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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/23

3:00 p.m., January 31, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. B. Diao, Temporary
	C. Taylor
J. de Groote	
B. de Maulde	A. Le Lorier
	M. Teijeiro
R. D. Erb	C. Dallara
	T. Alhaimus
A. H. Habib	Jaafar A.
T. Hirao	T. Yamashita
	M. Casey
	J. R. N. Almeida, Temporary
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	
F. Sangare	
M. A. Senior	
	L. Vidvei
	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: J. T. Boorman, R. J. Hides, S. M. Schadler. European Department: P. B. de Fontenay. Exchange and Trade Relations Department: S. J. Anjaria, E. H. Brau, M. Guitian, C. Puckahtikom. External Relations Department: A. F. Mohammed, Director; H. P. G. Handy. Fiscal Affairs Department: G. Blöndal, O. Pettersen. Middle Eastern Department: M. C. Niebling, G. Tomasson, S. von Post. Research Department: W. C. Hood, Economic Counsellor and Director; C. F. Schwartz, Associate Director and Director of Adjustment Studies; A. Crockett, Deputy Director; J. Artus, C. P. Blackwell, J. E. Blalock, J. M. Boughton, M. C. Deppler, S. J. A. Gorne, M. D. Knight, A. Lanyi, C.-Y. Lin. Secretary's Department: A. P. Bhagwat. Treasurer's Department: I. A. H. Diogo, J. R. Karlik. Western Hemisphere Department: S. T. Beza, Associate Director; J. Ferrán. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. J. Batliwalla, S. E. Conrado, J. Delgadillo, S. El-Khouri, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: H. Arias, L. Barbone, R. Bernardo, M. Camara, L. E. J. Coene, T. A. Connors, G. Ercel, I. Fridricksson, A. Halevi, M. Hull, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. K. Orleans-Lindsay, J. G. Pedersen, G. W. K. Pickering, E. Portas, J. Reddy, D. I. S. Shaw, P. S. Tjokronegoro, M. Toro, J. C. Williams, A. Yasseri, Zhang X.

1. WORLD ECONOMIC OUTLOOK - GENERAL SURVEY

The Executive Directors continued from the previous meeting (EBM/83/22, 1/31/83) their consideration of a staff paper giving a general survey of the World Economic Outlook (ID/83/1, 1/17/83). They also had before them a paper discussing trends and prospects in international capital markets and providing a survey of external debt developments (ID/83/2, 1/19/83).

Mr. Erb remarked that the discussion thus far showed significant differences of view among his colleagues with respect to how much importance should be attached to the efforts to achieve a degree of price stability in the world economy and how much emphasis should be given to reorienting policies toward economic growth. As in previous discussions on the World Economic Outlook, many speakers had suggested that the current period--including the past one or two years--was one of transition from higher and rising rates of inflation toward the sort of price stability that those speakers saw as a necessary condition for sustained and viable economic growth over time. The United States had taken a medium-term to long-term perspective in emphasizing the importance of putting in place appropriate policies and not regressing to the approach of earlier times when the fine-tuning of demand management policies had been seen as a way of smoothing out business cycles. The views of the United States were generally similar to those of Executive Directors who had strongly supported the staff's judgment that large industrial countries with lower inflation should not reverse the successful anti-inflationary policies in effect. The current situation allowed room for maneuver, but only in the sense that risks could be taken in framing anti-inflationary policy and not in the sense that policies should become more expansionary. For example, in the United States, the Federal Reserve Board was at present able to risk a temporary upward jump in monetary growth because institutional and other changes had created an upward shift in the demand for money in relation to GNP, without the fear that such a jump would be interpreted as ordinary monetary expansion.

Some held the view that the United States, especially in the short run, had some room for maneuver regarding the timing of its efforts to reduce the fiscal deficit, Mr. Erb noted. It was precisely that line of thinking that was behind the Administration's approach to proposing tax increases that would take effect with a lag and would be subject to conditions relating to economic growth. In his own view, considering both fiscal and monetary policies, it seemed that the United States had taken as many risks as it could, particularly given the strong expansion in monetary aggregates, current credit growth, and the large fiscal deficit. Some Directors, including Mr. Polak and Mr. de Maulde, had argued that an attempt to reduce the U.S. fiscal deficit sharply in the short run could have negative consequences for growth and that concern for the deficit might better be focused on later years. Indeed, he himself had made precisely that point in Executive Board discussions during the previous 18 months. However, time had passed since those arguments had been made, and the United States had begun to enter into the early stages of recovery, so that the need for more rapid fiscal adjustment was becoming imperative. An effort should be made quite soon to bring down the deficit, which had an impact on inflationary expectations, real interest rates, investment, and even the exchange rate. The existence of the fiscal deficit was indeed one reason why the dollar had been so strong and could remain so even in the face of a growing current account deficit; in effect, the rising current account deficit could represent an offsetting adjustment to the large fiscal deficit. He would also like to see some further adjustment in the exchange rate because he was concerned about the implications of current exchange rates on the structure of industry in the United States.

The Administration's forecast for growth in 1983 was 1.4 per cent, which was even more conservative than the conventional forecasts of business forecasters, Mr. Erb continued. Apparently, the Administration wanted to avoid the overoptimism of the past and had thus preferred to underestimate real economic growth. Even conventional growth rates--which were higher than 1.5 per cent--probably understated the real economic growth that could be expected during the course of 1983. His view of the forecast reflected the emphasis that he had placed on the direction of monetary policy and his interpretation of the strong monetary growth rates.

With respect to developments in other countries, Mr. Erb agreed with the staff that adjustment was needed in a number of smaller industrial countries as well as in the less developed countries, which continued to experience high rates of inflation and large current account deficits; some of them were also likely to face constraints in further external financing of those deficits. The restoration of competitiveness in such countries would require not merely lower inflation but sharp declines in the inflation rates; and, since many of their major trading partners were experiencing lower rates of inflation, a pari passu decline in inflation rates would only serve to prevent further deterioration in their relative economic positions. Hence, even if price stability was achieved in the major industrial countries--which would go some way toward exchange rate stability in those countries--the attainment of exchange rate stability in other industrial countries and developing countries would require a convergence of inflation rates toward greater price stability.

In response to the question by one Director about what constituted price stability, Mr. Erb considered that it was something quite close to a zero rate of inflation, perhaps in the range of 1-2 per cent. More important, however, was the policy approach that monetary authorities might take on the basis of their perception of price stability at whatever level of inflation. It would be unfortunate if their perception led them to justify a more stimulatory policy in order to deal with unemployment; that approach could be self-defeating in the long run and even result in a rise in inflation. Hence, what was important in determining price stability was the dedication of monetary policy toward that objective and a determination not to use the policy for countercyclical management.

Regarding more technical aspects of the World Economic Outlook papers, Mr. Erb agreed with Mr. Vidvei that it would be useful to have more analysis on a global basis of the discrepancy between the current and capital accounts. While recognizing the difficulties of gathering data, he felt that more could perhaps be done in collecting basic data from a large number of countries in order at least to reduce the statistical discrepancy. It would also be helpful if some analysis of the financing of current account deficits could be extended beyond the developing countries to include a larger number of industrial countries, especially those that had become major borrowers in the international capital markets.

On the topic of international cooperation, Mr. Erb considered that it was indeed important to encourage countries to recommit themselves to a liberal international environment for trade and payments. He supported the Fund's initiative in devoting greater attention in Article IV consultations to trade restrictions, and he hoped that the coverage would not be limited to the major trading countries. Particular attention should be paid to all countries that carried extensive trade restrictions or that had recently implemented new restrictions, whatever the relative importance of those countries in the international trading system.

In suggesting that countries should "coordinate" their policies, the staff had chosen a word that reflected what most countries would like to achieve, Mr. Erb continued. However, policy coordination was perhaps not a realistic objective; most countries, including his own, had difficulty with internal coordination of policies, and it might be unrealistic to expect them to be able to coordinate policies internationally. It would be better to recommend that countries move toward "harmonization" of policies or at least to establish policies "in concert" with others. The meetings that countries held periodically with the Managing Director on the evolution of their respective economic policies were a useful way of evaluating whether or not those policies were converging, and he hoped that such discussions would continue and evolve over time. At present, they served to point to divergencies among countries and to the implications of those divergencies for exchange rates and current account developments.

The role of the Fund vis-à-vis the commercial banks had been only touched upon in the staff papers, perhaps because it was scheduled for discussion later in the year, Mr. Erb noted. Clearly, while the Fund was playing a critical role in present circumstances, it was not so much arranging financing as spelling out to the various parties concerned--the governments of countries with balance of payments problems and the commercial and official creditors--the realities of their current situation. Such a catalytic role for the Fund was an important one and should be continued. While the Fund was in no sense in a position to impose solutions on governments or commercial banks, its powers of persuasion could certainly be effective.

With respect to Mr. Polak's concern about the widening interest rate spreads on new loans to member countries, Mr. Erb recalled that his own view had long been that the spreads were far too narrow and that some widening had been called for. Moreover, some differentiation in the spreads among countries, taking into account different risk assessments, was warranted as a way of creating more explicit financial discipline regarding the borrowing decisions of individual countries. Hence, he saw the widening of spreads to be a healthy development, although he was willing to continue to discuss the matter in the context of discussions on larger questions relating to the relationship between the Fund and the commercial banks and other institutions.

Mr. Prowse considered that the staff should be commended for standing by its objective conclusions in the face of pressure from others to take a less than objective view about the appropriate course of policy. There had long been a search--even within the Fund itself--for a simple solution to the world's economic problems; the control of the money supply had been viewed as such a solution in the recent past, and incomes policy was at present being promoted by some. The staff, in its balanced assessment, had rightly recognized that the problems were comprehensive and required comprehensive policy solutions.

He had been impressed by the remarks of both Mr. Hirao and Mr. Grosche at EBM/83/22, Mr. Prowse continued. Both speakers were well qualified to comment on macroeconomic problems, given the relative performance of their countries' economies. He also tended to agree with the staff that a relaxation of anti-inflationary policies would not be desirable in France, Italy, or Canada. That was not to say that he did not support some adjustment within the basic policy thrust of those countries, although the issue was simpler with regard to the other major economies in the industrial world where there was some room for maneuver, within the anti-inflationary framework of policy, to support the projected level of economic activity. In the United States, for example, there had been clear evidence of helpful maneuvering within the anti-inflationary framework, particularly in the area of monetary policy, although U.S. fiscal policy continued to require improvement.

The proposition that the major industrial countries should utilize what room they had for maneuver should perhaps be regarded not so much as a prescription but as a description of what had in fact been going on, Mr. Prowse said. In that respect, he could generally endorse what had been occurring, although he preferred the more specific approach outlined by Mr. Hirao, who had noted that profitability had been squeezed and that productivity had been poor in terms of per capita output of employed workers. Indeed, in some countries, productivity had been negative, although it had clearly begun to improve in the United States. Mr. Casey had mentioned that business investment had also been inadequate for some time and that the projected decline in 1983 would be the fourth successive year of such a decline in the larger industrial countries. Each of those major elements--profitability, productivity, and business investment--should be improved within the broad framework of anti-inflationary policy. The effort to achieve that goal should be related to the principal factors affecting those areas: real wage costs and real interest rates. If there was to be any consideration of more expansionary policy, it would be important to look at the effects of such a policy on real wage costs and real interest rates at present. He hoped that the staff would elaborate upon its general formulation and look at some of the specific difficulties that would be encountered in increasing the rate of economic growth, profitability, productivity, and investment in the industrial countries.

Attention might usefully be paid to fiscal policy, Mr. Prowse said. It had become fashionable to speak of the cyclical aspects of deficits as distinct from their structural aspects, and the approach was certainly appropriate as a theoretical proposition. In practice, however, the refinement was difficult to establish, and there was some risk that the focus on the cyclical and structural aspects of deficits could lead to a reversal of the belief that large budget deficits had undesirable effects in terms of interest rates, crowding out, inflationary expectations, and so on. Perhaps it would be better, in viewing the structural problems of economies, to take note of the structural difficulties of government finances in most of the major industrial countries. One point that should be emphasized was the relationship between a government's deficit and the total savings available in its economy. It was not a satisfactory approach merely to compare the ratio of the deficit to GNP in Japan, for example, with that in the United States, because the savings ratio in each economy was quite different, as was the effect of the deficit on such elements as interest rates.

The expenditure side of budgets also deserved attention, Mr. Prowse considered. It was difficult for the Fund to comment on such matters, because government priorities tended to be predominant in regard to the pattern of expenditure; however, it was certainly appropriate for the institution to recognize that some kinds of government expenditure were more productive than others in encouraging growth and private sector investment. Hence, when the Fund began to consider deficits in greater detail, it should not lose sight of the expenditure side of the budget.

On fiscal policy and the argument of some that greater expansion was needed, Mr. Prowse said that he had not heard an analysis that established that any of the major industrial countries was in a position to expand its budget deficit with good results. Since it was not evident that expansion should be brought about by increasing central government deficits, the only alternative was to look toward monetary policy; but it was difficult to associate a more relaxed monetary policy with existing large deficits except by increasing the money supply. In the circumstances, he was unclear about how an effective expansionary policy could be adopted. Even though some "maneuvering" had produced good effects in countries like the United States, there was a limit to what could be done, and maneuvering alone could not be expected to offset the damaging influence of the very large ongoing deficits.

In looking at the differences between the views of the staff and those of some of his colleagues who were calling for a more expansionary approach to policies in some countries, he had begun to wonder whether the staff's position had not in some way changed from the stance taken in previous discussions on the World Economic Outlook, Mr. Prowse said. The staff had suggested that no relaxation of the anti-inflationary stance should be permitted, whereas in previous World Economic Outlook discussions, it had focused on the need to tighten and concentrate anti-inflationary policies. He would not have labeled the staff overly conservative if it had argued that, in some of the countries concerned, the authorities should be continuing to attack the source of inflation--the budget deficit.

Turning to the problems of the non-oil developing countries, Mr. Prowse noted that world market prices for raw materials and agricultural products would need to rise as world recovery began. Such price increases would not represent a resurgence of financial inflation, but rather a restoration of the prices of products to more appropriate levels than had been seen in recent years; nonetheless, the prospect for such price rises should be recognized. In that connection, he hoped that the Interim Committee would be encouraged to focus on the problem of trade protection and restrictions. Those matters had been well covered in the appendix to the staff report, but the text of the report did not discuss them in any detail, and he hoped that the dearth of comment was not a reflection of the position on trade protection and restrictions that would be taken at the Interim Committee.

Some of his colleagues had suggested that the staff projection for a 1 per cent real growth rate in 1983 might be optimistic, Mr. Prowse recalled. His own feeling was that the projection was conservative and that, if the major countries maintained coherent policies, it might prove to be close to the mark or even an underestimate. The staff itself had suggested that the low projected growth rate essentially reflected unanticipated declines in fixed investment and inventories. Before a higher level of growth could be expected, higher profits and a stronger stock in investment growth would be needed; and the effect of high real interest rates on those elements could not be overlooked.

With respect to the effort to ensure external adjustment and financing, Mr. Prowse continued, the Managing Director should be commended for his recent achievements, including those involving the role of the commercial banks. Thus far, a relatively ad hoc approach had been taken, and it might be best to continue along that line for the time being. It was interesting to note, however, that the approach had evolved somewhat, with the sequence of events surrounding the case of Sudan, for example, differing from that in the case of Mexico. It seemed to him that the approach followed in the case of Mexico and other major countries was an appropriate one.

Mr. Malhotra observed that a number of industrial and other countries had followed policies that had led to a substantial moderation in rates of inflation, and they deserved commendation for their efforts. However, it was important to look at the cost of the successful fight against inflation. Rates of unemployment had risen to high levels, and under-employment of resources was acute. The adverse impact on output had also been dramatic; indeed, in some cases output had been negative; and the recession had continued over a period of years. In the circumstances, he wondered whether countries had perhaps not gone too far in adopting a wait-and-see approach, hoping that control of inflation would automatically lead to a recovery. The report of the OECD on the world economic outlook had suggested that the degree of weakness in activity in both OECD and non-OECD countries had tended to mitigate the effects of generally restrictive policies; indeed, the suggestion was that the international repercussions of a simultaneous pursuit by many countries of tight monetary policies might have been underestimated. In that respect, the OECD report seemed to be more realistic than the report of the Fund staff, which had not addressed that aspect of the issue.

The OECD report had also indicated that policies in some of the important economies were somewhat more accommodating than in others, Mr. Malhotra continued. Several of his colleagues had suggested that the flexibility of U.S. monetary policy had had some healthy effects on interest rates. On the other hand, the OECD report, which, while noting that some governments had not sought to reduce target rates of money growth in response to unexpectedly rapid progress in reducing inflation, had stated that output had remained weak and that it was uncertain whether declining inflation and nominal interest rates alone would prove sufficient to lead to a sustainable recovery of output and employment. The Fund staff paper, unfortunately, did not focus on that question.

While the costs of anti-inflationary policies had been high in terms of unemployment and the persistence of the recession, they had been particularly heavy in the area of investment activity, Mr. Malhotra considered. For the fourth consecutive year, rates of investment had fallen, which did not bode well for the future. Account should also be taken of the impact of the anti-inflationary policies on international trade, which had declined in 1982 following several years of stagnation. Worse yet, protectionism had been on the rise.

The impact of the current situation on the developing countries had been extremely severe, Mr. Malhotra commented. Their exports had fallen because of weak demand in the industrial countries; their terms of trade continued to suffer; and the decline in their overall current account deficit had occurred at the cost of a fall in much-needed imports. Growth rates as well had declined considerably, in some cases below the rates of population growth, so that per capita incomes had fallen. In the developed world--where per capita incomes were high, population growth was minimal, and savings capacity could support social security--the adverse effects of low growth were mitigated. However, even in countries like the United States, there was concern for restoring the economy to good health in order to reduce unemployment. The fact that people in the industrial countries were concerned about the adverse effects of low growth should serve to highlight the far worse situation in the developing world, where standards of living were falling. In the circumstances, it was important to undertake a more comprehensive review of the costs of policies being pursued and to determine the extent to which changes might be needed.

Even if the staff had recommended more expansionary policies for the industrial countries, Mr. Malhotra said, any change from the current situation would be dependent upon the perceptions of individual governments and their decisions about whether or not to maintain restrictive policies. Still, the Fund should reflect carefully upon its recommendations. The institution had negotiated a number of large adjustment programs with member countries in the developing world, and the success of those programs would depend on increases in developing country exports, which could not take place without growth in the industrial countries.

People at all levels of prosperity would ultimately adjust to the existing situation, as they had done through the centuries, Mr. Malhotra continued. However, that was not a desirable kind of adjustment; hence, the Fund should be encouraging adjustment that would bring about sustainable growth in member countries. He had serious doubts about whether the present world economic situation would permit successful adjustment under the programs negotiated by the Fund, especially given existing debts and debt servicing problems. He appreciated the efforts made by the Fund management in recent months to become involved in the relationships between the commercial banks and some member countries; in the end, however, the banks themselves would have to perceive that countries had the ability to service their loans, and that perception could only come about when exports and terms of trade improved.

He had been interested in the statement that progress in the control of inflation remained tenuous because commodity prices were low, Mr. Malhotra commented. He hoped the implication was not that commodity prices needed to remain low in order to help industrial countries consolidate their hold on inflation.

With respect to the scope for maneuver in various countries and the issue of whether or not policy actions should be coordinated, Mr. Malhotra considered that the staff had appropriately differentiated the situations of member countries. Those that continued to be plagued by high rates of inflation should probably maintain their anti-inflationary stance; however, there were other countries--such as Japan and Germany--where inflation had been under control for some time. As noted by one speaker, there was no empirical evidence showing a direct relationship between low inflation and high growth rates. Hence, something needed to be done through policy initiatives or changes to bring about a better situation.

Far less success had been achieved on the fiscal side than in the fight against inflation, Mr. Malhotra commented. Further action was therefore needed and, while there was some question about how far countries could go in taking action on the budget, it was clear that monetary policy and budget policy would have to be looked at together. One of the main purposes of the Fund was "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." In that context, the Fund should perhaps signal some change from the stance it had previously taken and indicate that, where there was room for maneuver, member countries should take positive steps to restore growth to the world economy. Unless they did so, problems with international trade, debt servicing, and payments imbalances would increase.

While the Fund seemed capable of reacting quickly to the debt crises of member countries, it did not appear to be making a strong enough effort to address the basic causes of the imbalances, Mr. Malhotra said. He had been interested in the observation by Mr. Hirao that an increase in the money supply did not necessarily mean that employment would improve, because structural imbalances in the industries of various countries had produced an unfavorable environment for profitability and productivity. Much needed to be done to modernize and improve the technology of various industries. There was no quick fix for the problem and no magic formula that would automatically create a rise in investment. All countries, both industrial and nonindustrial, needed to adjust further, and it was incumbent upon governments to consider how best to promote those adjustments. Of late, the view had been increasingly expressed in some countries that governments should leave most matters to the private sector. The authorities of many countries had been trying to manage government budgets and other economic aggregates and to determine the proportion of community savings that would go to the government and to the private sector. However, more could perhaps be attempted in other areas, as had been done in Japan, where the Government had greater contact with industry and was therefore better able to influence investment in such a way that noncompetitive industries were phased out and those willing to improve technology to meet changing circumstances were strengthened. It was simply not sufficient for governments to reduce inflation and hope that other positive results would follow; a more comprehensive approach was needed.

Turning to the staff report itself, Mr. Malhotra endorsed the view of those who felt that the staff had not dealt adequately with those countries that were dependent on development aid or concessional flows. Because industrial countries had been preoccupied with problems at home, concessional flows had been de-emphasized, and it was important for the Fund to point out the unfortunate impact that a reduction in development assistance could have on so many Fund members. More attention should also be devoted to exchange rate changes and changes in reserves. It had been stated in the report that about SDR 11 billion in reserves had been used up by non-oil developing countries during 1982, but further elaboration was needed. In that regard, he took note of the suggestion by Mr. Lovato and others for advancing consideration of the possibility of further SDR allocations.

Mr. Alhaimus considered that the staff papers on the World Economic Outlook provided a clear and concise analysis of the complex developments confronting the international economy. Particularly useful was the overview of recent developments and short-term prospects, which highlighted the further deterioration of economic activity, employment, and trade in 1982 while noting that some progress had been achieved in controlling inflation and high interest rates.

The staff's latest assessment of the outlook for industrial countries pointed to a modest recovery beginning in 1983 and gradually picking up in 1984 and beyond, provided that there was no major departure from the restrained financial policies currently being pursued, Mr. Alhaimus continued. Such a course seemed to be warranted, given the fragility of the gains made in the fight against inflation and the persistence of inflationary expectations. The staff had correctly acknowledged that output might continue to stagnate if, inter alia, uncertainties generated by the present severe recession were to feed on themselves. It could be argued that such a development might already have begun, judging by the further weakening of investment activity during 1982.

As to whether restrictive policies should be relaxed in those countries that had already made substantial progress in containing inflation, Mr. Alhaimus noted the indication by the staff that there was increased room for maneuver currently available to those countries to support the level of economic activity or to encourage recovery through a more flexible use of monetary and fiscal instruments within an overall policy framework of financial restraint. The staff had suggested that, while a pronounced shift toward a more expansionary policy stance might continue to be inadvisable in such countries, the choice of policy mix should be made with a view to keeping inflation under control without thwarting recovery. He agreed that the way to meet that challenge was through improvements in the mix of policies in the relevant countries and a better harmonization of policies among them, taking adequate account of the international repercussions of such policies and their implications for the adjustment process. Hence, while progress made thus far in containing inflation needed to be preserved and strengthened, it was important, in making policy choices toward that end, to bear in mind the dangers that could arise if the long-awaited recovery failed to materialize within a reasonable time.

Turning to the issue of external adjustment and financing, Mr. Alhaimus considered that the staff had correctly focused on the position of developing countries. Their 1982 current account deficit was estimated to have declined, and was projected to decline further in 1983, but the staff paper rightly indicated that such improvement had been achieved "at the cost of severe compression of imports and consequent low growth of output." The paper also highlighted the fact that "considerable adjustment has taken place in recent years." However, the combined effect of the protracted recession, the continued decline in the terms of trade, and the reduction in the rate of bank lending had given rise to a situation that could be addressed effectively only over a medium-term period. Given the magnitude of the problems experienced by the developing countries, and adverse external developments, the adjustment capacity of those countries was becoming increasingly limited.

The staff paper provided some interesting illustrations of the degree of dependence of the developing countries on developments in the industrial countries, Mr. Alhaimus noted. The impact of the terms of trade on export earnings had been fairly acknowledged, and it had been estimated that export earnings of the non-oil developing countries could fall significantly--by 7.5-13.5 per cent--in response to a 1 per cent fall in the average growth rate of industrial countries. It would be useful if the staff could also indicate the extent to which such a reduction in growth rate could affect the export earnings of the oil exporting countries.

Reduced export earnings and a decline in the availability of financing for the developing countries would have a severe impact on world trade and on prospects for growth in the industrial countries and the world economy as a whole, Mr. Alhaimus said. The staff had acknowledged that a drop in real imports of the developing countries had contributed to the further weakening of world trade and output, and it had quantified the implications of a $10 billion reduction in the annual rate of bank lending on the rate of growth of GNP in the industrial countries and other groups. Such implications raised the issue of financing--both conditional and unconditional--as an instrument for addressing the prevailing recessionary situation. The data available suggested that a sharp drawdown of reserves had already taken place, thus highlighting the urgency of the problem and strengthening the case for an SDR allocation.

The need for international cooperation was particularly relevant to the highly unsettled situation of the world economy at present, Mr. Alhaimus commented. It was thus regrettable that, during 1982, there had been a shift away from liberal attitudes, which raised concern about the future direction of trade policy. There was a clear need for the Fund to pay increased attention to protectionist tendencies in the larger nations where trade policies had an important impact on world trade.

Finally, with respect to other aspects of the role of the Fund, Mr. Alhaimus noted the staff reference to the more active part played by the Fund in recent months in arranging financing from private sources for some member countries. The approach taken by the Fund could be instrumental not only in restoring confidence in some major borrowers but also in improving the debt profile of other developing countries. In conducting its relations with the commercial banks, the Fund should continue flexibly its pragmatic ad hoc approach. There was no evident need to undertake binding commitments to institutionalize a relationship that might not prove necessary later on in the evolving pattern of the world economy.

Mr. Nimatallah noted that economic developments in 1982 had been mixed. On the positive side, a number of countries had made significant gains in the fight against inflation, an accomplishment that should not be underestimated. The world economy could not have survived a continuation of the inflationary spiral that had existed in recent years. He therefore wished to commend those countries that had been successful in controlling inflation, and he urged others to follow their example. On the negative side, the fight against inflation had led inevitably to a lower level of economic activity, an attendant increase in unemployment, a decline in the volume of world trade, and a rise in protectionism.

Furthermore, debt servicing problems had emerged for many countries and, consequently, the international financial system had come under severe strain.

For 1983, Mr. Nimatallah continued, the staff was projecting relatively modest average growth rates in each of the three country groups; a moderate growth in world trade had also been projected. Based on the staff's assumptions, the projections seemed reasonable. However, if the projected modest recovery in the industrial countries failed to materialize, the world economy could be in serious difficulty. Unemployment in the industrial countries could rise to socially unacceptable levels, leading to a return to inflationary deficit spending. Furthermore, for many countries debt servicing problems could be aggravated because of strained world trade. More generally, the stability of the financial system could be placed in jeopardy.

Turning to the policies in the major industrial countries, Mr. Nimatallah considered that the central issue seemed to be whether or not "there is room or need for a shift toward a more expansionary stance of policy in the United States, Japan, Germany, and the United Kingdom." In assessing the issue, the staff had noted that monetary conditions in all four countries had become notably easier during 1982. Furthermore, in 1982 fiscal policy in the United States, Germany, and Japan had become more expansionary, a development that would apparently be carried over into 1983.

The staff had concluded that, in the circumstances, the financial policies currently being followed in the four countries under consideration were in general sufficiently relaxed to permit a resumption of growth in 1983 and beyond, Mr. Nimatallah observed. The staff had noted that a shift to a more expansionary policy would be inadvisable because it would risk rekindling inflation. It was not his intention to disagree with the staff, although he believed that the issue needed more careful analysis than had been presented in the papers. One aspect that could perhaps have been investigated more thoroughly was the way in which expansionary demand management policies related to the level of capacity utilization in each of the four economies concerned. It was well known that additional government spending had multiplier effects; however, whether those multiplier effects turned out to be inflationary depended upon the degree of idle capacity. If the economy was operating well below full capacity, there was obviously more room to relax policies without generating inflationary pressures. Also missing from the staff analysis was a detailed discussion of the impact of incomes policies on recovery. In his view, recovery could be endangered by imprudent increases in real wages if productivity did not rise at the same or a faster rate.

In discussing the extent of any room for maneuver, it should be borne in mind that the current recession was different from those experienced by the industrial countries during the previous three decades, Mr. Nimatallah remarked. It had proved to last longer and be more obstinate than its predecessors and had been acccompanied by very high unemployment rates. What was being demonstrated was a deflationary spiral that was similar to the inflationary spiral that had existed during the past few years. During the period of inflationary expectations, people had tended to hedge against inflation by spending more at a faster rate, which had made inflation worse.

During the present recession, the unemployed and, more important, those who feared that they might become unemployed, were reluctant to spend on either consumption or investment, and their lack of confidence was deepening and prolonging the recession, Mr. Nimatallah maintained. Confidence-building policies were needed that would reduce the threat of unemployment. Perhaps the authorities of those countries suffering from high unemployment should accelerate their labor retraining programs, which would allow those workers who had lost or were about to lose their jobs in uncompetitive industries to acquire jobs in expanding industries. Governments should play a leadership role in developing or accelerating such programs, which could not simply be left to the private sector. Over the longer term, industrial countries should recognize that the conditions of the past that had permitted low inflation and unemployment rates, while real incomes were rising, might no longer exist. The time was thus ripe for such countries to begin reviewing what could be considered acceptable rates of inflation, unemployment, and growth in real income. The idea of introducing a smaller number of working hours a week might be examined with an eye to reducing unemployment even if the economy showed no growth. Such an approach would reduce the pressure on governments to artificially stimulate their economies in order to reduce unemployment rates while ignoring the inflationary risks involved. He hoped that the staff too would look in depth into the question of unemployment.

On the topic of external adjustment and financing, Mr. Nimatallah observed that the substantial adjustment efforts that had been undertaken in the past two years by the non-oil developing countries had helped to achieve a reduction in their combined current account deficit in 1982. The deficit was projected to decline even further in 1983, partly as a result of those adjustment efforts, and it was therefore important that the non-oil developing countries should continue to adjust in the context of programs with the Fund. He welcomed the attention that had been paid by the staff to the problem of financing the current account deficit of the non-oil developing countries, which had incurred a loss in their reserves of about $11 billion in 1982, compared with an increase of about $2 billion in 1981. For 1983, the staff had projected that the rate of increase in outstanding bank loans to those countries would decline to 7-8 per cent, a projection that, together with the expected continued sluggishness in foreign aid in 1983, seemed to indicate that the reserve position of the non-oil developing countries would remain tenuous, even with a decline in their current account deficit. Such considerations pointed to the need for a resumption of SDR allocations in the near future.

A welcome aspect of the World Economic Outlook report was the analysis of the external debt situation in the non-oil developing countries, which showed that the external debt problems of the non-oil LDCs as a group extended well beyond the publicized cases in the Western Hemisphere, Mr. Nimatallah remarked. For example, the payments arrears of more than 30 small developing countries had increased in 1982, and multilateral debt rescheduling had been arranged--or was currently being negotiated--for 20 countries. As the external debt survey (ID/83/2) showed, some countries outside the group of non-oil developing countries had increased their external indebtedness sharply in recent years and might encounter problems in the future. The debt problem was thus a serious one, and he welcomed the fact that the Board would be discussing it in detail in the near future.

Remarking on the oil exporting developing countries, Mr. Nimatallah noted that the large decline in their export receipts in 1982 had led to an increase in their external borrowing and a greater use of reserves. The difficulties of those countries added to the strains on the international financial system for several reasons. First, the rate of increase in their imports from the rest of the world had declined, thus aggravating the sluggishness of world trade. Second, as a result of the virtual disappearance of their current account surplus, the oil exporting developing countries had sharply reduced their deposits with the international banking system. Third, those countries had competed with other borrowers for the scarce resources of the international banking system. The situation would have been compounded if there had been a significant decline in the nominal price of oil in 1982, and he therefore looked forward to the staff's evaluation of a possible decline in nominal oil prices in 1983.

The matter of international cooperation deserved particular attention at present, Mr. Nimatallah considered, because of the strains facing the international monetary and trading systems. He agreed with the staff that attempts at detailed ex ante policy coordination between countries were not likely to be successful, simply because the approach was not realistic. The emphasis should be on a harmonization of policies whereby each country, in formulating its own policies, would take into account the interaction of the policies with those in other countries. Such an approach was particularly important in the case of the industrial countries because of their weight in the world economy. On trade matters, the General Agreement on Tariffs and Trade (GATT) was an important forum in which international cooperation on trade issues could be pursued; the time was ripe for concrete action to put the principles of the GATT Ministerial Declaration into effect, even though doing so would not be easy so long as economic activity and world trade remained sluggish. The emphasis that the Fund would also be placing on trade issues was to be welcomed.

The Fund was currently in a unique position to play an effective role in the preservation and smooth functioning of the international monetary system, Mr. Nimatallah observed. Recent problems surrounding the substantial debt servicing of a number of countries had made it clear that full cooperation among borrowing member countries, the Fund, and the commercial banks was needed in order to prevent crises from arising. Under the prudent and effective leadership of the Managing Director, the Fund had thus far helped to make the situation manageable; it was imperative that the institution should continue to be the focal point of coordination as long as that was needed, and the commercial banks and borrowing countries should cooperate with the Fund in its efforts, so as to avoid a collapse of the system. If the Fund was to play its role effectively, it needed a strong financial base. For that reason, his authorities were supporting a substantial increase in the resources of the Fund under the Eighth General Review of Quotas.

Mr. Wang observed that 1982 had been characterized by continued stagnant economic activity, rising unemployment, and mounting budget deficits in almost all parts of the world. A growing number of countries faced external payments difficulties, including debt problems, and the overall development of the world economy had been worse in 1982 than in 1981. Among the industrial countries, output was estimated to have declined fractionally, while the rate of unemployment for the group as a whole had reached an unprecedentedly high level. World trade had declined for the first time in the postwar period as a result of both the stagnation in the domestic economies of the industrial countries and increasing protectionism.

The situation of the non-oil developing countries had continued to worsen, Mr. Wang remarked, with GNP declining between 1981 and 1982 and the average growth rate at present at its lowest level in several decades. The current account deficits of the non-oil developing countries had also increased, and real per capita income had begun to decline for the first time in the postwar period. In addition, several large developing countries had in recent months experienced debt servicing difficulties, leading to severe liquidity crises in their balance of payments.

The immediate prospects for the world economy were a concern to all, Mr. Wang considered. Despite a recent moderation in inflation rates and a softening of interest rates in a few of the major industrial countries, the world economy remained in the throes of the deflationary process that had been set in motion by the restrictive policies initially adopted by the major industrial countries to deal with their domestic problems. Since recent developments in the world economy were clear manifestations of more difficult deep-rooted structural problems requiring long-term solutions, the conclusion had to be drawn that recovery of the world economy was not imminent.

Recognizing that the world economy was made up of interdependent nations, the major industrial countries should take the initiative in fulfilling their international obligations by developing a comprehensive and balanced set of economic policies and systematically implementing measures to deal with structural rigidities and sectoral imbalances, Mr. Wang commented. They should take fully into account the effects of their policies on other countries and should under no circumstances attempt to shift their own economic difficulties onto others, particularly the developing countries. The improvement in the economies of the industrial countries could not in his view be achieved without a successful implementation of adjustment programs in the developing countries; hence, the North-South dialogue should be strengthened, the level of official development assistance should be at least maintained, and policies and measures--including protectionism--that particularly hindered the process of adjusting the deficits of the developing countries and endangered the prospects for medium-term recovery in the world economy should be avoided.

A central problem in the international financial field in 1982 had been the worsening debt situation, Mr. Wang remarked. The problem had become acute because of a number of unfavorable factors that had been building up over the previous one or two years. Export earnings of the debtor countries had been declining sharply as a consequence of the recession in the industrial countries, the rise in protectionism, and the fall in primary product prices. Those developments had inevitably adversely affected the ability of the debtor countries to meet debt servicing requirements. In the meantime, high and rising interest rates in the international financial centers had increased the debt burden, as the cost of servicing the debt swallowed up an increasing percentage of export earnings. The debt dilemma could prove costly to both debtor and creditor countries, and a rash of defaults, if not properly handled, could render the recession unmanageable.

Despite painstaking efforts to reschedule debt, the international financial situation remained disquieting and highly fragile, Mr. Wang said. A number of major debt rescheduling operations had already taken place, and a large number of smaller operations were awaiting completion. Moreover, the possibility could not be ruled out that other important borrowers--perhaps among the groups of smaller industrial countries or oil exporters--would need to have their debts restructured. The developing countries would face unprecedented borrowing needs in 1983, as current accounts remained in deficit and the short-term debts that needed to be rolled over continued to mount. The environment in which the developing countries were being asked to adjust thus remained difficult, and the failure of any of the recent major programs with the Fund could cause market sentiment to turn against others seeking adjustment programs. In the circumstances, it would be premature to think that the strains facing the international financial system had been addressed and adequately dealt with.

In the face of mounting pressures in recent months and the uncertainty of the future, it was imperative that the Fund play an even more active role in seeking an effective solution to the problem of maintaining international monetary stability and meeting the balance of payments needs of the developing countries, Mr. Wang remarked. The actions in which the Fund had been engaged in recent months to stave off the deepening international liquidity crisis had been positive and should be commended. The Fund should become the focal point for future balance of payments financing and adjustment and, for that purpose, the institution would need to be equipped with the appropriate resources and financing mechanisms. Hence, a larger increase in quotas should be agreed upon, and a new allocation of SDRs was urgently called for. At the same time, the Fund should exercise its surveillance over the exchange rate policies of its members--both developing and developed--and should be more forceful in presenting its views to them. Toward that end, consultations should be conducted on a regular basis and staff reports should deal candidly with all countries.

Mr. Sangare observed that the information in the staff papers clearly showed that the recession that had begun in 1980 continued to plague the world economy. The level of world economic activity had declined in 1982 and, while inflation had been brought under control in a number of industrial countries, unemployment had risen to record levels. Reflecting the deepening recession, the volume of world trade, after stagnating in 1981, had declined in 1982, the first decline since 1975. The external payments problems of the developing countries, particularly the non-oil developing countries, had been compounded by difficulties in securing external financing as private commercial banks had curtailed international lending. While marked reductions in nominal interest rates had been witnessed in key financial centers, real interest rates remained high and, in general, prospects for the future were not bright.

The problems of the developing countries had reached critical proportions, Mr. Sangare continued. Weak demand in the developed countries, deteriorating terms of trade, and sharply higher debt servicing costs had complicated the economic situation of the developing countries. The rate of increase in output for those countries had fallen to less than 3 per cent in 1982, which represented a dramatic slowdown from the 6 per cent average growth rate achieved in the period 1968-72. The difficult external payments situation had, moreover, forced those countries to reduce the volume of their imports by as much as 4 per cent in 1982, thus further dampening prospects for future growth.

The evolution of the current situation depended in large part on the policies adopted by the major industrial countries, Mr. Sangare considered. He agreed with those who saw little room for maneuver in those countries where inflation remained high; however, in countries that had succeeded in bringing inflation under control, a shift in policy stance that would allow for greater recovery would seem to be advisable. Widespread unemployment posed a danger that could not be ignored for long, and it should be a major factor in any decision about how quickly recovery should be engendered. After all, the final objective of economic management was to promote the welfare of the population.

On the issue of external adjustment and financing, Mr. Sangare agreed that countries should continue to adjust; however, the extent to which many developing countries could follow such a path without external financing was limited if social order and stability were not to be put at risk. The reserves of the developing countries were already at low levels and, in some cases, nonexistent. The liquidity squeeze facing many countries and the decline in international reserves and in world trade seemed to point to the need for a supplement to international liquidity through a further allocation of SDRs. Recent events suggested that most countries could not rely on commercial banks for their financing needs, and the ultimate solution to the problem lay in the enlargement of resources at the disposal of the Fund. In that regard, he could only reiterate the view of other Directors that the need for an early doubling of Fund quotas had clearly been established.

On the matter of international cooperation, Mr. Sangare considered that there was a need to reverse the present trend toward protectionism and to preserve a liberal international environment for trade. Protectionism in all its forms should be eschewed in order to allow developing countries to "earn their keep." Steps should therefore be taken to remove the structural rigidities--which characterized certain sectors of the developed countries' economies--that made protectionism appealing. He could also agree with the staff that the developed countries should work toward harmonizing their economic policies. Toward that end, the Fund had an important role to play in the context of its surveillance activities in ensuring that countries--particularly those with significant weight in the world economy--should be fully cognizant of the international ramifications of their policies. Finally, he wished to commend the management of the Fund for the sustained effort made thus far in helping member countries to meet their adjustment needs; he hoped the effort would continue.

Mr. Diao observed that, while the world economy had performed below expectations in 1982, encouraging signs had been perceived for 1983, when a moderate economic recovery was expected due to the significant progress in the fight against inflation waged in most of the major industrial countries, particularly the United States, Japan, Germany, and the United Kingdom. Still, the current global economic situation was fraught with uncertainty, which reflected complex and controversial questions about the appropriate policies that should be followed by those industrial countries that had been most successful in controlling inflation and that had attained relatively strong external positions. The staff had itself asked "whether there is room or need for a shift toward a more expansionary stance of policy in the United States, Japan, Germany, and the United Kingdom." Policies in all four countries had been described as consistent, with a resumption of economic growth during 1983, although the timing and extent of recovery were uncertain. The problem of how to attain sustainable economic growth without resorting to more expansionary policies that would wipe out the gains made against inflation was an issue that did not lend itself to easy resolution. He agreed with the staff that the leading industrial countries should continue to pursue firm policies of monetary restraint, supported by appropriate fiscal policies and other measures designed to deal with structural adjustments. The need for stricter fiscal policies, especially control over public spending, was particularly evident in the case of the United States. The current deficit of the U.S. budget seemed to be excessive and was expected to widen in future. In his view, the revival of the U.S. economy would inevitably depend on the ability of the authorities to move decisively toward a position of budgetary equilibrium.

With respect to other industrial countries where greater progress was needed in the battle against inflation, the recommendation for stricter financial policies was reasonable, Mr. Diao said. Undoubtedly, the entire system of international trade and payments would function more smoothly if the problem of stagnation could be addressed through an appropriate mix of policies in each of the major industrial countries. The appropriate policy mix would, of course, include measures directed toward the restructuring of the production base in those countries. The continued subsidization of declining and inefficient industries constituted a costly and unnecessary delay in recovery; market forces should be allowed to play their role in restoring efficiency and dynamism in the production system.

Progress in the area of external adjustment and financing was highly dependent upon the success that could be achieved in bringing about economic recovery in the industrial world, Mr. Diao stated. In that respect, he hoped that those major countries that had made some progress in the fight against inflation would make full use of their room for maneuver to stimulate their economies. The adjustment efforts in the non-oil exporting developing countries had been significant and extremely painful. As pointed out by the staff, the sluggish markets in the industrial world had had an adverse effect on the export performance of the non-oil developing countries; and that performance, coupled with a significant and continued deterioration in the terms of trade and the heavy burden of external debt service charges, had contributed to an overall decline in economic growth. Less painful and stronger adjustment could perhaps be obtained through more genuine international financial cooperation, and the Fund had an important role to play in that respect. Finally, on the Fund's relationship with the commercial banks, he joined Mr. Taylor, Mr. Casey, and others in discouraging the establishment of formal ties, although he could accept continued ad hoc arrangements.

Mr. Senior, noting like others that the world economic situation was serious, remarked that the only encouraging development had been in the fight against inflation, and the success in that fight had been costly in terms of depressed economic activity and unemployment in all parts of the world. As the policies in the major industrial countries had played a key role in such developments, it seemed only reasonable that the staff and the Executive Directors should focus on an evaluation of the appropriateness of present policies in the industrial world. In general, he could agree with the staff that prevailing conditions would not permit a significant relaxation of the anti-inflationary stance of monetary and fiscal policies in those industrial countries that were still facing relatively high inflation rates. Such a policy shift would clearly erode some of the gains made recently in countries like Canada and France and could rekindle inflationary expectations, although there seemed to be room for some improvement in the policy mix of Canada that could reduce the cost of present policies without any relaxation in the overall policy stance.

He had been disappointed in the staff approach to the more complex question of whether there was room for a shift toward a more expansionary stance of policy in the four main industrial countries, where success had been achieved in bringing inflation under control, Mr. Senior commented. While hinting that there might be some room for such a shift, the staff had voiced its actual recommendations in such precautionary terms that they could only be seen as a warning to maintain present restrictive policies. The staff's conclusions seemed almost to be at odds with its analysis.

Most of his colleagues had underscored the high cost associated with the success of some of the industrial countries in reducing inflation, Mr. Senior noted. Clearly, lower inflation was required for sustained growth in the medium term, but reduced inflation should not be the only policy objective of the authorities; there needed to be a more appropriate balance among different objectives. Moreover, there was some question about what was the appropriate inflation rate for the industrial economies in current circumstances. In other words, to what level should the inflation rate be brought down before a policy shift could be considered acceptable? As Mr. de Maulde had indicated at EBM/83/22, the answer to the question was complex, and the matter needed further exploration, taking account of the risks associated with lower growth and rising unemployment.

Like others, he felt that there was at present room for a shift toward a more expansionary stance in the four industrial countries that had achieved low inflation rates, Mr. Senior said. The degree and nature of such a shift would vary from country to country but, in general, some action would seem to be necessary if economic activity was to recover. As Mr. de Groote had appropriately observed, low inflation was a necessary but not a sufficient condition for sustained economic growth. Among the industrial countries, the United States could certainly take a more restrictive fiscal stance in order to bring the fiscal deficit under control. The existing large current account deficit and the prospects for an even larger deficit in future could negatively affect expectations, give rise to a sustained high level of real interest rates, and impair economic recovery. Hence, it seemed essential for the United States to tighten its fiscal policy somewhat, although the need for such a change also underscored the importance of a more appropriate policy mix, with monetary policy somewhat more accommodating to financial needs. As for other countries in the group, he had found Mr. de Groote's comments regarding different policies for different stages of economic recovery to be most interesting.

On the matter of external adjustment and financing, Mr. Senior noted that the current situation of most developing countries was worrisome. Since 1979, a series of important developments had had a significant adverse impact, particularly on the non-oil developing countries. While some important adjustments had already taken place in those countries, they had come about mainly because the lack of available foreign exchange had markedly reduced imports. Such forced adjustment was clearly not an acceptable solution to the problems of the non-oil developing countries. Those countries had, of course, undertaken to adopt policies or make policy changes to bring about adjustment, but external developments had rendered their actions insufficient. The international recession had clearly had a severe impact on the developing countries, which were more vulnerable to the recession than the industrial countries. Moreover, their short-term prospects would not be favorable without a more than significant recovery of economic activity in the industrial countries. A further compression of imports could only make the situation more difficult and would affect the ability of countries to service their external debt. In that regard, he agreed with Mr. Kafka's views on the debt situation and supported the call for a substantial new allocation of SDRs.

The Fund would clearly have a crucial role to play in assisting and supporting a multicountry process of adjustment over the next few years, Mr. Senior considered. The expanded role played by the Fund in recent programs was a welcome development, which he hoped would be continued. The Managing Director had also been most helpful in acting to avert a nascent debt crisis that could have had powerful repercussions in the international financial system. His authorities were grateful for the Managing Director's efforts in that regard, and they strongly supported a wider role for the Fund in the international adjustment process. Adequate funding was needed for the purpose, however, and a doubling of quotas under the Eighth General Review therefore seemed warranted.

Mr. Salehkhou, noting that there was a wide margin for error in the World Economic Outlook exercise, said that the working hypothesis that the average exchange rates of December 1982 would prevail throughout 1983 might be difficult to justify. There had been many changes in exchange rates in 1982, with most currencies having depreciated considerably in value against the U.S. dollar, which itself had strengthened vis-à-vis the SDR. It would be preferable in the circumstances to forecast exchange rates on the basis of available indicators, despite the uncertainties and problems that such an approach would entail. In general, while recognizing that the working assumptions adopted by the staff might be standard operating procedure for the purposes of statistical projections, he wondered about the possibility of changing those assumptions as circumstances or developments began to alter their essential elements. For example, how plausible was the assumption of the constancy of the price of oil throughout 1983? The point was an important one because, as had been mentioned in the staff paper, the analysis and conclusions of the report would be greatly affected if some of the assumptions did not prevail.

Regarding the paper on trends and prospects in the international capital markets and the survey of the external debt situation (ID/83/2), Mr. Salehkhou remarked that, in discussing the debt burden of the developing countries, it would be appropriate for the staff to change the classification somewhat by separating major borrowers from the remainder of the developing countries and assigning them a separate category. It was misleading to talk about the debt profile of non-oil developing countries when 20 countries--half of them not even developing or non-oil developing countries--accounted for 90 per cent of all outstanding claims of the banks on non-oil developing countries. If the group of special borrowers was assigned a separate classification for the purpose of debt analysis, then the potential needs and use of commercial credit by the large majority of non-oil developing countries could be more clearly projected and analyzed;

and the commercial banks' refusal of credit to a few large borrowers would not create so much of a negative attitude about all non-oil developing countries.

The staff had acknowledged that the major borrowers as a group were different from other developing countries in several key respects, Mr. Salehkhou commented. It had separated the non-oil developing countries into low-income countries, net oil exporters, and so on, which was helpful; however, most of the subdivisions included one or several of the major borrowers as well as other non-oil LDCs. In the main body of the report, the staff had focused on the major borrowers as one group and on all non-oil developing countries--including the major borrowers--as another group. Because of the magnitude of the debt figures of the major borrowers, such an approach tended to cloud the debt situation of the developing countries as a whole.

Turning to the suggested topics for discussion, Mr. Salehkhou considered that 1982 could best be described as a year in transition or a period of depressed economic activity that had to be endured before success could be achieved in future. All indications pointed to 1983 as an extension of 1982 and to the postponement of a meaningful recovery until 1984 or even 1985. The two main causes of the deferral of the moderate recovery that had originally been projected for late 1982 were the decline in fixed investment and the drop in real imports by the non-oil developing countries. While he would not wish to sound any more pessimistic than current conditions warranted, he found it difficult to see any appreciable change in fixed investments or real imports by the developing countries in either 1983 or 1984 in the absence of substantial real improvements in key economic variables: interest rates, commodity prices, and the terms of trade.

In the final paragraph on page 4 of ID/83/1, the staff provided an excellent description of the conditions in the non-oil LDCs between 1981 and 1983, noting the lower capacity of those countries to adjust to a significant deceleration in their growth rate because of their already low income levels, Mr. Salehkhou observed. The general situation in the industrial countries had been characterized as a trade-off between the need to continue to curb inflation and the need to deal with an already unacceptable unemployment rate. On the oil exporting countries, the staff had spoken of the need to adapt to a new environment characterized by lower oil revenues and gradually emerging budget and payments deficits.

According to the data, the volume of world trade in 1982 had fallen by 1.5 per cent, and the unit value of world trade in dollar terms had declined by 4 per cent, the largest annual decline in the past 20 years or more, Mr. Salehkhou remarked. For 1983, the staff was projecting a 3 per cent rise in the volume of oil trade, which, considering the available indicators, seemed to be on the high side, especially given the present widespread protectionism.

With respect to the projections for the movement of commodity prices--both metals and agricultural raw materials--few details had been given in the report, apart from those in Table 6 on page 48 of ID/83/1, Mr. Salehkhou commented. In that table, market prices of non-oil primary commodities were projected to rise by 3 per cent following double-digit declines in both 1981 and 1982. The forecasts and developments in the commodity markets--which were the main causes of the payments difficulties of so many non-oil and oil producing developing countries--deserved greater analysis and in-depth discussion of the sort that had been provided in the 1982 Annual Report. He joined Mr. de Maulde and Mr. Vidvei in asking the staff for a further elaboration on the projections of commodity price trends for 1983.

The staff's recommendations with respect to the policy stance of the industrial countries seemed well taken, Mr. Salehkhou said. Even in those countries that had been relatively successful in controlling inflation, the room for maneuver toward a more expansionary policy stance was limited. Moreover, the sizable budget deficits foreseen for the future could well hamper the current optimism regarding a further decline in interest rates and an eventual economic recovery. Indeed, as the staff had pointed out, a marked shift in the stance of market and fiscal policies aimed at stimulating growth in the short run would carry the serious risk of dampening medium-term prospects along the lines of those described in Scenario B.

He had expected a more in-depth analysis of the economies of the oil exporting countries than had been presented in the staff report, Mr. Salehkhou explained; with the current weak situation in the oil market, there seemed to be a greater need than in the past to know exactly where the economies of the oil exporting countries stood and what the future held in store for them. The main development on the external side in 1982 had been the virtual elimination of their surplus on current account; for 1983, judging by the current situation in the oil markets, the staff estimate of a $3 billion combined surplus was probably optimistic. Indeed, there were already projections for a deficit of some $50 billion if the 10-20 per cent reduction in the price of oil in 1983 should materialize. In that event, the oil producing countries would no doubt need to borrow far more on the capital markets than the $9 billion that they had borrowed in 1982. At the same time, the credit crisis of 1982 could prove to be a major stumbling block, not only for oil producing countries but for all developing countries, because it had produced among the banks a negative attitude toward extending loans and credits to all developing countries, whether or not they had been involved in the crisis. The oil producing countries would thus certainly feel the pinch in 1983.

In discussing the plight of the non-oil developing countries, particularly the low-income ones among them, most major studies and reports in the past had attributed a large part of the difficulties experienced by those countries--either directly or implicitly--to the rise in the price of oil, Mr. Salehkhou recalled. It was thus surprising to note that, in the second successive year of falling oil prices, the situation in the non-oil developing countries continued to look bleak. Appropriately, the staff was gradually beginning to place greater emphasis on other factors--such as high interest rates, the recession in the industrial countries, and weak commodity prices--as primarily responsible for the continued deterioration in the economies of the non-oil developing countries. In that regard, he joined Mr. Taylor in requesting further studies to determine the effects of falling oil prices on inflation and other economic variables in member countries.

With still-mounting current account deficits and weak commodity prices, the low-income developing countries faced increasing balance of payments deficits and debt burdens in 1983, Mr. Salehkhou noted. Among the group of non-oil LDCs, the major oil exporters and major exporters of manufactures would apparently fare better in 1983 than the low-income members of the group because the commercial banks would be more likely to extend credit to them. Still, the indications were that the commercial banks would be channeling most of their loans toward the industrial countries. Like Mr. Casey, he believed that the Fund could play a more significant role than in the past in providing an environment for the restoration of confidence by the commercial banks in the non-oil developing countries; the Managing Director's efforts toward that end during the year were commendable.

Access by the low-income countries to capital markets would prove an uphill battle for 1983, Mr. Salekhkou observed. Their need for concessional credit was acute and, because of their low level of income and low standard of living, it would be difficult for them to further curtail domestic demand or to raise taxes. Such countries needed external resources urgently. Any potential increase in their exports would be dependent upon a strengthening of commodity prices in international markets and a recovery in the industrial countries. Without such developments, the low-income countries would require outside financial resources to sustain their economies. The situation underscored the urgent need for substantial strengthening of Fund and World Bank resources and for a sizable allocation of SDRs; at a minimum, a doubling of the size of Fund quotas under the Eighth General Review was needed. Cooperation among all member countries--particularly the wealthier nations and those in surplus--would be necessary to provide the Fund and the World Bank with sufficient resources to enable them to fulfill their central role in dealing with world economic problems.

Mr. Teijeiro considered that recent developments in the monetary policy of the United States and other industrial countries were to be welcomed. Following their remarkable success in bringing down inflation, such countries might be able to ease monetary policies somewhat in future without risking the successes those policies had achieved. Such an easing of policy, and the consequent effects on interest rates, could begin to reverse the unfortunate rise in unemployment, squeezing of profits, and sluggishness of investment.

Taking a more global view, Mr. Teijeiro noted that the world faced several worrisome developments: the pressure for expansion of public sector expenditures and intervention; the tendency to protectionist policies; and the situation of the highly indebted developing countries. A reorientation of policies in the industrial countries would be crucial to relieving those difficulties. One had only to look at developments during the 1930s to see the effects of a major world recession on trade policies and public sector intervention in most countries. The fall in interest rates and the reversal of the terms of trade that should come about with the reorientation of policies in the industrial countries would be a necessary condition for avoiding such developments. For most developing countries, a stable world economic environment was the sine qua non for a liberalization of trade policies; he hoped the industrial countries would not wait too long before establishing such an environment.

With respect to the difficult situation of debtor countries, Mr. Teijeiro recalled that, in the context of other discussions, he had already praised the efforts being made by the Fund to manage the present situation. Further efforts would be needed to maintain the commercial banks' exposure in the debtor countries until the world economy began to recover. Finally, he foresaw a major role for the Fund in helping to resolve balance of payments problems. He therefore looked forward to a decision on a substantial increase in quotas and to an effort to deal with the issue of SDR allocations at an early date.

The Executive Directors agreed to continue their discussion of the World Economic Outlook on Wednesday, February 2, 1983.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/22 (1/31/83) and EBM/83/23 (1/31/83).

2. COSTA RICA - FUND REPRESENTATIVE

In response to a request from Costa Rica for a Fund Resident Representative, the Executive Board approves the proposal set forth in EBAP/83/36 (1/27/83).

Adopted January 31, 1983

APPROVED: July 6, 1983

LEO VAN HOUTVEN
Secretary