:30 p.m.	3. Anti-Inflationary Policies in the Adjustment Process Speaker: Jorge Braga de Macedo (Portugal) Discussants: Roberto Fernándes (World Bank) Manuel Pinto Barbosa (Portugal)

January 18, 1985

9:30-11:30 a.m.	4. Fiscal Policy in an Economy Characterized by High Inflation and High Debt Speaker: Vito Tanzi (IMF) Discussants: Anibal Cavaco Silva (Portugal) Paulo Pitta e Cunha (Portugal)

3:00–5:00 p.m.	5. Public Enterprises and Macroeconomic Adjustment in Portugal Speaker: Teodora Cardoso (Portugal) Discussants: Antônio Sousa Franco (Portugal) Carlos Alcobia (Portugal)
5:30–7:30 p.m.	6. External Debt Service and Growth: The Long-Term View Speaker: Carlos Antônio Lemgruber (Brazil) Discussants: Alfredo de Sousa (Portugal) Manuel Antônio Pinho (Portugal)

January 19, 1985

9:30–11:30 a.m.	Concluding session and summing-up
1:00 p.m.	Farewell luncheon

Moderator: José da Silva Lopes (Portugal)