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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/93

10:00 a.m., June 15, 1984

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
	H. G. Schneider
B. de Maulde	X. Blandin
	M. A. Weitz, Temporary
	M. K. Bush
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	
A. Kafka	C. Robalino
	G. Grosche
G. Lovato	N. Coumbis
	C. J. Batliwalla, Temporary
	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present:
L. de Azcarate, Director, Country Policy Department, IBRD. African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; F. d'A. Collings, J. C. Williams. European Department: P. C. Hole, M. H. Rodlauer. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; G. Belanger, H. W. Gerhard, M. Guitian, S. Kanesa-Thasan, D. A. Lipton, R. L. Sheehy. External Relations Department: A. F. Mohammed, Director. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel; W. E. Holder, Ph. Lachman, S. A. Silard. Middle Eastern Department: P. Chabrier, Deputy Director. Research Department: W. C. Hood, Economic Counsellor and Director; A. Salehizadeh. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; S. I. Fawzi, D. Gupta, T. B. C. Leddy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, H. A. Arias, S. E. Conrado, S. El-Khouri, K. A. Hansen, S. M. Hassan, H.-S. Lee, W. Moerke, G. E. L. Nguyen, I. R. Panday, P. Péterfalvy, M. Z. M. Qureshi, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, I. Angeloni, R. L. Bernardo, J. Bulloch, M. B. Chatah, Chen J., L. E. J. M. Coene, G. Ercel, C. Flamant, V. Govindarajan, N. U. Haque, H. Kobayashi, E. Landis, J. K. Orleans-Lindsay, E. Portas, M. Rasyid, J. Reddy, A. A. Scholten, Shao Z., S. Sornyanyontr, A. J. Tregilgas, Wang C. Y.

1. PROLONGED USE OF FUND RESOURCES

The Executive Directors considered a staff paper on the prolonged use of Fund resources by member countries (SM/84/91, 4/27/84; Cor. 1, 5/7/84; and Cor. 2, 5/9/84), together with supplementary material (EBS/84/104, 5/4/84).

Mr. Kafka suggested that, to avoid any misunderstanding, conclusions drawn from the present discussion that affected Fund operations should be incorporated in a formal decision.

He had some problems with Section II comparing the use of Fund resources in recent years with that in earlier periods, Mr. Kafka continued. For instance, the increase in the number of consecutive upper credit tranche programs in 1960-83 shown in Table 1 was not very meaningful because the Fund's membership had also grown. Moreover, there was no clear long-term trend in the share of consecutive upper credit tranche programs in all upper tranche programs, and by itself the number of member countries with upper tranche liabilities outstanding for five or more consecutive years was of little significance. Table 1 did usefully suggest that member countries with upper credit tranche liabilities outstanding for five or more consecutive years as a proportion of all members with such liabilities had been just 17 percent in 1983 and 18 percent in 1982, compared with an average of 22 percent in 1965-74; the figures for the periods 1975-81 and 1960-84 were lower. Hence, the rough trend that was discernible was not an increasing one. In fact, even though the decisions since 1974 establishing the extended Fund facility, the supplementary financing facility, and the enlarged access policy were intended to extend repayments over longer periods than the usual three to five years, and the world economic situation had led to a greater use of Fund resources in the previous decade than in earlier years, the proportion of members with outstanding upper tranche liabilities for five or more consecutive years to all members having such liabilities had been lower in 1982 and 1983 than in the period before 1974.

Table 2, entitled "Length of Continuous Period of Outstanding Liabilities in the Credit Tranches," was less informative than it could have been and was somewhat confusing, Mr. Kafka considered. Parts A and B, which showed liabilities in excess of 25 percent of quota, and liabilities in excess of 25 percent of maximum access, respectively, did not reflect the distinctions between the two kinds of liabilities needed to make the presentation meaningful. In discussing the liabilities, the staff had made only brief mention of the new facilities introduced since 1974 and their effect on outstanding liabilities, even though the trend in those liabilities since 1974 was attributable to the successful implementation of those facilities. If the staff had meant to question the continued need for those facilities, it should have done so in a direct fashion.

In Section III, Mr. Kafka noted, the staff had turned its attention to prolonged use of Fund resources by member countries that had not made sufficient progress toward achieving a viable balance of payments. Table 3 classified Fund member countries with upper credit tranche arrangements according to (a) outstanding liabilities as a percentage of quota, and (b) number of annual programs over the ten years to end-April 1984. The staff had suggested that prolonged use was evident whenever a country had four or more annual programs during a decade and had outstanding liabilities exceeding 100 percent of quota. In his view, that criterion was not useful. It could be met merely by the successful implementation of an extended arrangement--which involved three annual programs--followed seven years later by a modest one-year stand-by arrangement, a situation that certainly would not be dangerous. The kind of mechanical criteria that the staff had suggested would be meaningless, even as warning signals; a larger number of consecutive annual programs during a decade than the four the staff had suggested, together with outstanding liabilities of, say, 50 percent of maximum cumulative access would be more meaningful criteria.

The discussion in Section IV, Mr. Kafka observed, was only moderately informative in some respects, was indiscreetly informative in others, and should have placed more emphasis on the failure of program design and less on problems with program implementation. That the Fund often designed programs without knowing the range of values of the relevant parameters was a major cause for concern, but the primary responsibility obviously rested with each country. Any member that had not undertaken the required research should be encouraged to do so; when necessary, the Fund should provide technical assistance: it had made a considerable effort to develop needed statistics but had done little to specify the behavioral equations essential for good program design, and the multiplicity of program objectives had meant that member countries had had to implement nonessential measures as well as essential ones.

The staff had not presented convincing evidence that the Fund faced a current or prospective major problem of consecutive use of its resources, Mr. Kafka considered. The most that the staff need be asked to do in the coming period was to make periodic reports on developments with respect to consecutive use.

Its analysis suggested to the staff that two main policy issues should be addressed, Mr. Kafka noted. The first was the appropriate access policy for members that had made prolonged or repeated use of Fund resources or were likely to do so in the future. The Executive Board had already adopted a policy on maximum annual and cumulative limits, in accordance with recommendations of the Interim Committee. The staff apparently wished to consider adding another access limit, based on the number of a country's annual programs or the length of its use of Fund resources; alternatively, the staff had suggested, net repurchases could be required after a certain period, even if they were not called for under present policies.

The staff had also suggested that the Fund should continue to deal flexibly with issues involving prolonged use, even if the additional access limit and repurchase requirement it favored were adopted, Mr. Kafka continued. In that connection, the staff had distinguished between two categories of member countries and had suggested that for the first group, countries likely to make decisive improvements in their economy after prolonged use of Fund resources, large-scale Fund financial assistance might be justified, depending on the country's record of use of resources. For the second category of members--countries whose policies were unlikely to yield significant improvements in their economy--the staff suggested that the Fund should give limited financial support until they had clearly made progress in correcting their payments problems.

He was concerned, however, by the staff suggestion for a third category of member countries, namely, those whose structural characteristics, and particularly their outstanding debt service obligations, led the staff to believe that they would require exceptional financing and might be unable to repay the Fund over the medium term, Mr. Kafka went on. Under the staff proposal, Fund financial assistance for such a country would be designed in part merely to help it to meet its repurchase obligations; there should be a clear prospect that other financing sources would provide sufficient amounts to close the country's financing gap.

While it was not clear to him whether the proposed categories were meant to represent a radical break with present practice, Mr. Kafka continued, they obviously implied a reduction in the assurance that a member country prepared to adopt an adjustment program could count on receiving financial assistance from the Fund. That assurance had already declined drastically in recent years: five years ago a member country contemplating an approach to the Fund had a fairly good idea of the access it would be given under the various facilities; at present, a country had no such assurance, as the extent of its access depended on the discretion of the staff. Weakening the predictability of access for member countries--including those that had not made repeated use of Fund resources--would undermine the relationship between the Fund and individual countries. The need for predictable access should not be met by setting foreseeable but extremely limited access, and the staff's suggestions concerning categories of member countries should not be approved.

The second main policy question posed by the staff was how the Fund could ensure effective adjustment by countries whose programs had not produced satisfactory results, Mr. Kafka remarked. In that connection, the staff had suggested possible improvements in designing programs and in monitoring program implementation and, in particular, that longer-term retrospective reviews of a country's performance, supplemented by staff analysis of the particular circumstances in the country, should be part of the staff paper on a new program presented for approval by the Executive Board. That approach was sensible and should be complemented by a genuine effort to gain a better understanding of the main parameters of the economies of member countries.

Commenting on the staff proposals for improving the monitoring of program implementation, Mr. Kafka noted that the Fund had already taken important steps by requiring prior actions, review clauses, and phasing of, and conditions for, purchases. Excessive increases in the number of conditions, the frequency of phasing, and the number of review clauses could undermine the very nature of stand-by and extended arrangments. It would be extremely dangerous to accept the staff's suggestion for specifying clearly at the beginning of a program period various areas in which measures might need to be strengthened in the event of shortfalls relative to targets. Such a procedure would undoubtedly encourage speculation, something that should obviously be avoided. Similarly, the proposal for phasing purchases specifically to limit drawings early in a program period would not be productive as a general practice. The success of any adjustment program always depended to an important extent on public confidence in it, and hesitation by the Fund to commit its resources would therefore be counterproductive.

The staff's suggestion for improving program design and implementation by strengthening the cooperation between the Fund and the World Bank was sensible, Mr. Kafka considered, but it would be important to avoid situations in which one institution was stymied because the other had failed to act. For instance, insisting that the Fund could not approve a country's program unless the World Bank had approved either a structural adjustment loan for the country or its investment program would not be appropriate in each and every case.

Commenting on the conclusions summarized in Section VI, Mr. Kafka said that the staff concern expressed in paragraph 1 about prolonged and repeated use of Fund resources seemed exaggerated. The conclusions in paragraph 2 were essentially correct, but greater emphasis should be placed on failures of program design, and such failures should be prevented. The proposals in paragraph 3 would dangerously reduce the degree of predictability of Fund assistance for a member country prepared to adopt an adjustment program; no new policies were justified at present, although the staff could usefully continue to review prolonged use.

The proposals in paragraph 4 were inappropriate, Mr. Kafka concluded, and while the suggestion in paragraph 5 for lengthening the period covered by reviews of past performance might help to improve program monitoring, care should be taken to avoid excessive use of prior actions, periodic reviews, phasing, conditions, and back-loading of purchases; indeed, there was already some danger that they were being used to excess. Finally, the suggestions in paragraph 6 should not create obstacles to timely action by the Fund, and any obvious or disguised cross-conditionality should be avoided.

Mr. Polak said that the staff had obviously needed to include references to specific countries in SM/84/91, and that it had done so in an objective way in Table 3. However, the references--some positive and some negative--to individual countries in the text could be seen by countries as the staff's verdict on their performance. The staff should have anticipated that possibility and have been more careful in its presentation. The lower right-hand portion of Table 3 listed 17 countries with 5 to 7 upper credit tranche arrangements each and current liabilities of at least 100 percent of quota. However, 4 of them were not mentioned in the text, and ten had been mentioned in what had originally been footnote 1 to the title of Section IV, "Circumstances Underlying Prolonged Use Without Effective Adjustment," thereby implying that they had made prolonged use without effective adjustment. After he had drawn that implication to the attention of the staff, a correction to the paper had been issued with the footnote appearing in a harmless place, on page 1.

Four of the countries he had in mind were described in the text as not being a cause for concern because they had strengthened their balance of payments, leaving the clear impression that the other 9 countries were a cause for concern, Mr. Polak continued. That conclusion might be accurate for some or most of the countries, but certainly not for Romania. On page 10 the staff had given some of those 9 countries faint praise in stating that "repeated or frequent use did not necessarily represent uninterrupted failures of successive arrangements or programs"; and Romania was credited with "arresting the process of financial deterioration." However, the text implied that failures had indeed occurred and did not explain that, of the 17 countries in the lower right-hand portion of Table 3, Romania was one of the few that had decided to forgo a stand-by arrangement for 1984. Thus, the text might give readers the wrong impression of the Fund's views on the countries concerned. As for Romania in particular, he assumed that the Fund's view was still the one that the Managing Director had summarized in a speech in February 1984: "In Romania and Yugoslavia the very sharp improvements in their current account positions that have been achieved over the past two years are, in large measure, a reflection of the policy adaptations undertaken by the authorites in connection with Fund-supported programs."

He agreed with Mr. Kafka, Mr. Polak continued, that the statistical evidence presented by the staff did not convincingly show that prolonged use was clearly more of a problem than it had been 15 or 20 years previously. However, that conclusion might be accurate for two reasons. First, the use of Fund resources had grown both in absolute terms and in relation to quotas, and, as a result, prolonged use had begun to have an impact on the Fund's liquidity, probably for the first time. Second, at present, Fund resources were used exclusively by countries with structural current account deficits that would probably have to rely on capital inflows to be able to repay the Fund. In earlier years, a large proportion of Fund credit had been extended to industrial countries, which had been expected to repay as and when they had restored their normal current account surplus position.

There was certainly good reason to discuss the issue of prolonged use, Mr. Polak went on. It was clearly incompatible with the temporary and revolving character of Fund credit, and large-scale prolonged use could undermine creditors' confidence in the liquidity of their claims on the Fund, thereby reducing their willingness to contribute to the institution's resources.

The problem of prolonged use had arisen for the reasons that the staff had described in Section IV, Mr. Polak said. For instance, programs had sometimes been too weak and, indeed, had been known to be so from the start. In addition, the economic situation in a member country had occasionally been worse than it had appeared or had worsened soon after the adoption of a program. In other instances, policies had been implemented inadequately, and members had failed to adopt additional measures as needed.

In theory, Mr. Polak noted, the risk of prolonged use could be minimized by handling each case on its own merits and by approving only programs that were considered to be temporary ex ante. However, there seemed to have been a tendency for programs that were acceptable ex ante to turn out to be unsatisfactory ex post. That outcome was not of course the rule; some countries had encountered the same difficulties for years, even decades, and had then managed to adopt a good program, adhere to it, and solve their payments problems.

The risk of prolonged use could be reduced by improving conditionality and by increasing the Fund's cooperation with the World Bank, Mr. Polak considered. Such efforts could be reinforced by building into the Fund's judgmental approval mechanism a device that would warn the Fund when a member needed a new program after protracted and substantial net use of the maximum resources available under the access limits. The new device could be based on the presumption that the member's next program might not be successful, and, as a rule, the amount of Fund resources under that program should be smaller than the repurchases during the program period. In essence, his proposal was the same as the staff's in paragraph 3 on page 16. Accordingly, the presumption he had described could be overridden if there was what the staff had called "a persuasive reason justifying a departure." However, the Fund would have to be satisfied that the member was approaching the new arrangement in a different frame of mind than it had approached previous arrangements. His proposal would add a new dimension to the existing rules on annual access, maximum access, and repurchases while preventing an excessively rapid increase in a member country's use of Fund resources and limiting over time its level of total indebtedness. It could be decided that, in addition, after a specified cumulative use of Fund resources, the member country's indebtedness could rise no further, or perhaps should decline in an agreed way, even if it had new arrangements with the Fund.

If the rule he had described was to be effective, it would have to be integrated into the policy on access, Mr. Polak went on. The staff had mentioned three possible bases for such a rule, namely, the number of consecutive arrangements for a country, the duration of a country's use of resources in the upper credit tranches, and the amount of its use. The first criterion was the least relevant; the past practice of successive undrawn stand-by arrangements was a good form of association between the Fund and member countries, and there was no reason to view it in a negative light. According to his proposal, a member would not fall under the new rule until it had used Fund resources for a specified number of consecutive years. The ingredients of the rule would have to be specified in such a way that it would be fully compatible with the Fund's access policy. For instance, under the present policy, a member could make drawings under an extended arrangement for 3 years with repurchases stretching out over 10 years; net use of the Fund's resources for 13 years under a single extended arrangement should not be subject to the criticism of prolonged use.

Longer periods of use should be permitted for countries whose continuous use of Fund resources had been relatively limited, Mr. Polak commented. A shorter period should be required for members whose continuous use had taken them near the ceiling on access. That approach would be consistent with the definition of prolonged use based on the amount of resources used and the length of their use.

Further staff work on the various dimensions of the problem of prolonged use was needed, Mr. Polak considered. It should take into account the important restraint on outstanding use under the existing repurchase provisions, as well as the effect of the existing rule on "access in individual cases," which limited gross use of Fund resources in certain circumstances.

The Fund already had a policy permitting the use of its resources in modest annual amounts by a member country that needed a large amount of financing--usually concessional assistance--and where the Fund's main function was to provide assurance to other creditors that the country's policies were reasonable, Mr. Polak remarked. The extent to which such countries should be permitted to become indebted to the Fund should be decided on a case-by-case basis. The established policy on the use of Fund resources by members needing large amounts of financing would be fully compatible with any new policy designed to avoid prolonged use, as the modest annual amounts now permitted such countries, together with the existing repurchase provisions, would prevent them coming close to the limits on maximum access.

He was pleased that a representative of the World Bank was attending the present discussion, Mr. Polak said. In its paper the Fund staff apparently had meant to say that, while the existing procedures with respect to cooperation between the Fund and the World Bank were adequate, a greater effort by the World Bank was needed to ensure their more effective implementation. The Fund should give the World Bank adequate notice of its intention to deal with a member country facing structural problems, and it should then expect a timely appraisal by the Bank of the adequacy of the country's structural measures or investment program. If the appraisal was negative, the Fund should not enter into an extended or multiyear stand-by arrangement with the country, except in the rare instance in which the Fund deliberately decided to proceed despite the World Bank's negative views. If the Fund was closely collaborating with the World Bank in helping a country, it should, as Mr. Wicks had suggested on a previous occasion, ask the responsible World Bank staff to attend Fund Executive Board discussions on the country to answer any questions Executive Directors might have. Such a practice would encourage timely responses by the World Bank to Fund requests for analysis of a country's structural measures or investment program. Fund staff members should also be available to explain the Fund's views to members of the World

Bank's Executive Board. The question of collaboration between the Fund and the World Bank was a broad one, but there was no reason to wait for a complete review of all aspects of it before practical steps, such as the one that he had mentioned, were taken, perhaps on a trial basis.

Mr. Ismael considered that the statistics in Tables 1 and 2 were helpful but incomplete. The issue of prolonged use could be seen in perspective if the amounts outstanding in 1983 and in 1984 for the prolonged users of Fund resources were provided. If the amounts involved were large in relation to the Fund's total usable resources, one would readily conclude that the issue of prolonged use was serious. If the amounts were small, prolonged use need not necessarily be a cause for concern.

The staff had mentioned various causes of the lack of effective adjustment by countries that had made prolonged use of Fund resources, such as an unexpectedly harsh economic environment, inadequate program design, and incomplete implementation of programs, Mr. Ismael noted. Another problem, which the staff had not addressed, was that, being short term in nature, Fund-supported programs adequately addressed demand-related problems but not structural problems requiring more fundamental remedies. In that connection, the recent trend in the Executive Board to approve successive stand-by arrangements, rather than extended arrangements, for members facing serious structural imbalances was a cause for concern.

Ineffective adjustment was also traceable to a lack of adequate financing, Mr. Ismael continued. It was regrettable that countries requiring large-scale assistance had found their access to the Fund's resources limited by recent policy changes; a Fund-supported program could fail because of insufficient financial support. And it was distressing to note that the staff had even suggested in the present paper that the Fund should abandon a member country that lacked sufficient external financing. If the Fund did so, many member countries, including some in his constituency, would be permanently excluded from the benefits of membership. Such an approach would be clearly inconsistent with the Articles. Similarly, the suggestion in paragraph 3 on page 16 for devising strict rules limiting in a predetermined way access for potential or actual prolonged users was unacceptable. Limiting access on any basis other than the need to deal with adjustment problems would penalize members in genuine need of assistance beyond the period of one or two arrangements with the Fund. A similar burden would be placed on member countries if a net repurchase requirement was introduced.

In paragraph 4 on page 16, Mr. Ismael noted, the staff had described two categories of prolonged users, namely, member countries that had a reasonable chance of re-establishing a viable balance of payments, and members that were likely to require, because of the size and nature of the problems they faced, exceptional balance of payments assistance beyond the medium term. That distinction was inappropriate, both because it was inconsistent with the principle of uniform treatment, and because it gave the impression that the Fund should abandon the countries in the second category. The staff should not make such generalizations and should not propose any limitation on access on the ground that a member country was having difficulty in establishing medium-term payments viability. The Fund should maintain a flexible, case-by-case approach to prolonged users of its resources and should always make genuine attempts to assist member countries. After all, financial assistance was one of the benefits of membership.

The staff suggestion in paragraph 4 for extending the period of past performance that was reviewed as part of the examination of a request for a new program was helpful, Mr. Ismael considered, but the recommendations concerning the monitoring of the implementation of adjustment programs--such as requiring prior actions, back-loading purchases, and use of end-year ceilings as performance criteria, would tighten conditionality and were therefore entirely inappropriate. In the absence of sufficient financing, prior actions could be costly and painful for a member country; back-loading of purchases also could have harmful consequences for a member country, and the use of end-year ceilings as performance criteria would serve no practical purpose.

The staff's conclusions in paragraph 6 were not fully clear to him, Mr. Ismael said. Closer collaboration between the Fund and the World Bank was acceptable in principle, but there should be a clear understanding of the arrangements for achieving that objective. A detailed examination of the matter, leading to concrete proposals, was warranted.

The problem of inadequate program design was important, but the staff had made no proposals to deal with it, Mr. Ismael remarked. A member country should not be penalized because the design of its adjustment program was found to be inadequate. He wondered how many cases of inadequate program design had actually been evident among the prolonged users of Fund resources.

There was no need to devise rules to deal with prolonged use, which, after all, was not a common occurrence, Mr. Ismael concluded. As Mr. Kafka had suggested, the Fund should instead keep a watch on the prolonged use of its resources in coming months.

Ms. Bush said that she was generally pleased with the staff's largely factual analysis. The concise and informative supplementary material on Fund relations with selected members was particularly helpful.

In assessing the effects of prolonged use on the role of the Fund, Ms. Bush continued, the focus should be forward looking; there was no need to become enmeshed in a debate on the appropriateness of past policies. However, the dangers for the Fund of failing to address the problem of prolonged use should be understood. For instance, prolonged use threatened to undermine both the monetary character of the Fund and the revolving nature of its resources, and it was not consistent with the basic purpose of Fund financing, namely, to assist members with temporary balance of payments difficulties. It could, moreover, weaken the Fund's financial integrity by reducing creditors' confidence in the liquidity of their claims on the Fund and thereby increase the Fund's need for frequent injections of resources. Furthermore, the failure of prolonged users to make needed adjustments tended to reduce the value of the Fund's "seal of approval," thereby limiting its ability to serve as a catalyst for private and official financing. Prolonged use also gave the mistaken perception that the Fund was a mechanism for resource transfers. The combined impact of those effects could reduce the Fund's ability to continue to play its central role in the international monetary system.

She agreed with the staff that four or more programs over a decade and/or current outstanding liabilities of 100 percent or more of quota were acceptable signs of prolonged use, Ms. Bush said, but the Fund should not be tied too tightly to that definition. In passing, she noted that it would be useful to examine the frequent use of the special facilities.

Estimates of the prolonged use of Fund resources based in part on the experience of the late 1960s could be on the low side if the use of resources in relation to quota was greater at present than it had been on average in the 1960s, Ms. Bush remarked. In assessing the extent of the problem of prolonged use, it was important to note that, in the absence of policy changes, the number of prolonged users of Fund resources might well increase considerably during the coming several years.

The large number of prolonged users was due to several factors, particularly the shortcomings in policies implemented by members and the impact of the Fund's basic lending strategy, Ms. Bush went on. She fully recognized that many member countries had faced the need for economic adjustments that were financially and sometimes politically difficult to make, and that adverse external developments had considerably increased the difficulty. However, as the staff had indicated on a number of occasions, experience showed that members that implemented effective economic adjustment programs were better able to restore their external positions while achieving higher levels of growth and development than countries that did not adjust.

Solving the problem of prolonged use would require better policy implementation by members as well as continued adjustment in the Fund's own lending policies, Ms. Bush considered. The rapid expansion of access to Fund resources, the lengthening of adjustment and repayment periods, and the increased focus on longer-term lending, had fostered the perception that the Fund was a source of regular financing, rather than temporary financing. Indeed, an underlying, troubling theme of the staff paper was that, in virtually all cases of prolonged use, the provision of net financing by the Fund had been appropriate and desirable.

It was important to recognize that prolonged use had been made possible by the previous access policy, Ms. Bush commented. In the future, it would be difficult to establish precise ex ante limits on the use of Fund resources that would be both restrictive enough to deal effectively with the problem of prolonged use, and flexible enough to allow the Fund sufficient leeway to handle special cases. Flexible limits would have to be applied with great care in order to ensure evenhanded treatment of member countries.

The Fund already had a mechanism--namely, access limits--for dealing with the problem of prolonged use, Ms. Bush continued. Reducing the cumulative access limits might be a better way of solving the problem than adopting new guidelines specifically for cases of prolonged use. Lower cumulative access limits could go a long way toward preventing prolonged use and could help to keep a country's use of a large amount of Fund resources from aggravating its overall debt servicing difficulties. Potential borrowers with serious debt problems would need to weigh carefully the advisability of accumulating further short-term financial obligations to the Fund. Repurchase obligations to the Fund already constituted a substantial share of the total debt service of a few countries; the staff could usefully provide data showing where such high concentrations existed.

There was a wide variety of cases of prolonged use, Ms. Bush remarked, as the staff had shown. In the final analysis, however, the prospect for successful adjustment in a reasonable period was the best way of distinguishing member countries that deserved further lending from those that did not. One extreme solution to the problem of prolonged use would be to give countries with a good performance record a kind of seal of approval that would, however, not commit Fund resources; a country's performance could be part of the Fund's expanded surveillance role and would no longer be expressed solely through the provision of financing. At the other extreme, the Fund might have to accept that some member countries had fundamental economic problems that were not amenable to solution under Fund-supported programs. The Fund was not a development institution and did not have either the mandate or the resources to address economic problems that were essentially developmental in nature. Closer cooperation between the Fund and the World Bank seemed the most appropriate way to deal with such problems.

The most difficult cases to judge, Ms. Bush went on, were probably those in the middle of the two extremes she had described, namely, countries for which continued Fund financing might be justified for fairly brief periods, even though the member's record of adjustment was only fair. The Fund should not necessarily provide financing for a member country that was unlikely to implement measures needed to solve its payments problems, even if the country experienced a net outflow of capital as a result of the Fund's decision.

She agreed with the staff, Ms. Bush said, that a review of past performance covering a relatively long period would help in the assessment of a request for a new stand-by or extended arrangement. In addition, there was a need to examine program design and the effectiveness of techniques for ensuring and monitoring the implementation of adjustment programs. A proposed program should be judged mainly on its prospects both for achieving effective adjustment and for ensuring timely repayment to the Fund. And once a member country had restored its creditworthiness, Fund financing of that country should be promptly phased out. The staff should provide a detailed description of member countries' performance under previous programs similar to the analysis in EBS/84/104 and including the extent of past use of Fund resources, the causes of it, and the prospects for reducing the volume of outstanding credit over the medium term.

Greater use could be made on an ad hoc basis of prior actions, review clauses, back-loading of purchases, comprehensive performance criteria, informal targets, end-year performance criteria, and contingency financing plans and policy packages, Ms. Bush considered. Reduced access limits could automatically exercise considerable restraint on the prolonged use of Fund resources.

She did not wish to explore in detail at the present meeting the issue of collaboration between the Fund and the World Bank, though it was clearly relevant to the issue of prolonged use of Fund resources, Ms. Bush said. The two institutions already collaborated effectively in many areas, but she agreed with the staff that there was room for improvement, including perhaps some revision of established procedures.

Prolonged use had important implications for the Fund's financial well-being, but there was no need at present to establish additional specific quantitative guidelines, Ms. Bush concluded. Revising the cumulative access limits might be the most appropriate way of dealing with the problem, and the matter should be addressed during the coming general discussion on access policy. Finally, she agreed with previous speakers that the Fund must continue to evaluate the adequacy and design of programs.

Mr. Finaish said that everyone would surely agree on the importance of using Fund resources to achieve desired balance of payments results within a reasonable period, thereby preserving the revolving character of those resources. The staff papers gave Executive Directors an opportunity to examine the reasons why some member countries had been unable to make adequate adjustments despite their relatively long use of Fund resources, and the implications of that situation for the Fund's policies on the use of its resources.

The historical evidence presented in the papers seemed to show that, when the increase in membership and the introduction of multiyear arrangements were taken into account, there had been no sharp changes in the trend in the use of Fund resources since 1960, Mr. Finaish remarked. Both the number of Fund programs and the more relevant measure for studying prolonged use, namely, the number of consecutive programs, indicated substantial fluctuations without a clear trend, and a more intensive use of Fund resources during periods of global economic difficulties, such as the previous three years. In passing, he noted that the usefulness of the number of consecutive programs as an index of prolonged use would have been increased if the distinction had been made between completed programs, and programs that had had to be terminated well in advance of their scheduled completion.

The expectation of a sharp increase in the coming several years in the incidence of prolonged use was supported in the paper mainly by reference to the length of continuous periods of outstanding liabilities to the Fund in the credit tranches, Mr. Finaish noted. The number of member countries with continuous periods of liability exceeding five years in the credit tranches was expected to increase sharply in the coming several years. However, that forecast was hardly surprising, given the difficult world economic situation of recent years, the scope and nature of the adjustment efforts required in a large number of member countries, and the use of extended or successive stand-by arrangements to support those efforts. In any event, since any member country that had had either an extended arrangement, two more or less successive stand-by arrangements, or conceivably even a single stand-by arrangement involving the use of enlarged access, could have continuous liabilities to the Fund in the credit tranches for more than five years, it was difficult to see how that particular measure could serve as an adequate indicator of the problem of prolonged use.

A more informative quantitative measure of prolonged use was the number of consecutive programs together with an indication of the magnitude of outstanding use of resources relative to quota, Mr. Finaish continued. However, the standard that the staff had suggested, namely, the use of four or more programs over a decade, together with current outstanding liabilities exceeding 100 percent of quota, could be too restrictive in many cases. Moreover, it was important to remember that, however measured, the extent of past use of Fund resources was only one of several factors determining further access, the other important ones being a country's record of adjustment, and the outlook for its adjustment effort.

Although there was not an alarming upward trend in prolonged use of Fund resources, examining it was an important way of gaining a greater understanding of the adjustment process, Mr. Finaish commented. In itself, continuous use of Fund resources was not a cause for serious concern when it was accompanied by substantial adjustment efforts and when the speed of adjustment maintained was broadly appropriate, given the particular circumstances in a member country. Prolonged use was a problem when a member country failed to make commensurate progress in implementing needed adjustment measures. The staff had shown that adverse exogenous developments, inadequate policy implementation, relaxation of adjustment measures in the period after the completion of a program, and weak program design had all contributed in varying degrees to insufficient adjustment by individual member countries. The importance of adequate policy implementation for the success of an adjustment program was obvious. In the interest of brevity, he would focus his further remarks on the discussion in the staff paper on the implications of the experience with prolonged use for program formulation.

Inadequate program design could result both from underestimating the extent of the needed adjustment and from misreading the kind of adjustment required, Mr. Finaish remarked. That distinction was significant, as it had a bearing on the formulation of policies subsequent to the discovery that inadequate program design had caused difficulties. The staff statement on page 13 that "in general, shortfalls in adjustment indicate that the policies need to be strengthened," should be interpreted broadly. The appropriate response to adjustment shortfalls would not always include a larger dose of the same kind of measures provided for under previous programs; in some instances, the solution might also involve trying a different, broader composition of policy.

In discussing member countries that had failed to make full adjustment despite having made prolonged use of Fund resources, the staff had appropriately stressed the role of inadequate structural adjustment, Mr. Finaish continued. Such adjustment sometimes resulted from less than full implementation of a program, but in other instances the program itself had either underestimated or defined too narrowly the structural aspects of the needed adjustment, thereby encouraging the government to place excessive reliance on demand restriction. The staff had noted that "the complexity of the problem or the difficulty of altering underlying relationships to improve production was often underestimated" and that "supply responses were frequently less than hoped for." As a result, the deficiency of the structural component of the program had undermined the program's capacity to achieve lasting adjustment.

The experience of recent years underscored the importance of structural factors underlying payments problems, and of the measures to address them, in achieving sustainable and durable improvements in a country's payments position, Mr. Finaish went on. The design of Fund-supported programs should therefore pay adequate attention to such factors. The existence of structural problems had a bearing on both the composition of adjustment policies and the timing of successful program implementation; structural adjustment, particularly to solve deep-rooted problems, took longer to introduce and to bear fruit than other adjustment policies. In passing, he noted that the points he had made reaffirmed the case for the extended Fund facility and were an argument against the Fund's recent reluctance to recommend its use by members.

The prospects of sustainable balance of payments adjustment were enhanced, and those of prolonged use were diminished, when improvements in a country's external position were combined with the maintenance of adequate economic growth, Mr. Finaish commented. A rapid turnaround in a country's payments position due mainly to a sharp compression of imports and a slowing of economic growth did not represent a sustainable or viable position. Such a position could be maintained only at the cost of depressed import levels and low growth rates; the adjustment would doubtless be quick, but austerity alone might not be sufficient to achieve lasting adjustment. The prospects for more durable adjustment increased when adjustment was based on export promotion, thereby focusing attention on required domestic structural adjustments--to be implemented over an appropriate period and with adequate financial support--and on a favorable external environment for exports. The more harmonious relationship between external adjustment and domestic economic performance resulting from such a strategy could serve to enhance the effectiveness of the use of Fund resources by inducing member countries to approach the Fund at an early stage of their payments problems and by strengthening countries' commitment to their Fund-supported programs.

As in other matters where the diversity of individual country characteristics and circumstances were likely to be important, both in assessing past performance and in determining appropriate action for the future, the guidelines to deal with cases of prolonged use should have sufficient flexibility to permit all the relevant aspects of individual cases to be taken adequately into account, Mr. Finaish remarked. That general conclusion should be kept in mind in assessing the various recommendations in paragraphs 3-6 of Section VI.

The approaches suggested in paragraph 3 appeared too rigid and mechanistic, Mr. Finaish considered. Rigid quantitative rules should be avoided when qualitative considerations were likely to be more important in reaching sound conclusions. In any event, efforts to improve the effectiveness of Fund resources should take precedence over proposals that would restrict members' access to them.

The criteria used to determine access in normal situations could also be used to determine the access for member countries that had had successive Fund-supported programs, as they broadly covered all the relevant factors, Mr. Finaish continued. Those criteria included the expected speed of payments adjustment, the extent of balance of payments need, the strength of the adjustment effort envisaged under the proposed program, the extent of past use of Fund resources, and the adjustment record. An appropriate and flexible application of those criteria would permit the determination of access in different types of cases, including those involving previous use of Fund resources. Accordingly, a member that had made previous use of Fund resources could still be given access to a large amount of Fund resources if its new program contained adjustment measures that were sufficiently strong to lead the Fund to expect that balance of payments viability would be achieved within a reasonable period. The level of access would be lower for a country whose new adjustment program was considered weaker, or if balance of payments viability was expected to be attained over a longer period; the precise access in such cases would depend on the particular circumstances of the country. In both sets of cases, the extent of past use of Fund resources and the record of adjustment would of course be taken into account. The criteria for determining access should be applied flexibly and in an evenhanded fashion, on the basis of the particular circumstances in individual countries. In passing, he noted that concern had been expressed in the recent past that the criteria had been applied in a way that restricted access. Staff papers on new Fund-supported programs should clearly explain how the proposed level of access had been determined.

The suggestion for reviewing a country's performance over longer periods as a part of the consideration of requests for new programs was helpful, Mr. Finaish said. Prior or early actions, periodic reviews, and phasing were of course useful techniques for ensuring and monitoring program implementation, and should be used appropriately and in relation to the nature of the case in question.

The suggestion for an early approach to the World Bank for its assessment of certain structural aspects of a proposed Fund-supported program was useful, Mr. Finaish remarked. There was also a need for a more systematic treatment of individual programs where structural elements were important, in respect of both the extent of World Bank involvement in the important structural issues and the reporting of World Bank views in staff reports on proposed programs, than the paper indicated to be the case at present. However, in drawing upon the expertise of the Bank on the relevant structural matters, issues concerning cross-conditionality could arise and ought to be carefully examined.

Mr. Schneider commented that the frequency and continuity of use of Fund resources in recent years was not out of line with earlier experience. That conclusion was valid even in the light of the trends in the number of consecutive programs, the number of members with outstanding liabilities for five or more consecutive years, and Fund resource use in relation to world imports. Also, that conclusion suggested that the need for the enlarged access policy was a reflection of the inadequacy of the Fund's resources and, contrary to an often-expressed opinion, not of exceptional financial intervention by the Fund. In fact, total use of Fund resources as a percentage of world imports had been lower in 1982 (1.09 percent) than in 1977 (1.22 percent) and 1969 (1.5 percent), the previous years of peak use of Fund resources.

The impression that the enlarged access policy represented exceptional financial intervention by the Fund had been created because access was expressed as rather high percentages of quota, and quotas had lagged in relation to all relevant variables, even after the most recent quota increase, Mr. Schneider continued. The reliance on borrowing to finance the enlarged access had reinforced the impression that Fund financing under that policy was exceptional, but the figures showed that resource availability in recent years had been unexceptional. Because the considerable strengthening of Fund conditionality in recent years had not been accompanied by an increase in Fund resources, it had had a deflationary impact on member countries with Fund-supported programs.

There was one development concerning prolonged use that was different from past experience: upper tranche liabilities were outstanding for longer periods; and the use of Fund resources over consecutive years was expected to continue for some time, Mr. Schneider commented. That development had fostered the notion that the counterpart of the outstanding liabilities, namely, reserve positions in the Fund, were less liquid than in the past.

The question had been raised whether consecutive use of Fund resources was inconsistent with the revolving character of those resources, Mr. Schneider continued. The implication was that resources tied to specific adjustment efforts should become available, within a relatively small number of years, for use in support of new adjustment efforts. The revolving character of the Fund's resources was meant to ensure that resources would always be available to finance adjustment efforts in deficit countries under conditions in which the distribution of surpluses and deficits changed over time. In his view, however, the revolving nature was ensured by the repurchase provisions, including those for early repurchase. As the distribution of deficits and surpluses among member countries had remained broadly unchanged, it was not surprising that the liabilities of member countries had been outstanding for long periods; deficit countries had repeatedly resorted to Fund resources in response to the emergence of new adjustment problems, and he did not agree that prolonged use of those resources would in itself undermine their revolving character.

It was useful to make a distinction between proper and improper prolonged use of Fund resources, Mr. Schneider considered. The main issue at hand, whether or not a country's prolonged adjustment efforts were likely to enable it to achieve a viable balance of payments position, was related more to the quality and implementation of adjustment programs than to the amount of access. Prolonged use was a cause for concern only if a member country did not have a reasonable prospect of improving its balance of payments, something that was likely to result from inadequate program design, incomplete implementation, and ineffective monitoring of implementation. Countries that had made prolonged use of Fund resources but did not seem able to restore a viable balance of payments had probably concentrated excessively on demand management, had been bound to see their programs fail when external circumstances deteriorated, and had sometimes discontinued their demand management policies when a program lapsed. The same outcome was likely if insufficient attention had been paid to the need for structural improvements to create conditions for better economic management even in the period after the termination of a program. Hence, in future, the Fund might have to give greater attention to supporting both structural reform, by linking its technical assistance more closely to efforts to monitor program implementation, and the institution building needed to ensure continued adequate economic management. That effort would, of course, require closer collaboration than hitherto with the World Bank.

At all times, Mr. Schneider added, the Fund's role was to promote adjustment and to assure creditors that countries facing balance of payments difficulties were pursuing appropriate adjustment policies. Accordingly, the Fund's financial assistance should be tailored mainly to the specific present and prospective financing needs of member countries. The applicability of the Fund's catalytic role should not be a guideline for determining access; that role was not clear cut and its use was bound to create confusion. In playing that role, the Fund had granted a wide range of access, from the maximum limit to less than 50 percent of the limit. Recent discussions had clearly shown that the catalytic role of the Fund was controversial. His chair had stated that it could not accept the idea that annual access should be no more than 50 percent of quota in cases in which the Fund played a catalytic role. Nor could he accept the proposal under which the Fund would reduce its financing to countries that were likely to make continued use of its resources, thereby placing the financing burden on other creditors.

The tendency of the staff to support mechanical links between the guidelines on the use of Fund resources and specific access limits was a cause for concern, Mr. Schneider stated. Balance of payments need should be the overriding factor in the determination of access. He could not accept a policy under which the Fund's financial intervention on behalf of a country would be tailored in the light of the country's impact on the international monetary system. Hence, he did not favor adopting strict rules to limit either the number of programs for individual countries or the length of period of outstanding liabilities to the Fund. The present limit on cumulative use of conditional Fund resources was sufficient to ensure their prudent use. The introduction of a rule requiring net repurchases after a certain period would not be helpful.

The best way of dealing with the problem of prolonged use was to examine program design and methods of monitoring program implementation, Mr. Schneider concluded. It might be useful for the Fund to have the equivalent of the World Bank's Operations Evaluations Department to review experience over an extended period with a view to improving program design and implementation, and to reducing improper prolonged use of Fund resources.

It was not clear to him, Mr. Schneider said, which criteria had been used to select the five countries assessed in EBS/84/104. A number of other countries had used the Fund's resources extensively and over a prolonged period. Korea could have been cited as a positive example of prolonged use. The Fund should be careful in referring to individual countries as illustrations of specific problems; repeated mention of the same country could give mistaken impressions.

Mr. Lovato considered that the Fund's role in providing medium- and long-term balance of payments financing was important and an entirely appropriate subject for examination by the Executive Board. The limited amount of available resources and the requirements of the Articles compelled the Fund to stress the revolving character of those resources and to avoid their prolonged use unless it was accompanied by progress toward a viable balance of payments position within a reasonable period.

He generally agreed with the summary of the staff's conclusions on pages 16 and 17 of SM/84/91, Mr. Lovato continued. There was no need to introduce fixed rules limiting the Fund's lending to countries that had made prolonged use of its resources. Such rules would not enable the Fund to take into account either the strength of a country's past adjustment efforts or the quality of its cooperation with the Fund. The Fund should maintain a flexible approach, evaluating the appropriateness of prolonged use on a case-by-case basis. At the same time, the principle of equal treatment of member countries had to be maintained, and the fact that the prolonged use of resources by some countries did not seriously affect the Fund's liquidity position in the short run did not reduce the need to examine the issue carefully.

The Fund's role in helping member countries face particularly serious payments problems and requiring sustained assistance should be essentially to facilitate the provision of resources from private capital markets, bilateral sources, and multilateral official institutions, Mr. Lovato considered. To that end, the recent agreement encouraging the Fund to play a more direct role in mobilizing financial assistance through its participation in donors' meetings and by providing technical advice was welcome.

Although the Fund had had considerable success in providing medium- and long-term balance of payments assistance to developing countries, the need for such assistance and the adequacy of present flows should be examined in greater detail, Mr. Lovato said. Fund lending was supposed to be limited to countries where external adjustment was expected to be completed in a relatively short period. However, it was useful to broaden the Fund's analytical perspective by further studying the relation between balance of payments adjustment and the process of solving structural problems over a relatively long period. Developing appropriate relationships between World Bank operations, various sources of balance of payments assistance--including the Fund--and the conditionality on medium- and long-term financing was indispensable.

He agreed with the staff suggestions on pages 14 and 16 concerning collaboration between the Fund and the World Bank, Mr. Lovato concluded. In particular, the World Bank was in an especially good position to assess promptly development priorities and public investment policies, and its assessment was often valuable in the Fund's analysis of proposed adjustment programs. Although the World Bank and the Fund were autonomous, their decisions and actions should be mutually complementary.

Mr. de Maulde recalled that during December 1983 the Executive Board had established policies governing access for 1984. The attempt to modify the decisions adopted subsequently at EBM/84/3 (1/9/84) through the proposals in SM/84/91 was most regrettable. The staff had usefully brought the problem of prolonged use of Fund resources to the attention of the Executive Board, but the proper time to discuss possible changes in those policies would be after the next meeting of the Interim Committee, and not before.

He agreed with Mr. Kafka and Mr. Polak that the prolonged use of Fund resources was not a cause for serious concern at present, Mr. de Maulde continued. The share of continuous upper credit tranche programs in total upper tranche programs had declined over the years, even though, as Mr. Polak had noted, the use of Fund resources in recent years had been limited to developing countries and the world economic situation had been very difficult. Given those circumstances, the good payment record was admirable and strongly suggested that Fund policies on the use of its resources were tight rather than loose.

The revolving character of the Fund's resources and thus the liquidity of claims of creditor countries were quite different issues from the prolonged use of resources, Mr. de Maulde considered. The differences were reflected in the Fund's treatment of Turkey in recent years. If the Fund had decided two or three years previously to cease providing financial support to Turkey, the liquidity of creditor countries' claims would have been greatly reduced. Linking proposals to preserve the revolving character of the Fund's resources with suggestions for shortening the period of access for member countries was not helpful. It was useful to bear in mind that one of the factors behind the recent decision raising the rate of remuneration was that members with creditor positions in the Fund had made resources available for longer periods than in the past.

In analyzing the reasons for prolonged use, Mr. de Maulde said, the staff had given excessive weight to members' lack of policy implementation *and had not paid enough attention to the problems caused by deterioration* in the overall economic environment, including increased interest rates, growing debt service burdens, rising import prices, and impediments to increasing the volume of exports, particularly of primary products. More stress could also have been placed on the need to make structural changes in parallel with short-term macroeconomic adjustments. Because of those shortcomings, the Fund, through the programs it supported in member countries, had in effect been building castles in the sand; financial flows from banks and capital markets to most developing countries had dried up, and the volume of lending from other international sources had been reduced. Moreover, there had obviously been a lack of coordination between adjustment and development programs. The staff should have taken those developments into account in assessing the causes of prolonged use.

The staff suggestions for categorizing countries on the basis of prolonged use, and for establishing different access guidelines for each category were inconsistent with the September 1983 recommendations of the Interim Committee, Mr. de Maulde remarked. The Committee had concluded that the amount of access in individual cases should vary with the circumstances of the member country and should be determined in effect on a case-by-case basis. Accordingly, access for a member country with temporary balance of payments problems should be based on the strength of its adjustment effort and could conceivably reach 125 percent of quota.

Moreover, Mr. de Maulde went on, the Fund should not automatically rule out the possibility of providing assistance to countries facing medium- or longterm payments problems due to structural imbalances. Many such countries often had no other source of financing or were not likely to be able to improve their balance of payments position in the immediate future. Such cases usually could best be handled through the adoption of an extended arrangement, rather than a one-year stand-by arrangement, and the amount of access should depend on the strength of the adjustment effort, the size of the balance of payments need, the amount of outstanding debt, and the extent of the Fund's prior involvement in the country. At the same time, the Fund should work more closely than hitherto with the World Bank on formulating medium-term scenarios for adjustment and development in countries facing structural problems. In that connection, continued involvement by the Fund could be supplemented by an increase in both technical assistance and traditional World Bank lending. Moreover, innovative schemes could be used to progressively replace financial support by the Fund with World Bank financing. Any shortening of the period of involvement by the Fund should be offset by an increase in lending by the World Bank and IDA.

The Fund should make every effort to act consistently and responsibly, Mr. de Maulde stated. It seemed inconsistent and irresponsible both to oppose further allocations of SDRs and to reduce official development assistance.

In assessing the issue of prolonged use, it was important to bear in mind the principle of equal treatment of members, Mr. de Maulde considered. It was inappropriate to accept prolonged use by some countries because their problems jeopardized the well-being of the whole financial system, and to refuse prolonged use for other member countries despite their adjustment efforts. The principle of equal treatment assumed particular importance in the light of the attitudes of some countries toward increasing the resources of the World Bank and IDA.

He fully agreed that there was a need to monitor the length of the involvement of the Fund in individual member countries, Mr. de Maulde concluded. However, there should be no rules automatically reducing access on that basis; such rules would certainly be counterproductive.

Mr. Wicks said, first, that a fundamental principle, stated in Article I(v), was that the resources of the Fund as a monetary institution must be revolving. In the past, that principle had been applied flexibly, and correctly so, but the Fund was not in the business of providing long-term development or balance of payments financing. Ignoring the principle of the temporary use of the Fund's resources would ultimately jeopardize the financial integrity of the institution and undermine its ability to help member countries. If there was a general disposition radically to alter the monetary nature of the Fund, the Governors should amend the Articles.

Second, the world economic environment was not as supportive of rapid adjustment as it had been 20 years previously, Mr. Wicks continued. Accordingly, it might take longer for the Fund's resources to revolve in the coming period than in the past. Nevertheless, they must continue to be revolving; Article I could be interpreted flexibly, but it must not be distorted out of all recognition. His own calculations supported the staff view that prolonged use was likely to increase sharply in the coming several years, a conclusion that could not be viewed with equanimity. The present discussion was therefore timely and should provide guidelines for the future conduct of the Fund.

Third, it was important to recognize that the Fund could not be expected to solve all the world's financial and economic problems, Mr. Wicks commented. Although the Fund could help, in the final analysis countries themselves would have to solve their own economic problems. If a member country was unwilling to take the difficult decisions needed to solve its problems, the Fund would have to draw its own conclusions; permitting the Fund's resources to be used in a country where the conditions for successful adjustment did not exist would in the long run do the member concerned no service, would be unfair to countries that were prepared to make hard decisions, and would compromise the effectiveness of the Fund.

Fourth, Mr. Wicks continued, neither management, staff, nor the Executive Board was infallible, and economic stabilization was not an exact science. The social and political constraints on economic policy implementation were often considerable, and reasonable persons could differ about the merits of any particular economic stabilization measure. In that connection, the Fund had appropriately been ready to look sympathetically at the views of a member country, particularly one with a good record of cooperation with the Fund and with an adjustment program that was currently in its initial stage of implementation. But it was also reasonable for the Fund to take into account its experience in support of a member country's program or series of programs; if previous programs had shown little success, there had to be an increasing onus on the member to demonstrate, especially through prior actions, that a new program offered the necessary prospect of success.

Given those four general considerations, Mr. Wicks said, the issue of prolonged use of Fund resources should be tackled on three fronts. First, the demand for prolonged use could be limited by improving the design and implementation of programs. Second, the Fund could re-examine its access policies, and particularly the possible need for constraint on continuous access. Third, since the nature of the adjustment measures required by many member countries fell partly within the province of the World Bank, the Fund should take another look at its collaboration with that institution.

The staff had indicated that there were essentially three reasons why Fund-supported programs were thrown off track, namely, exogenous shocks, failure of program design, and inadequate program implementation, Mr. Wicks noted. The question at hand was what could be done in advance to minimize those risks.

It was clear that nothing specific could be done in advance to avoid exogenous shocks, Mr. Wicks went on, but a program that did not initially make some allowance for such shocks was more likely to fail. In addition, sensitivity analysis could help management and the Executive Board to assess the viability of a program while encouraging the authorities to consider the possible dangers the program might encounter and make appropriate contingency plans.

Failures of program design were bound to occur occasionally; after all, the staff was not infallible, Mr. Wicks remarked. As a general rule, however, it seemed safe to assume that adequate analysis of past failures reduced the likelihood of repeating them. The Executive Board's proposed work program included opportunities to examine the design of arrangements with the Fund, and he particularly looked forward to its review of upper credit tranche arrangements and of the problem of what he would call "nominal observance" of performance criteria.

If the staff was uncertain about its predictions of the behavior of key aspects of a country's economy, the relevant program should have sufficient built-in tolerance to withstand the possibility that the nature and size of the economic effects of adjustment might differ from those originally projected, Mr. Wicks continued. Just as scenarios were constructed on the basis of a range of assumptions about external factors, so should program areas dependent on uncertain macroeconomic relationships be fully examined in staff reports. Furthermore, the existence of uncertainty about important aspects of an economy should call for relatively frequent monitoring of program performance, especially if a prior program had broken down for reasons that were only imperfectly understood.

He welcomed the staff's frank admission that there had been some unsatisfactory compromises in program design in the past, Mr. Wicks remarked. The staff had stated on page 9 that "the Fund's support [in these cases] was based on the premise that, under the circumstances, international collaboration with the member was justified even though the prospects for a rapid transition to stable conditions were uncertain." While that statement reflected real and difficult problems, it was nonetheless worrying. He fully agreed that every effort should be made to encourage a country in need of adjustment to approach the Fund, but the Fund should not support a program that was clearly unviable.

To minimize the risk of program breakdown because of inadequate implementation, Mr. Wicks said, the Fund should aim for arrangements that committed a member country to measurable targets, thereby enabling the staff to monitor precisely a country's progress under a program. Both the performance criteria and the intentions of the authorities must be as specific as possible. He looked forward to discussing those matters in the Board in greater detail later in 1984. He supported the staff's suggestions on page 13 and the top of page 14 as interim measures prior to the next full-scale review of conditionality, when the Executive Board would have the benefit of a longer period of experience than usual. The suggestions for looking at longer periods of past performance when considering a request for a new program and for clearly specifying at the outset the various areas in which additional measures might be needed in the event of shortfalls relative to targets were acceptable. In addition, program monitoring should be strengthened through prior actions, review clauses, and the phasing of, and conditions for, purchases, and end-year ceilings under multiyear arrangements should be used as performance criteria. Without anticipating the outcome of the scheduled discussion on the relation between performance criteria and drawings, he suggested that, broadly speaking, drawings should be phased in line with the extent of the adjustment that a member was undertaking. For instance, if important prior actions had been taken, some degree of front-loading might be warranted. Similarly, it might be unwise to provide for front-loading if uncertainties about program implementation existed. The incentive effects of a degree of back-loading could be powerful.

Commenting on access policy, Mr. Wicks said that he fully supported the staff's effort in paragraph 4 on page 16 to distinguish between different borrowers according to the likelihood that they would be able to adjust within a reasonable period. That approach was consistent with the Executive Directors' discussion on enlarged access in December 1983. For the time being, it was unnecessary to devise strict rules limiting either the number of programs permitted a country, or the period of a member's outstanding liability to the Fund. He recognized that a fixed period for access would give a member country an incentive to stick to its adjustment program, but no two borrowers were alike either in their current economic conditions or in the prospects for their economy. Strict rules would not allow for unforeseen events and could undermine the confidence of other creditors if they led to the sudden termination of a country's financial relationship with the Fund.

There was no reason to press for the adoption of rigid rules at present, Mr. Wicks went on, but that conclusion might warrant reconsideration if unjustified prolonged access were to continue, and there was merit in the alternative approach--mentioned by the staff in paragraph 3 on page 16--of adopting a norm requiring net repurchases after a certain period unless there was a persuasive reason justifying a departure. Under that approach, there would be a presumption--and no more than that--that net repurchases would be made after a certain period, and the staff would be able to ask the Executive Board to approve exceptions. That approach would have the advantage of alerting the Board to instances of prolonged use, and the Board would, of course, be flexible in deciding whether or not an exception was warranted. The new approach would represent a refinement of present access policies, rather than a departure from them. Requiring net repurchases would enable a number of countries to continue to benefit from the sponsorship of the Fund--in the form of its "seal of approval"--permit the Fund's resources to revolve, and protect the Fund from becoming a residual source of financing and from offering its support merely in effect to prolong an unsatisfactory relationship. Such an approach was not intended to alter in any way the December 1983 agreement on the access policy for 1984.

In his comments on collaboration between the Fund and the World Bank, Mr. Wicks remarked, Mr. Finaish had usefully drawn attention to the staff conclusion that the failure of programs and the occurrence of prolonged use of resources had sometimes been due to inadequate supply responses. The staff had referred in particular to the limited transport infrastructure of some countries, constraints on expanding land under cultivation and raising yields, and the low productivity of public sector investments. Some member countries had had to focus their adjustment efforts on remedial action to deal with such problems while making the traditional effort in demand management. The main source of expertise in handling supply-side problems was the World Bank, and he agreed with the staff that a new relationship between the Fund and the World Bank was needed. In particular, Fund papers on the use of its resources should include detailed World Bank assessments; more frequent assessment by the Fund's Executive Board of the adequacy of member countries' structural policies would also be helpful. He recognized that there could be problems if the World Bank's assessment of a new Fund-supported program were not immediately available, but that probably showed the need for greater awareness by the World Bank of macroeconomic issues, and he agreed with the staff that sufficient advance warning of an impending Fund-supported program would enable the World Bank to provide a timely assessment.

A number of years had passed since the previous review of the collaboration between the Fund and the World Bank, Mr. Wicks remarked. The present discussion would provide a good background for a fresh examination of the issue that could facilitate the early introduction of improvements in working practices between the two institutions.

Prolonged use of Fund resources was indeed a cause for concern, Mr. Wicks concluded, not only because of the need to adhere to the Articles, but also for a practical reason, namely, the need for a reasonable match between the character of the Fund's assets and liabilities. Member countries that financed the Fund's lending by accumulating substantial reserve tranche positions saw their claims on the Fund as liquid resources they were entitled to use at short notice and entirely at their own discretion. Permitting the assets of the Fund to become locked up in a way that held out no reasonable prospect of repayment except over a very long period was simply imprudent financial management, and permitting such a situation to persist would place at risk the Fund's main source of finance. The design and implementation of effective adjustment programs that achieved objectives within a reasonable period was the principal means of ensuring that the Fund's resources remained revolving. An effective adjustment program involved a joint commitment by the Fund and the prospective borrower: the Fund must use its technical expertise to identify and monitor appropriate policy measures; and the borrower must bring a firm political commitment to the implementation of those measures. If management and staff were not satisfied that the conditions for adjustment by a member country existed, a program for that country should not be presented to the Executive Board.

Another important conclusion, Mr. Wicks said, was that effective program design and implementation might not in themselves be sufficient to ensure that the Fund's resources would revolve. External factors could disrupt a program, or the process of adjustment might take appreciably longer than had originally been expected. The Fund already had precise limits on the aggregate amount of its lending to a member country, but there was no corresponding restraint on the period of its involvement in a country. There was no need for rigid rules in that area, but it would be useful to have informal guidelines indicating when the duration of the Fund's involvement in a country was becoming excessive. Drafting such guidelines would be a challenge, but they should be formulated, and Mr. Polak had already made useful comments on their possible shape.

It was important to remember that the Fund was only a part--although a centrally important one--of the international financing picture, Mr. Wicks stated. It should not be assumed that the Fund was solely, or even mainly, responsible for dealing with all problems concerning economic imbalances. The World Bank had a role to play in dealing with countries whose difficulties were due mainly to fundamental weaknesses in their supply structure. The Bretton Woods institutions together had a vital role to play in helping member countries to deal with their payments problems, but there was an important issue of the appropriate balance of their involvement in each case; he doubted whether the Executive Board should try to reach any conclusion on that matter at the present stage, but it should certainly figure prominently in future discussions.

Mr. Tvedt agreed with Mr. Kafka that the prolonged use of Fund resources was not an important problem in quantitative terms at present. Given the increasingly structural nature of member countries' balance of payments problems, the widespread use of multiyear arrangements, and the difficulty of predicting international economic developments, the prolonged use of the Fund's resources in recent years was not surprising. However, the staff conclusion that the incidence of prolonged use was likely to increase in the coming several years was troubling, and a more detailed analysis of that prospect would have been helpful.

Against that background, Mr. Tvedt continued, the cautious tightening of the Fund's lending practices on a selective basis suggested in SM/84/91 seemed reasonable. However, the problem of prolonged use of resources could be solved only by strengthening the surveillance and monitoring procedures to ensure that programs were implemented as planned. To that end, the Fund should frequently review its projections, taking into account all relevant factors, including possible constraints on a member country, to ensure to the extent possible that programs were based on realistic assumptions. On previous occasions his chair had suggested that the Fund should explore ways of expanding and improving its short- and medium-term projections and early warning systems with a view to detecting and discussing needed economic policy adjustments at an earlier stage than in the past. However, the statistical base for making such improvements would admittedly continue to be inadequate in the near future, and some countries would be unable to provide the needed data even in the medium and longer run. Meanwhile, the Fund could increase the number of program performance reviews and conduct them well in advance of the target date for compliance with performance criteria.

He fully agreed with the staff that end-year ceilings under multiyear arrangements should be performance criteria, so that adjustment efforts would not be relaxed toward the end of a program period, Mr. Tvedt said. However, proposals for concentrating Fund financial assistance in the latter part of a program period were not acceptable. The possibility of front-loading a program in support of early policy implementation should be maintained. Back-loading might be appropriate in some instances of prolonged use.

He fully agreed with the staff that the cooperation between the Fund and the World Bank should be intensified, Mr. Tvedt commented. The Fund and World Bank staffs could move ahead with the suggestions concerning collaboration on page 17 of SM/84/91.

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/84/92 (6/13/84) and EBM/84/93 (6/15/84).

2. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to an Executive Director, as set forth in EBAP/84/126 (6/11/84) and Correction 1 (6/12/84).

Adopted June 13, 1984

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/128 (6/12/84) is approved.

APPROVED: January 28, 1985

LEO VAN HOUTVEN
Secretary