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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/50

10:00 a.m., April 2, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. Koné, Temporary
J. de Groote	H. G. Schneider
	X. Blandin
A. Donoso	M. Teijeiro
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	
	L. Leonard
A. Kafka	
G. Laske	G. Grosche
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	J. L. Feito
J. Tvedt	
	T. A. Clark
	Wang E.

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

Also Present
C. F. Schwartz, Consultant. African Department: O. B. Makalou, Deputy Director. Asian Department: S. Ishii, G. R. Kincaid. European Department: P. B. de Fontenay, A. Fidjestol, S. Kashiwagi. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; M. Allen, E. H. Brau, H. W. Gerhard, G. G. Johnson, S. Kanesa-Thasan, P. A. Molajoni. External Relations Department: A. F. Mohammed, Director; H. O. Hartmann, N. K. Humphreys. Fiscal Affairs Department: R. A. Feldman. IMF Institute: C. Tognetti. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel; P. L. Francotte, Ph. Lachman. Middle Eastern Department: J. G. Borpujari, S. von Post. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. Artus, C. P. Blackwell, J. E. Blalock, M. E. Bond, J. M. Boughton, K.-Y. Chu, M. C. Deppler, S. J. A. Gorne, O. E. G. Johnson, M. D. Knight. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. S. Cutler, D. Gupta, Q. Md. Hafiz, T. B. C. Leddy, D. V. Pritchett, G. Wittich, B. B. Zavoico. Western Hemisphere Department: E. Wiesner, Director; C. Brachet, P. D. Brenner, J. Ferrán, J. F. van Houten. Bureau of Statistics: J. V. Carter. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, H. A. Arias, J. Delgadillo, S. El-Khouri, K. A. Hansen, S. M. Hassan, L. Ionescu, H.-S. Lee, G. E. L. Nguyen, Y. Okubo, M. Z. M. Qureshi, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, J. R. N. Almeida, I. Angeloni, R. L. Bernardo, M. Camara, Chen J., L. E. J. M. Coene, G. Ercel, I. Fridriksson, D. Hammann, A. K. Juusela, H. Kobayashi, M. J. Kooymans, E. Landis, G. W. K. Pickering, E. Portas, J. Reddy, D. J. Robinson, A. A. Scholten, S. Sornyanyontr.

1. ARGENTINA - REPORT BY MANAGING DIRECTOR

The Chairman, recalling that Argentina had been approaching a March 31, 1984 deadline for the payment of $500-600 million in interest payments to commercial banks, noted that, if the payments had not been made, a number of the banks would have had to make changes in their claims and assets corresponding to the unpaid interest. Those changes had not been necessary because, as he understood it, a number of Latin American countries had decided to participate in an important collective bridging operation, the details of which were not yet available. Apparently there had been agreement on a $500 million package, including Mexico ($100 million), Venezuela ($100 million), Colombia ($50 million), Brazil ($50 million), and Argentina ($100 million), with the 11 banks represented on the Advisory Committee contributing $100 million. The bridge loan had made it unnecessary for the banks involved to change the categorization of their assets and liabilities. It was also his understanding that, after a letter of intent with the Fund had been signed by the Argentine authorities, the United States would enter into a swap arrangement for $300 million in order to repay the bridge loan contributions by Mexico, Venezuela, Colombia, and Brazil.

The Fund had not played a role in the negotiations on the bridge loan, the Chairman explained. Its function in the overall effort to assist Argentina had been to continue the discussions with the Argentine delegation to the Fund in order to reach an understanding on a new program. During the previous week, the staff and management had worked intensively with the Argentine delegation, led by Mr. Prebisch, the Personal Representative of the President of Argentina. The discussions, which had focused on recent economic policies in Argentina and the main elements of a stabilization program, had been very constructive, and several elements of likely policy emphasis in the coming period had become clear. The Argentine representative considered that a decisive reduction in the rate of inflation was of the utmost importance, and it had been agreed that a key element of the counterinflation effort should be a dramatic curtailment of the fiscal deficit. Those steps would of course be important in the effort to revive the economy, improve economic efficiency, and gain sustained growth of output and employment. It had also been agreed that the balance of payments objectives for 1984 and 1985 must reflect the external financing constraints and the need for Argentina to improve its international creditworthiness. It was clear that exchange rate policy would have to be geared to stimulating exports and to promoting efficient import substitution in order to facilitate both balance of payments adjustment and the achievement of sound economic growth.

He was not yet in a position to describe all the specific actions that the Government would take under the new program, the Chairman remarked, but it was important to note that the authorities intended to reduce the fiscal deficit sharply, from an estimated 18 percent of GDP in the fourth quarter of 1983 to 6 percent of GDP in the first quarter of 1985. There was still considerable work to do on the program, particularly with respect to the revenue and expenditure measures and to the treatment of interest subsidies and other fiscal operations of the Central Bank. However, the authorities were clearly moving in the right direction. Indeed, they had also agreed that it was essential for domestic interest rates to be positive in real terms in order to encourage domestic savings and to strengthen the capital account of the balance of payments.

The discussions with the Argentine delegation had also encompassed current policies, the Chairman said. He had expressed his concern to the delegation that decisions recently adopted or contemplated on wages, price controls, interest rates, and exchange rates were resulting--or could result--in an acceleration in the rate of inflation and in increased distortions in the price system. The Argentine representatives had agreed that, in the light of recent experience, the policies in the areas concerned would be readjusted in order to be consistent in the future with the economic objectives that he had mentioned with respect to inflation, the balance of payments, and economic growth. Wage policy, for example, would be based on prospective inflation, rather than on retroactive adjustment to compensate for past inflation.

The discussions with the Argentine delegation were continuing, the Chairman remarked. The negotiators still had to work out the specific measures that would support the achievement of the basic objectives of a comprehensive stabilization program. In a telephone conversation, the Minister of Finance had expressed his great satisfaction with the understandings already reached between the Fund and the Argentine delegation; he had indicated that he was looking forward to resuming discussions with staff and management in the coming days.

In response to questions by the participants in the bridging operation about the negotiations on a new Fund program for Argentina, the Chairman explained that, while no agreement on a letter of intent had been reached, constructive discussions had been held, which were reflected in a "progress report," the contents of which he had just outlined. A final agreement on a letter of intent would take some time yet to complete, as the matters involved were complex.

The manner in which the Latin American countries concerned had participated in the bridging operation for Argentina was heartening, the Chairman said. It was the first time that a regional operation had been mounted to help a country, and it reflected not only regional cooperation but also an attitude of responsibility by the countries concerned toward their debt obligations.

The Executive Directors took note of the Chairman's comments.

2. WORLD ECONOMIC OUTLOOK - GENERAL SURVEY

The Executive Directors continued from the previous meeting (EBM/84/49, 3/30/84) their consideration of a staff paper on the World Economic Outlook - General Survey (EBS/84/33, 3/2/84; and Cor. 1, 3/26/84). They also had before them as a background paper a report prepared by the Fund staff and the OECD Secretariat on the statistical discrepancy in global current account balances (EBS/84/49, 3/9/84).

The Director of the Research Department explained that data available since the distribution of the staff paper showed that the strength of the recovery in both Europe and the United States was growing. If that trend continued, the staff would probably wish to amend its economic growth projections for the industrial countries.

Commenting on the effects of exchange rate changes since November 1983--the base date for the staff's projections--the Director noted that, through March 1984, movements in exchange rates for currencies of the main industrial countries had not been pronounced; in particular, there had been little net change in the effective exchange rate of the U.S. dollar. In passing, he observed that a high value for the U.S. dollar had a greater effect on the interest burden of the developing countries than on their export earnings, mainly because the debts of those countries were denominated in U.S. dollars, while their exports were denominated in a range of currencies.

There had been no attempt by the staff to downplay the short-term effects of the U.S. fiscal deficit on either U.S. domestic growth or growth in other countries, the Director said. However, the staff had been taking a longer-term view in noting that the U.S. position in general, and the fiscal deficit in particular, threatened to limit growth in the United States and abroad, both because of the higher interest rates associated with the deficit and because of the multiplier effect on other countries of limited growth in the United States.

On protectionism, the Director said that the staff agreed with Mr. Erb on the importance of including--among the various forms of protection--subsidies that artificially stimulated exports. The staff also agreed that it was important to take account of protectionist measures in all countries, both developed and developing. However, in present circumstances, the protectionism emerging in the industrial countries was of particular concern. The staff had not planned to include an appendix on protection in the published version of the World Economic Outlook, because it had recently discussed the matter in a paper prepared for the Development Committee. If Directors so desired, the staff could adapt the paper to the requirements of an appendix for the published World Economic Outlook.

While agreeing with Mr. Polak and Mr. Laske on the importance of taking into account certain stock adjustments in the determination of past exchange rates, the Director considered that such adjustments perhaps should not be regarded as more than contributing factors in exchange rate changes. On another point, he agreed with Mr. de Maulde that the base scenario for the developing countries indicated a challenge to policymakers, as it represented the minimal set of conditions to be met if the debt problem were to work itself out in due course. That was a more useful way of thinking of the scenario than trying to label it either optimistic or pessimistic.

Finally, the term "solvency" as used by Mr. Donoso was difficult to apply in an analysis of the situation in developing countries, the Director of the Research Department said. It was perhaps more useful to think in terms of the viability of the position of those countries, and, if actual developments were consistent with the base scenario, policies of the developing countries should then lead them to viable and sustainable economic positions.

The Deputy Director of the Research Department explained that an estimate of the the cyclically adjusted fiscal balance was of course technically possible, but the outcome would depend on assumptions that were made about what constituted a cyclically "normal" level of activity and on the interest rates that would prevail under such conditions. In present circumstances, assumptions about those two factors would be particularly tenuous, especially for European countries, where the margin of spare capacity was large, and considerable time had passed since normal economic conditions had been observed. Of course, similar assumptions had to be made in calculating year-to-year changes in the fiscal positions, but the scope for error in such calculations was less than in calculations comparing a current situation with a hypothetical norm that had not been observed for a number of years. The staff preferred to avoid giving undue credence to any estimate of a structural deficit that would inevitably have a highly conjectural element. Still, in undertaking a major review of its fiscal analysis, the staff had explored the implications of different methods of measuring and adjusting the fiscal balance and hoped that its exploratory work could be reflected in future reports on the World Economic Outlook.

It had been noted by Mr. Laske that the German authorities tended to look at the general government rather than the Central Government as the best indicator of a country's fiscal position, the Deputy Director recalled. In the Appendix, the staff had given more emphasis than usual to the general government balance and had tried to look at the fiscal position from the viewpoint of both the general government and the Central Government. Even in countries with a federal structure, however, the central government fiscal position was an important measure of the impact of policies.

There apparently was some feeling among Executive Directors, the Deputy Director remarked, that the staff had not paid enough attention to official development assistance (ODA). The figures on such assistance were provided in Table 20 under the category of official transfers and, based on figures provided by the recipient countries, were somewhat smaller than the figures reported by donor countries. The staff had not analyzed in depth the changes in official development assistance in its discussion of debt, adjustment, and financing, partly because, in practice, aid flows had not had a particularly volatile effect on the capital account of the recipient countries. The considerable decline in nondebt-creating flows in recent years, which Mr. Ismael had noted, had been due entirely to the fall in direct investment. In general, however, the staff agreed with Executive Directors who had stated that adequate increases in official development assistance were of fundamental importance in enabling poorer countries, in particular, to regain the momentum of development.

Questions had been raised about why the category of "major borrowers" had been expanded to cover 25 countries, and why the criterion had been changed in a way that defined major borrowers in terms of total debt outstanding, rather than in terms of debts owed to private creditors, the Deputy Director recalled. The group of major borrowers had been expanded to include four oil exporting countries (Algeria, Nigeria, Niger, and Venezuela), and the criterion had been changed partly because of the difficulty in breaking down debts between official and private creditors, but mainly because the staff had wished to avoid giving the impression that, in some sense, debt owed to official creditors was less important than that owed to private creditors. Moreover, the criterion for the group of major borrowers had not been specified in terms of a ratio of debt to exports, because the ratio method would have yielded a large number of very small countries and would have missed some of the larger debtors that were important in the global debt picture, even though their ratio of debt to exports was not as high as that of some of the smaller countries.

Hence, the staff had followed the principle used in the past of identifying the countries that were the major debtors, rather than merely identifying the countries with the largest debt ratios, the Deputy Director noted. Still, the staff would wish to take Executive Directors' comments into account in developing analytical groupings that were as useful as possible. In that respect, the staff had been having second thoughts about the whole issue of the grouping of countries in the World Economic Outlook reports. In future, the staff hoped to experiment with country groupings that were developed for a specific analytical purpose, rather than use the same grouping for a variety of purposes. That approach would help the staff to deal specifically with the newly industrialized industrial countries as a group, for instance. It would also enable the staff to present a smaller group of major borrowers, if it seemed desirable to do so.

Commenting on the assumptions employed in the scenario analysis, the Deputy Director explained that the projected increase in lending of 7 percent used in the staff's analysis covered all private lending and included suppliers' credits. Much of the lending concerned was import financing. The staff had felt it reasonable to assume that, in normal circumstances, import-related lending would increase at broadly the same pace as the imports they financed, or by about 10 percent in nominal terms for the period covered by the scenario. If trade-related lending were to increase at broadly the same pace as imports, then an annual 7 percent growth rate for total private credit would imply an increase in nontrade-related lending by banks of about 4 percent. At that rate, there would be little change in that category of lending in real terms, and it would decline quite rapidly as a share of banks' total portfolios. Those aspects of the scenario assumptions had not been spelled out in detail in the staff paper, and it might be useful to provide a fuller discussion in the published version.

As for the London interbank offered rate (LIBOR), the staff had projected a rate of 10 percent on average for 1984 and 1985, the Deputy

Director commented. That rate reflected the staff's projections for developments in output, inflation, and policies that were likely to affect credit markets. For the period after 1986, the numbers shown should be considered an assumption, rather than a projection; in that regard, the staff had presented a sensitivity analysis based on different interest rates. The staff felt that it was reasonable to project a decline in nominal and real interest rates after 1985 for several reasons. First, apart from the past two or three years, there was no historical period in which real interest rates had been as high as at present. Even under the staff projections, developing countries would be paying a real rate of interest on their borrowing of 5 percent at the end of the 1980s. Second, if inflation in the developed countries were contained, there would be some decline in the present premium in nominal rates that reflected the remaining uncertainty about the possibility of an acceleration in inflation. Third, the staff had implicitly assumed that countries with large fiscal deficits would act to reduce the imbalances. Fourth, if, as had been assumed, the relative burden of debt and debt service in the developing countries should decline, it seemed reasonable to expect some reduction in the spread over LIBOR that those countries would have to pay.

Commenting on the staff's use of ratios in its analysis of the debt burden and on Mr. Donoso's suggestion for using a ratio that might better measure a country's solvency, the Deputy Director of the Research Department said that no single statistic could enable one to judge with great accuracy whether or not a particular country's external debt position was appropriate or viable. Such a judgment would have to be made in the light of all the relevant conditions in a country. Ratios should be used merely as a guide in such analysis and should not be given excessive weight.

Mr. Prowse considered that the published version of the World Economic Outlook should include an appendix on protection.

Mr. Erb remarked that his view on the concept of the industrial country policy mix was similar to that of Mr. Polak. It was inaccurate to characterize present policies as a combination of loose fiscal policy and tight monetary policy. During the previous one or two years, the monetary policy of industrial countries had moved in a direction that was likely to result in increases in inflation in the future, rather than decreases; such a policy stance could not be characterized as one of restraint. The staff's references to the policy mix gave the impression that the member countries concerned should tighten fiscal policy and loosen monetary policy; in fact, both kinds of policies probably needed adjustment in order to achieve noninflationary growth.

In an assessment of the experience of the developing countries, Mr. Erb went on, it would be useful to distinguish between those whose economies had performed well during the previous several years and those that had not, and to attempt to determine why such differences had occurred. The performance of the Asian countries, for instance, had been considerably better than the performance of developing countries in other regions.

He agreed with Executive Directors who wished to see a reduction in U.S. fiscal deficits sooner rather than later, Mr. Erb commented, but it was misleading to attribute many of the problems in the world economy to the fiscal deficit in the United States. It was true that the recovery of the U.S. economy had played an important part in the recovery abroad. The United States had experienced a strong recovery together with a sharp reduction in unemployment, which had contributed to the world economic recovery through the development of the U.S. trade balance and the current account. The United States clearly had not been exporting unemployment during its economic recovery.

The U.S. authorities had appropriately decided not to restrain the exchange rate and trade balance consequences of the developments in the U.S. economy, Mr. Erb remarked. Indeed, any effort by the United States to restrain the appreciation of the U.S. dollar would have been inconsistent with the spirit and the principles of the Articles and would have had a potentially detrimental effect on other countries. Growth in the United States had helped to reduce protectionist pressures generally, although the appreciation of the exchange rate had intensified pressure to protect certain industries. At the same time, the growth of the U.S. economy and of the U.S. trade deficit should have been encouraging other countries to reduce their trade restrictions. A reduction in the U.S. fiscal deficit would have worked its way through the economy to cause a downward adjustment of the exchange rate; however, given the course of the world economy and the exchange rate in the previous two years, the exchange rate had actually not behaved in an undesirable way.

The Director of the Research Department said that it should be clearly understood that the staff was not maintaining that monetary policy in the United States should be eased; any change in the U.S. policy mix should come from an effort to reduce the fiscal deficit. On another matter, the staff had attempted on various occasions in the past to assess the reasons why some developing countries had performed better than others and--despite the substantial statistical pitfalls in such an analysis--would continue to make such assessments.

Mr. Polak remarked that it might be best to avoid the use of the term "policy mix" in the paper and to mention only fiscal policy instead. After all, references to a change in the policy mix were often unclear, because they could refer to substantial changes in fiscal policy, monetary policy, or both.

The Chairman agreed with Mr. Polak. The reference to the policy mix in the staff paper had been meant to suggest that monetary policy in the United States should remain essentially unchanged while fiscal policy should be more restrained than hitherto; and the hope was that an appropriately restrictive monetary policy, together with a more restrained fiscal policy, would loosen monetary conditions somewhat. The relevant text of the report would be re-examined with a view to ensuring that it accurately reflected the point the staff had intended to make.

Mr. Prowse asked whether Mr. Erb had meant to imply that monetary policy had become somewhat easier in recent months in some or all the industrial countries. In his view, monetary policy had been more appropriate, and governments had observed their money growth targets to a greater extent in the preceding six months than in the preceding 12-18 months.

Mr. Erb replied that, while there had been a significant adjustment in monetary policy in the right direction about six months previously, money and credit market conditions in the United States at present were such that money growth had begun to climb to the upper end of the target range--indeed, the target likely to be exceeded in coming months--rather than to fall to the lower end of the range, thereby helping to ensure further improvement on the inflation front. He was worried about the possibility of a turnaround in inflation in 1984 and 1985.

Mr. Nimatallah wondered whether the staff had examined the practical consequences of stretching external debt repayments far into the future--perhaps 15-20 years--as Mr. Prowse and Mr. Malhotra had suggested.

The Deputy Director of the Research Department remarked that an agreement to stretch debt repayments into the distant future would of course be an important development, although it would have little direct effect on the staff's scenarios, under which it had been assumed that maturing debt in the second half of the 1980s would be refinanced in some manner, perhaps through rescheduling, or a voluntary rollover.

The Chairman commented that he was somewhat concerned about the emphasis that Executive Directors had placed on the size of the "hump" in amortizations projected for the later part of the 1980s. Of course the scheduled repayments would be heavy and would have to be rolled over, but the banks and other creditors seemed willing to cooperate. It was important to appreciate that, if debtor countries performed reasonably well and were in a position to service their stock of debt, the refinancing or rescheduling of the heavy repayments falling due should take place rather smoothly. No one could reasonably expect that the working capital stock of very large countries would be fully repaid over just a few years.

It was important, the Chairman went on, to focus not on the scheduled repayments, but rather on the kinds of policies that would make the repayments easier to finance or refinance. He agreed with Executive Directors who had stressed the need to formulate and implement those policies in a more organized way in order to prevent problems from recurring from one year to the next. The banking community would have to reflect on the problem; its members were well aware of the relevant data and understood that an organized approach to dealing with debt repayments would be helpful. In that connection, there were two main schools of thought: there was some feeling that the refinancing of the heavy debts should be organized well in advance and on a rather long-term basis; others felt that the debt repayment problems should be treated case by case on a more current basis, in the light of existing policies. They felt that it was difficult to determine in advance an optimum debt profile over a long period for a group of countries, and that the most practical solution was to look at each country's debt profile on a year-to-year basis.

There were of course advantages and disadvantages to both approaches, the Chairman continued. The first had the clear advantage of providing a framework for the determination of appropriate policies. Debtor countries would know that they could expect a certain treatment of their external amortization debt profile over a long period, and they would have some security while perhaps resorting to more market-oriented new financing in the meantime. It might not be possible to make such arrangements in all cases; finding a long-term solution for a country characterized by a number of major uncertainties could well be difficult as a country's balance of payments prospects could change dramatically for unexpected reasons. As Mr. de Groote had stressed, a change in a country's terms of trade could considerably affect its debt servicing capacity. Hence, there was some feeling that, in certain cases, it might be best to tailor the treatment of a debt rescheduling package to the performance of a country and to its particular needs at the moment.

It was difficult to find a straightforward solution to the treatment of the heavy schedule of debt repayments, the Chairman continued, but extending the repayments over a longer period would probably be useful. The decision to deal with Mexico's amortization problems over two years had facilitated adjustment in that country. It seemed necessary to develop an understanding with the banks that it was important to keep likely future events in mind--without trying to treat all the various problems in a very long-term framework--as a part of a debtor country's adjustment effort. A number of banks had indicated that they were interested in a more forward-looking approach to dealing with debt problems. They were clearly interested in medium-term scenarios and in adapting their practical treatment of debt problems to a sensible medium-term approach.

Mr. Erb agreed with the Chairman that, as debtor countries began to recover and their investment and borrowing opportunities increased, the countries and the banks could work out ways in which part of the debt could be restructured over a longer period. It was his understanding that, in some cases involving debtor countries and requests for new borrowing, bankers had oversubscribed the amount that the countries were seeking, which suggested that opportunities for appropriate debt restructuring could perhaps permit some banks to reduce their exposure and other banks to increase their exposure, thereby making an important contribution to dealing with the debt problem.

The Chairman commented that, as shown recently with Mexico, banks were already beginning to move toward significantly longer maturities in restructuring agreements than had been the custom one or two years previously.

Mr. Nimatallah agreed with the Chairman that it was important to find the appropriate longer period for stretching out repayment. Using a very long period ran the risk of increasing the debtors' burden because of the accumulation of interest over time.

Mr. Prowse remarked that it would be helpful to hold a separate discussion on the various problems concerning rescheduling. It was important not to become complacent in assuming that banks would invest their assets and would not seek repayment of debt on schedule, or that countries normally would be expected to liquidate their debts only over a long period. A global view of the debt problem could conceal a number of specific difficulties; the challenge was to meet the financing needs of individual countries, not merely to assure that the aggregate asset structure of the banks was kept intact.

As Mr. Nimatallah had suggested, the debt profile of countries was perhaps the central concern, and it was affected not only by the possibility of new financing, but also by the debt service ratio, which could fluctuate sharply and perhaps become unduly high if debt were not extended over a long period, Mr. Prowse continued. The idea of relating debt service payments to a measure of debt servicing capacity should certainly be further explored. It was also important to consider the possibilities for rescheduling over longer periods and to recognize that bunching of maturities affected new financing capacity and a country's debt servicing ratio over time. Careful thought should be given to the implications of rescheduling for the formulation of adjustment programs for individual member countries. By the end of a program period, a country should ideally have a viable payments position that would enable it to make its scheduled payments; a country's position could be genuinely viable only if the payment of its external commitments enabled it to maintain dynamic economic growth.

Mr. Kafka said that he was less concerned about the possibility of successfully rolling over debt than about the manner in which the rollovers were achieved. Ideally, they should be market-directed, as they had been before 1982. He was pleased that the banks were being encouraged to stretch out their rollovers within prudent limits, but it was important to face up to the problem of high interest rates, charges, and additional fees, especially as interest rates were on the rise again and showed no signs of falling. As the sponsor of a large number of debt renegotiations, the Fund should explore with the banks the problem of high interest rates and charges. The reasonable cooperation of the larger banks could generally be counted on, but a closer look should be taken at the attitude of the smaller banks.

Mr. Polak commented that stretching out debt over time and the problem of the amortization hump that would arise later in the 1980s were matters of concern primarily to the banks, and he was pleased to learn that they were interested in the Chairman's ideas. The cyclical risks to which countries were exposed, and the risks of constant debt service independent of developments with respect to exports, were familiar matters to the Fund. It might be useful to think of a country's debt service as a function of its exports, or perhaps of the external conditions under which it could reasonably hope to achieve the best possible export performance. The Fund, given its experience with compensatory financing, was best suited to examine such a possibility without necessarily advocating it.

Mr. de Groote said that he strongly supported Mr. Polak's proposal.

The Chairman made the following summing up:

Executive Directors had a thorough discussion of recent developments in the world economy and of the issues now facing policymakers. They noted that several important improvements had taken place in the world economic situation in 1983 and were projected to continue in 1984. These included the revival of activity and better price performance in industrial countries, and progress toward effective adjustment by indebted countries. Nevertheless, a number of serious problems continued to confront policymakers, that would need to be skillfully handled if the more favorable outlook described in the staff paper was to materialize.

In summarizing the discussion, I will follow the order of the main issues listed in the concluding section of the paper.

1. Economic management in the industrial countries

Executive Directors strongly endorsed the view that financial stability was an essential prerequisite for satisfactory economic growth in the medium term. Accommodative monetary policies had sometimes been allowed to persist too long during past recovery periods, and it was important that such a mistake should be avoided on this occasion. The course of monetary policy should therefore be such as to continue to bring down inflation and inflationary expectations. A balanced recovery, however, would be likely only if action were taken to reduce the share of savings being absorbed by government deficits. In the absence of such action, interest rates were likely to remain high, thus hampering the prospects for a sustained revival of investment, particularly in longer-lived capital goods. All Directors stressed the importance of prompt measures to bring down the U.S. fiscal deficit, although it was noted that reducing the deficit was only one aspect of the U.S. authorities' objectives in the fiscal field.

It was pointed out by some Diretors that fiscal stimulus appeared to have played an important role in strengthening the recovery in those countries that had experienced the fastest demand growth during 1983. They therefore felt there might be a case for a somewhat more relaxed attitude toward fiscal deficits in those countries--Germany and Japan, for example--where recovery had been slower to take hold. As was recognized, however, recovery could also be attributed to improving consumer and business confidence in the medium-term stability of fiscal policy. I should note that the German and Japanese Directors both felt that the positive effects of their policies were now beginning to be felt quite remarkably in their countries.

A number of Directors agreed with the staff's view that structural improvements in the functioning of goods and labor markets would be required to significantly improve economic performance in industrial countries and to bring down unemployment, especially in Europe, where it is still very high. They felt that it was important to introduce greater flexibility into labor markets, that undue protection for declining industries should be avoided, and that government regulations affecting industry should take due account of their economic consequences. The point was made that for countries in a position to moderately stimulate their economies, such action would accelerate the required structural changes in their economies, while reinforcing the expansion of the world economy.

On the question of exchange rates, there was general agreement that the most striking development of 1983 had been the continued strength of the U.S. dollar. Most Directors felt that this could be attributed in large part to the U.S. fiscal deficit, and to the effect of this deficit in pushing up interest rates in the United States and thus attracting capital inflows. But other factors had also played a role in the dollar's continued strength. These included the attractiveness of the United States as a haven for investors seeking political and economic stability, the strength of the U.S. economy, and the inclination of U.S. banks to increase domestic lending at the expense of foreign lending.

In the view of a number of Directors, the continued strength of the dollar had a number of disturbing aspects. Most important, it was being sustained by high interest rates in the United States. These posed problems for other countries--both by making a revival of investment activity more difficult and by adding to the burden of servicing external debt. It was pointed out that the interest burden of debt was relatively greater for countries than for individuals and corporations borrowing domestically, since the latter could avail themselves of tax-deductibility provisions. Another danger in the high exchange rate for the dollar lay in the risk of provoking additional protectionist pressures.

While most Directors took the view that the present pattern of exchange rates could not be regarded as indefinitely sustainable, few of them felt the likelihood of a sharp change in rates was great. It was noted that monetary policy in the United States was being firmly maintained and that this would help ensure that any downward movement in the dollar took place gradually.

Concerning current account developments among the industrial countries, Directors drew attention to the large and growing deficit of the United States and the somewhat lesser increase in the Japanese surplus. A number of Directors felt that a U.S. deficit of the size projected was a source of concern, viewing it as an unwelcome distortion in the allocation of global savings.

Some Directors, however, noted that the growing U.S. current account deficit was associated with a number of positive developments. Part of the deficit reflected the stronger cyclical recovery in the United States, and part the strong adjustment of external accounts being undertaken by developing countries, notably in the Western Hemisphere. Furthermore, the counterpart of the U.S. deficit was an increase in other countries' net exports--a development that had helped initiate recovery and payments adjustment in these countries.

Directors did not in general suggest direct action to influence the pattern of exchange rates. They felt that an improvement in the U.S. fiscal position, coupled with a firm monetary policy, would facilitate a reduction of interest differentials between the United States and other countries, and that this would in turn lead to a gradual decline in the dollar and restoration of a more sustainable pattern of exchange rates and current account balances.

2. Debt and adjustment

Directors felt that the staff's medium-term scenario, together with the sensitivity analysis, provided a useful framework for assessing the medium-term evolution of the debt situation. For the most part, they found the assumptions underlying the base scenario to be reasonable, and they were encouraged that these assumptions appeared to be consistent with an improving economic performance and some alleviation of the relative burden of external debt. Nevertheless, most Directors emphasized that there was little margin for unexpected adverse developments or policy shortfalls. This made it all the more important for countries, creditors and debtors alike, to pursue firm policies of adjustment. For the industrial creditor countries, policies of structural adjustment were necessary if the growth rates assumed by the staff, and needed to sustain demand for the developing countries' exports, were to be achieved. For debtor countries, a continuing emphasis on adjustment was needed to demonstrate creditworthiness, and to enable them to take advantage of the upswing that seemed to be getting under way in the industrial world.

Most Directors drew attention to the "hump" in amortization payments projected for 1986-88. The view was expressed that refinancing of these obligations should not be too serious a problem in the circumstances expected to prevail at the time, if the adjustment process were continuously pursued. Most Directors, however, felt that the magnitude of the sums falling due was a cause for concern and warranted careful advance planning. Given the lack of a margin for adverse contingencies in the base scenario, it was important to begin thinking now about how these heavy amortization payments would be dealt with. Some specific suggestions were made, including that debtor countries should plan an even greater measure of adjustment than in the staff's base scenario; that amortization schedules should be linked to export earnings and put in the context of cyclical developments, and that a role for Fund assistance could be developed on a contingency basis. A number of Directors also expressed the view that an SDR allocation would be desirable in this context, as well as for other reasons.

Concerning economic developments within the developing countries themselves, widespread concern was expressed at the low rates of economic growth recorded over the past few years. In both 1982 and 1983, economic growth in developing countries had been below the rate of population increase. While a substantial portion of this increase in output had been devoted to improving the external position, it was clear that external adjustment had taken the form mainly of cutbacks in imports.

While all Directors accepted the need for effective adjustment policies in the developing countries, some considered that adjustment programs should take greater account of the hardships that the populations in these countries were being asked to bear. They warned that sharp cutbacks in living standards could not take place without serious damage to the social fabric. Taking into account that external factors had played a major role in the difficulties faced by developing countries, and that global economic activity was still weak, these Directors considered there might be a case for adapting Fund conditionality and stretching out the process of adjustment.

Most Directors, however, felt there was no practical alternative to the kind of adjustment that, suitably adapted to individual circumstances, was incorporated in Fund programs. They emphasized that the Fund had limited resources and that Fund conditionality should not and could not be regarded as an instrument of worldwide countercyclical policy. Weaker adjustment measures would cast doubt on the ability of the countries concerned to eventually overcome their debt difficulties, and might lead to a drying up of new credit altogether. This would make the needed external adjustment even greater than in situations where Fund assistance was used in support of viable programs and acted as a catalyst for large external capital flows.

A number of Directors drew attention to the role of official development assistance in the adjustment process, and considered that the staff paper had not adequately addressed this issue. They pointed out that low levels of such assistance were complicating the task of low-income countries in responding to their recent difficulties, and emphasized that more satisfactory levels of ODA could play a pivotal role in enabling poorer countries to regain the momentum of development.

3. Protectionism

All Directors, without exception, condemned the growth of protectionist tendencies over the past few years. In emphasizing the adverse consequences of protectionism, Directors noted that import restrictions in industrial countries severely handicapped the efforts of developing countries to reduce their debt burden through expanding exports. While this was perhaps the most serious aspect of protectionism in present circumstances, it was noted that it was not the only source of concern. Specific attention was also drawn to protection extended through subsidies and other means of support for declining industries, and to the widespread restrictions in developing countries.

While Directors endorsed the views put forward by the staff, a number of them considered that it might have been helpful to have had a more extended treatment of this issue in the World Economic Outlook document. As the Economic Counsellor had explained, a separate paper was not prepared, as it would have covered essentially the same ground as the paper entitled "Linkages Between Trade and the Promotion of Development" referred to on page 36 of the World Economic Outlook document and discussed in the Board on March 9, 1984. However, I understand and agree with the Board's wish that the paper be adapted for publication and included as an Appendix in the published World Economic Outlook.

4. Procedure

It was suggested during the discussion that, in some form, the analysis in the World Economic Outlook should be available to the press at the time of the Interim Committee meeting. As Directors know, it is intended to publish the entire report, but copies will not be available until the end of April, and the planned publication date is in the first few days of May. I understand that it would be agreeable to the Executive Board to provide the press with the revised version of the General Survey paper, together with the statistical tables, in the form in which it will be sent to the printers.

After a further brief discussion, the Executive Directors concluded their discussion on the World Economic Outlook.

3. LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors considered a staff report on the Fund's liquidity position and financing needs (EBS/84/44, 3/7/84).

Mr. Nimatallah stated that his authorities remained firmly committed to a financially strong Fund that could respond effectively to the needs of borrowing countries and give creditors assurance that they would be repaid. A financially strong Fund that played a central role in the adjustment process was in the best interest of all member countries. The Fund should continue to manage its resources prudently, and his authorities attached considerable importance to the policies that had been established to safeguard the Fund's financial position and to enhance its credit standing. Those policies should be maintained, or improved where necessary, on the basis of semiannual reviews of the Fund's liquidity position. The Fund had to keep a continuous watch on its liquidity, so that it could anticipate possible strains well in advance; the reviews were an important way of ensuring that the Fund's financial position remained strong.

The ratios presented in Table 2 of the Appendix were important tools for assessing the Fund's liquidity position, Mr. Nimatallah continued, and should be closely monitored by the staff and the Executive Board. For that purpose, they should be circulated more frequently--at least every three months--with an explanation of any actual or prospective changes. In addition, the staff should give priority to improving the ratios, particularly the asset ratio. It was essential for the longer-term financial strength of the institution to maintain an appropriate balance between the Fund's liabilities and the assets effectively available to meet them. It should be possible to assess that balance in a suitably constructed ratio or set of ratios that would indicate to the Executive Board how to react if there were a substantial change on either side of the Fund's balance sheet. The Executive Board needed to have a more reliable set of indicators and trigger points so that early action could be taken to prevent or reverse any deterioration in the underlying financial position of the Fund.

The staff report clearly showed that the Fund's liquidity position had improved considerably in recent months, Mr. Nimatallah remarked. The quota increases under the Eighth General Review had come into effect, the General Arrangements to Borrow (GAB) had been enlarged, the currencies of several important members had become usable in the operational budget, and new borrowing arrangements totaling SDR 6 billion were close to completion. Taken together, those developments had significantly strengthened the Fund's ordinary resources and had placed sizable borrowed resources at the Fund's disposal. At the same time, the Fund's usable resources had increased relative to the revised limits on enlarged access. As a result, the Fund was well equipped to meet the likely demands on its resources in 1984. The available information suggested that, in the absence of major shocks, the Fund would not need to borrow more money in 1984. There were also no indications as yet that the commitments assumed for the smaller industrial countries in the staff estimates would materialize.

As for 1985, Mr. Nimatallah went on, the Fund's liquidity could again come under pressure if the staff projections proved to be accurate. He hoped that the pressure could be alleviated through a continuing world economic recovery and expansion in world trade.

The Fund was currently in a much stronger financial position than it had been for some time, Mr. Nimatallah concluded. If the world economic recovery continued, the demand for Fund resources might be less than was projected, and the Fund's resources might be sufficient to assist members through 1984, and perhaps 1985 as well. However, if the recovery faltered and the Fund's liquidity came under pressure, there might be a need to turn to the enlarged GAB. For the moment, the Fund would do well to continue to manage its resources prudently, to plan ahead realistically, and to take all other necessary precautions to ensure that its financial position remained strong.

Mr. Tvedt, agreeing generally with the view in the staff report, commented that the Fund's liquidity position had substantially improved since the previous review as a result of the various factors that Mr. Nimatallah had mentioned. He agreed with the staff's main conclusion that the question of further borrowing could be postponed until the next review. However, it was important to note that a commitment gap with respect to borrowed resources might emerge again as early as the end of 1984. In principle, the Fund ought to have in hand the financing needed to meet commitments that had already been undertaken. It should therefore approach potential lenders at an early stage in an effort to avoid building up commitment gaps in the future. If the enlarged access policy were extended through 1985 and the guidelines remained unchanged, a need for further borrowing would arise.

Although the outlook for 1984 regarding the possibility for covering the Fund's financing needs seemed reasonably good, Mr. Tvedt remarked, it was important to note that the ordinary resources available to the Fund had to cover the financing needs for the entire period through the completion of the Ninth General Review of Quotas, a period when member countries' needs for Fund assistance might continue to be strong. The staff had not presented an estimate of the needs after 1985, but it was important to bear in mind that many of the loans rescheduled in 1982-84 would fall due in 1987-88. Hence, the Fund should carefully monitor developments and be prepared in case relatively small deviations from the projections for growth and demand in the industrial countries, and for lending by the international banks, created a substantially larger financing need than seemed likely at present.

Mr. Grosche observed that the Fund's liquidity position had been strengthened considerably during the previous several months, mainly because of the increase in quotas. There would, moreover, be available considerable uncommitted borrowed resources as a result of the formal completion in the near future of an agreement on short-term loans amounting to $6 billion from the BIS, a group of industrial countries, and the Saudi Arabian Monetary Agency (SAMA).

On the other hand, Mr. Grosche continued, the demand for Fund credit in the coming period was expected to be substantial, although there was no need to fear that a commitment gap would arise during the coming several months. In the absence of unexpected dramatic developments, the

Executive Board should be in the comfortable position of being able to discuss the question of additional borrowing by the Fund without any pressure during the second half of 1984.

The staff's estimate of the demand for Fund credit in 1984--nearly SDR 10 billion--was realistic, Mr. Grosche considered. Because the estimate was also substantial, staff and management should be urged to maintain their prudent approach to evaluating the appropriate amounts to be provided to member countries under Fund-supported programs. In that connection, the information provided by the staff in the second and third paragraphs on page 6 was reassuring.

The staff's effort to present its findings more clearly than in previous papers was welcome, Mr. Grosche said; unfortunately, the attempt to ensure clarity had led the staff to exclude some data--which had been included in previous papers--that would have permitted Executive Directors to view the Fund's resources in a multiyear perspective. Perhaps such additional information could be included in annexes to future reports.

Mr. Prowse noted that, for the purpose of the present review, the total of unadjusted usable currency holdings as of March 1, 1984 had been reduced by one fourth, instead of by one fifth, as in previous liquidity reviews, so that the stock of adjusted usable resources had fallen to SDR 31.5 billion. The larger reduction in holdings had been made because of the weakening balance of payments positions of some member countries whose currencies were currently regarded as usable and which comprised a relatively large share of usable currency. He wondered whether the criteria for the inclusion of countries in the operational budget should not be reconsidered in the light of the increase in the adjustment factor. Did the budget include countries that should actually be excluded?

In estimating the demand for Fund finances, Mr. Prowse observed, the staff had included SDR 2 billion for what it had called the smaller industrial countries. It would be useful to know the individual countries involved and the amounts for each, particularly as most of the projected commitment gap consisted of the SDR 2 billion for the smaller industrial countries, an estimate that seemed on the high side.

It was useful to have a separate figure for the likely amount of the use by member countries of their reserve tranche positions, Mr. Prowse continued. What assumptions had underlain that estimate? It was of course difficult to provide precise information, and a case could be made for a conservative approach to such estimates, but the use of reserve tranche positions, like the possible purchases by the smaller industrial countries that he had mentioned, would have an important effect on the commitment gap.

In estimating the likely demand on Fund resources in the coming period, the staff had not made any provision for use of resources in the range of 102-125 percent of quota, Mr. Prowse continued. In future reports, the staff could usefully estimate the effect of a further scaling down of enlarged access. Such a scaling down was possible, particularly in the longer run.

The changes in the Fund's resources were described in Table 3, Mr. Prowse commented, but it would be useful to have the table show the same breakdown of purchases and repurchases of borrowed resources as it already did for ordinary resources. The use of borrowed resources would be the subject of increasing attention in the coming period. In Table 2, the revised estimates for 1984 showed that the use of borrowed resources would exceed the use of ordinary resources in 1984. That estimate was important in the light of the general attempt that was to have been made to give more weight to ordinary resources than to borrowed resources. Finally, he agreed with Mr. Nimatallah that the staff should circulate the relevant ratios on the Fund's liquidity position every quarter; the Executive Board could continue to discuss the liquidity position every six months.

Mr. Senior said that he broadly agreed with the staff's analysis and conclusions. The considerable strengthening of the Fund's liquidity position since the critical low point in the second half of 1983 gave the staff some room to be relatively conservative in its estimates and the Executive Board considerably more room to accept such figures; the traditionally conservative nature of the staff's liquidity estimates was well known.

There was an overriding need for the Fund to maintain a strong liquidity position in order to meet the demand for its resources and to continue to play its proper role in the international adjustment process, Mr. Senior said. While the current liquidity situation was comfortable, credit demand in 1984 and 1985 was expected to be substantial, and the Fund would continue to need to use borrowed resources. The Executive Board should try to make timely arrangements for appropriate amounts of borrowing, so that the demand for the Fund's credit could be adequately met. Otherwise, the Fund might be placed in the position of inappropriately adjusting credit demand through a more stringent application of conditionality or through a much more stringent rationing mechanism, such as the access limits.

The staff's estimates for 1984 did not include any arrangement for amounts equivalent to more than 102 percent of quota, Mr. Senior noted. The access limits should be applied flexibly, and the present limit of 125 percent of quota should be seen as the appropriate equivalent of the former limit of 150 percent. The staff's conclusion that no arrangements for amounts in excess of 102 percent of quota would be needed apparently was based on its assessment of the present situation; the staff was not trying to modify the policy on access. Why did the staff believe that two thirds of the new arrangements expected in 1984 would be for only 30-60 percent of quota? The external financial position of many member countries remained somewhat precarious, and the adjustment effort that those members would undertake might well warrant a larger use of Fund resources than the staff had estimated.

The staff had also estimated that one existing arrangement might be augmented by the equivalent of SDR 250 million, Mr. Senior observed. The current world economic and financial situation indicated that such a provision was prudent, and it was quite possible that other legitimate requests for additional resources might well be made by other members. The Fund should stand ready to meet those requests in the event of unforeseen adverse developments.

No commitment gap was expected until the second half of 1984, Mr. Senior noted. He agreed with the staff that consideration should be given to the financing of the commitment gap in the event that such financing was warranted by large new arrangements involving the commitment of borrowed resources. At the latest, the financing gap should be considered in the next half-yearly liquidity review, when further estimates on the use of resources in 1984 would be available. However, the best solution was to take appropriate steps to avoid such gaps.

Mr. Wang agreed with the staff that, despite the strengthening of its liquidity position, the Fund should continue to manage its liquidity prudently in order to avoid accelerated depletion of its ordinary resources and the development of a sizable commitment gap. The staff had projected that the majority of new arrangements in 1984 would be stand-by arrangements, and that about two thirds of them would be for amounts at annual access rates below 60 percent of quota. Most of the countries, particularly the debtor countries, that were likely to use Fund resources in the coming year suffered from serious payments imbalances that were structural in nature. Adjustment by those countries would require both a longer period and a larger amount of resources than the staff had implied. It might be more appropriate to agree on extended arrangements, rather than stand-by arrangements, for those countries and on larger access to the Fund's resources, so that members' actual balance of payments and financing needs could be adequately met.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by Executive Directors without meeting in the period between EBM/84/49 (3/30/84) and EBM/84/50 (4/2/84).

4. EQUATORIAL GUINEA - EXCHANGE SYSTEM

The approval by Decision No. 7326-(83/30), adopted February 16, 1983, of Equatorial Guinea's restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/83/4 is extended until September 30, 1984 or the completion of the 1984 Article IV consultation with Equatorial Guinea, whichever is the earlier. (EBD/84/99, 3/27/84)

Decision No. 7657-(84/50), adopted
March 30, 1984

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/163 and 83/164 are approved. (EBD/84/97, 3/26/84)

Adopted March 30, 1984

APPROVED: September 7, 1984

LEO VAN HOUTVEN
Secretary