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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/106

10:00 a.m., July 20, 1983

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	A. Le Lorier
	M. Teijeiro
R. D. Erb	
	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	
	C. Robalino
G. Laske	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
	A. Agah, Temporary
F. Sangare	E. I. M. Mtei
	J. L. Feito
J. Tvedt	A. Lindø
N. Wicks	
	Wang E.

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

Also Present
C. F. Schwartz, Special Consultant. African Department: A. B. Diao, A. G. A. Faria. Asian Department: J. T. Boorman, R. J. Hides, S. M. Schadler, G. Szapary. European Department: L. L. Perez, S. M. Thakur. Exchange and Trade Relations Department: C. D. Finch, Director; S. J. Anjaria, G. Belanger, G. G. Johnson, C. R. C. Saint-Etienne. Fiscal Affairs Department: P. S. Heller, P. R. Rado. Legal Department: W. E. Holder. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell. Western Hemisphere Department: S. T. Beza, Associate Director; K. B. Bercuson, C. V. A. Collyns, L. E. DeMilner, J. Ferrán, E. Hernandez-Cata, Y. Horiguchi, L. R. Kenward, L. Mendras. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: C. J. Batliwalla, S. E. Conrado, S. El-Khouri, L. Ionescu, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Arias, R. Bernardo, J. Bulloch, M. Camara, L. E. J. Coene, T. A. Connors, R. J. J. Costa, M. Eran, C. Flamant, I. Fridriksson, G. Gomel, N. U. Haque, M. Hull, H. Kobayashi, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, G. W. K. Pickering, T. Ramtoolah, J. Reddy, Shao Z., Wang C. Y., Zhang X.

1. UNITED STATES - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with the United States (SM/83/135, 6/20/83; and Sup. 1, 7/19/83). They also had before them a report on recent economic developments in the United States (SM/83/152, 7/6/83).

Mr. Erb said that he had no major disagreements with either the thrust of the staff's policy proposals or its characterization of the views of the U.S. Administration. The latest data in Supplement 1 to SM/83/135 showed a strong recovery to be underway in the United States. While the staff had projected slightly lower real economic growth rates than the Administration, the differences were minimal; both were in the range of 5-5.5 per cent for 1983 and 4-4.5 per cent for 1984. The staff's projection for inflation was somewhat lower than that of the Administration for 1983 and slightly above that of the Administration for 1984, but both were in the range of 4.5-4.75 per cent. The staff had projected an unemployment rate of 9 per cent for end-1984, while the Administration's projection was for a rate of 8.6 per cent.

Section II of the report, covering the overall strategy and aims of the Administration, accurately summarized the way in which U.S. officials viewed their successes and failures, Mr. Erb continued. The reduction of inflation was seen as the Administration's major accomplishment; the failure adequately to curb growth in government expenditures and to reduce the fiscal deficit had been the Administration's major disappointment. However, as pointed out by the staff, it was too soon to evaluate the full impact of some of the key elements of the Administration's programs.

The basic policy goal continued to be the attainment of a steady, long-lasting expansion with price stability, Mr. Erb considered. Given the important international monetary and financial roles played by the U.S. dollar, he would place special emphasis on the achievement and maintenance of price stability in the United States. From an international perspective, steady economic growth and price stability in the United States were viewed as necessary, although not sufficient, conditions for the world economy to return to sustained growth and to achieve exchange rate and financial stability.

The staff deserved commendation for its efforts to spell out the major differences of view among economic officials within the Administration, Mr. Erb remarked. First, there were different analytical and empirical views on how the U.S. economy worked in its interaction with other economies, and those were reflected in different assessments of the impact of the deficit on the domestic economy, on exchange rates, and on the current account. Similar differences of view were evident in the area of monetary policy. Second, there were different judgments about how the political/economic process worked in the United States, and those were most clearly reflected in different views about the needed pace and extent of revenue increases and expenditure reductions. Finally, different views existed with respect to the priorities that should be attached to various objectives over time. Some officials placed greater emphasis on achieving price stability, while others considered the achievement of growth to be more important. Ultimately, the decisions that were taken by any Administration reflected a process of discussion and agreement among officials, which was why he considered that the differences in analyses and judgments that shaped ultimate policy decisions should be incorporated in Article IV reports.

With regard to monetary policy, Mr. Erb observed that the staff had rightly pointed to the risks of allowing money growth--particularly M-1--to continue at the high rates recently registered. Institutional changes due to deregulation had complicated estimates of M-1 growth, although the major impact of those changes had taken place in late 1982 and 1983, and the staff had noted that velocity normally diminished in the early stages of a recovery. To the extent that the large decline in velocity in 1982 had been due to precautionary demand for highly liquid assets in the face of uncertainty about future economic developments, a steady recovery could lead to renewed confidence and a decline in precautionary demand for such assets, which might mean a significant increase in velocity. As recent actions and statements of its officials had indicated, the Federal Reserve was well aware of the danger of allowing money growth to continue at high rates and was prepared to accept some tightening of money market conditions in the short run in an effort to bring down the rate of money growth. In his view, such a response at an early stage in the recovery was likely to reduce the risk of excessive growth in the immediate future while increasing the likelihood of a sustained recovery. According to a statement that would be delivered by the Chairman of the Federal Reserve later in the day, "the Committee felt that an appropriate approach would be to assess future growth from a base of the second quarter of 1983, looking toward growth close to or below nominal GNP." More specifically, the range for M-1 was to be set at 5-9 percent for the remainder of 1983 and at 4-8 percent for 1984. The Chairman of the Federal Reserve had also observed that "the Committee, in the light of recent developments, looks toward substantially slower, but not a reversal of, M-1 growth in the future. Velocity is expected to increase, although not necessarily to the extent common in earlier recoveries." Velocity would need to be monitored closely during the course of 1983, and there were likely to be further modifications in the monetary target path if there were indications that velocity might turn out to be higher than currently anticipated by the Federal Reserve.

On fiscal policy, Mr. Erb said, the U.S. Administration was unhappy with the continued high rate of growth of government expenditures. The staff had noted a broadly held view within the Administration that, in the final analysis, the only way to free resources for use in the private sector was through a reduction in the growth of expenditures. That was not to say that Administration officials were opposed to tax increases; indeed, they could go along with them if the necessary expenditure cuts were accepted by the Congress. However, as reported by the staff "they [U.S. officials] were opposed to further tax increases at this time..., since they feared that additional revenue would only make for higher government spending, with little impact on the deficit. They felt that the experience of 1982, when the passage of a tax package had lessened the pressure for spending cuts, was very telling."

During the 1981 Article IV consultation, he had expressed the view that the deficit could be a problem in the "outer" years, Mr. Erb continued; earlier in 1983, he had indicated that the United States was entering the potential problem period. His main concern at present with the deficit was not so much its impact on growth per se, or even on inflationary expectations; rather, he was worried about the impact of the deficit on the structure of the domestic and international economy. Hence, he could agree with those who felt that, if there were significant reductions in the deficit at present and into the future, and if those reductions were accomplished through a clear-cut political consensus on restraining expenditure growth and implementing tax increases that were not biased against savings and investment, there would be a downward adjustment in the dollar and a corresponding adjustment in the U.S. current account. Such a downward adjustment did not imply that there would be either a continued decline in the dollar or a continued strengthening of the dollar after the adjustment had been accomplished; much would depend upon rates of inflation in the United States relative to rates of inflation in other key currencies, particularly those in Japan and Germany.

With regard to the balance of payments and the exchange rate, Mr. Erb considered that the exchange market intervention study had been particularly valuable. It represented the first time that the impact of exchange market intervention had been evaluated with extensive and detailed data. More important, the discussions of the working group had enabled each country to understand better the intervention policies and objectives of others. As a result of the study--which had essentially confirmed the appropriateness of a limited intervention policy by the United States--the United States was prepared to engage in joint intervention in times of disorderly markets. Based on the intervention objectives and practices of other countries, it appeared that U.S. intervention would mainly be vis-à-vis the deutsche mark and the Japanese yen since, for the most part, other countries were not interested in direct intervention by the United States in their currencies. Indeed, he suspected that Canada, for example, might have ambivalent feelings if the United States decided actively to intervene in Canadian/U.S. dollar exchange markets; and the United Kingdom might have a similar view if the United States were to intervene heavily in sterling. Nonetheless, as a result of the exchange market intervention study, the United States was committed to closer consultations with other governments with a view to determining those times when exchange market intervention might be appropriate to deal with disorderly markets.

Mr. Nimatallah observed that the U.S. economy was currently emerging from a difficult period. The campaign against inflation had been remarkably successful over the past 12 months: the rates of increase in all major price indices had fallen to low levels, and wage increases had moderated significantly. Moreover, interest rates had come down from their peak levels of mid-1982, real growth had picked up considerably, and unemployment had begun to fall. The prospects for continued growth in the rest of 1983 and during 1984 were thus encouraging. Nonetheless, there remained a number of obstacles in the way of a balanced and sustained recovery. Foremost among those was the large federal budget deficit and the prospect that it would persist at high levels in the years ahead. As a consequence, inflationary expectations continued, interest rates remained relatively high in real terms, and there was a risk that private investment might be crowded out.

The U.S. authorities remained committed to the goal of a balanced budget, Mr. Nimatallah noted. They had made some progress in reducing expenditure, although federal government outlays had continued to rise in relation to GNP. The continued emphasis on expenditure restraint in the 1983/84 budget was appropriate, but recent experience suggested that the scope for sizable expenditure cuts might be limited. On the other hand, there was scope for new measures to raise revenue in a way that would not jeopardize incentives for savings and investment. Specific steps to achieve the objective of a balanced budget were needed, and he hoped that the authorities would give serious consideration to the staff's suggestions for increasing indirect taxes. In his view, the most effective course of action would be the adoption of legislation that would allow tax measures to be implemented in, say, 1985--a move that was in line with views expressed by the U.S. Council of Economic Advisors and the Chairman of the Federal Reserve Board. Such legislation and tax measures were urgently required to reduce the deficit over time and could have an important psychological impact on inflationary expectations at present and on interest rates later on. Moreover, the tax increases would take effect at a time when the economy might be in danger of overheating.

Firm action on the fiscal side would set the stage for a more balanced recovery and would reduce the burden on monetary policy, Mr. Nimatallah considered. Heavy dependence on monetary policy was subject to limitations: given the fiscal constraints, and the difficulties in interpreting recent movements in the monetary aggregates, the Federal Reserve might have little choice but to follow a fairly restrictive monetary policy. Unfortunately, such a policy could be harmful to recovery in the United States and elsewhere, particularly the heavily indebted countries.

On the external side, the large budget deficit and high real interest rates could have a number of other unfortunate effects, Mr. Nimatallah remarked. First, they had already kept the dollar strong to the point of discouraging U.S. exports and encouraging imports, leading to a widening current account deficit. Second, they might serve to delay the recovery in the main trading partners of the United States by necessitating high interest rates in those countries just to prevent capital outflows. Third, high real interest rates in the United States were dampening the adjustment process in general, and the repayment of debts in particular. Fourth, because high interest rates were discouraging private investment expenditure, unemployment remained high in the United States; with a lower level of exports, the result was protectionist pressure from labor unions, which posed a serious threat. Protectionist measures imposed by the United States could not continue without retaliation, which could interrupt the process of world economic recovery, and many countries might fail to adjust and grow.

He had the impression that recovery in the main trading partners of the United States was not moving as expected, perhaps because the usual links between those economies were weak, Mr. Nimatallah said. What seemed to be lacking was an appropriate level of interest rates in the countries of the Organization for Economic Cooperation and Development (OECD) and a dismantling of protectionist barriers. It was essential that the United States should take the lead, in cooperation with other major countries, in dismantling those barriers. Such a move would be particularly important for the developing countries, whose adjustment efforts depended to a considerable extent on their access to industrial country markets.

The United States should also resume its role of a leading aid donor, Mr. Nimatallah commented. Official aid was particularly important to the low-income countries, and, in helping them to develop through the provision of official aid, the United States and other donors would benefit from the creation of income and employment in their own economies. It was also vital that the United States should continue to meet its commitments to multilateral institutions. In that regard, he welcomed the vigorous action of the U.S. Administration in pushing for speedy legislation to increase the U.S. quota in the Fund. Early ratification of the quota increase by all Fund members was essential to enable the institution to continue playing its role effectively.

Miss Le Lorier said that she could share almost all the views contained in the staff appraisal, which provided a comprehensive enumeration of the fears and doubts that her authorities had had for some time about the U.S. economy. Two main positive developments had occurred since the previous consultation: the return to price stability, and the bottoming out of the protracted recession of 1981/82. The fall in interest rates that had occurred during 1982 and early 1983 should not be placed in the category of positive developments for which the authorities should be commended; real interest rates were as high as ever and provided no reasonable assurance of a long-term recovery; and they were more likely to go up than down over the following few months.

The authorities should be commended for their success in the fight against inflation and for the lead that the United States had recently taken in the recovery of activity in the industrial world, Miss Le Lorier continued. Of course, there was little magic about the observed decline in the rate of inflation, and her commendation should perhaps be more directed toward the willingness of the authorities to accept paying the very high cost that a restrictive monetary policy had imposed on the economy. Similarly, the recovery of activity in the United States was by no means magical, in the sense that a severe and widespread decline in activity and capacity utilization in the most vital sectors of the economy should normally be expected to show a significant rebound in demand sooner or later. While the positive results of the policies pursued by the present Administration should be recognized, the lasting character of those gains remained in doubt for two reasons. First, what had been achieved thus far were the easiest elements to achieve; moreover, and perhaps more important, the areas where success had been limited or lacking could act as a severe constraint on the authorities' room for maneuver.

The constraints on maneuverability appeared to derive from three main factors: an excessively large budget deficit, too high real interest rates, and an overvalued currency, Miss Le Lorier remarked. The staff had rightly identified the main priority as an appropriate reduction in the fiscal imbalance. Although the causal links between high budget deficits, high interest rates, and high exchange rates remained a matter of debate, there was little doubt that such links existed. A solution to the current budget problem would certainly alleviate pressures on financial and exchange markets. The apparent lack of progress toward a better budget balance, even under the assumption of a stronger-than-expected recovery, was a matter for concern, particularly since continued progress against inflation might, under the current tax policy, lead to a further deterioration in the federal accounts. In the circumstances, the risk of a conflict between public and private demand for credit was obvious. The recent evolution of financial markets would seem to indicate that, even if such a conflict had not yet fully materialized, it was inevitable; and the recent tendency of interest rates to reverse their downward trend certainly signaled that conflict.

The staff in its appraisal seemed to prefer a prompt tightening of credit conditions--i.e., a rise in interest rates--over a tightening of credit further into the future, Miss Le Lorier observed. That preference appeared to be based on the consideration that any delay could lead to larger and longer-lasting increases in interest rates. She found it difficult to agree with the staff on that matter for several reasons. First, the merits of a tightening of monetary conditions should be carefully assessed against the negative consequences of a further aggravation of the present imbalance between monetary and fiscal policy. The proposal to tighten conditions would be more attractive in the context of a convincing move toward slowing down the public sector borrowing needs, but that move had not been made thus far. She wondered, in that connection, whether the staff had estimated the consequence of the implementation of the third tranche of the income tax cut on U.S. Treasury borrowing over the second half of 1983.

Second, tightening the money supply could appear to be "too much too soon" at the present stage, Miss Le Lorier considered. The credibility of M-1 as a reliable guide was not yet fully established, and interpreting the recent increase in M-1 as the beginning of a new trend might be a premature conclusion. At a minimum, such a conclusion would need to be substantiated by some evidence of a commensurate growth in corporate and household demand for credit and she had not found such evidence in the report. Finally, too great a willingness to allow interest rates to rise again could only have negative consequences for the exchange markets. In recent weeks, the effect of a moderate firming of interest rates on the exchange rate of the dollar against all other currencies had been clear; anything stronger could have severe consequences for the trading partners of the United States and for heavily indebted countries. In that respect, she welcomed the acknowledgment in the staff appraisal that participation by the United States in coordinated intervention with other countries could serve to counter disorderly market conditions.

A number of economic factors might be mentioned in the effort to explain the current level of net capital inflows from abroad, including the level of interest rates, the progress made in the fight against inflation, and the reform of the tax system with respect to investment, Miss Le Lorier said. However, analysts had also referred to other explanations that were much more volatile and quickly reversible, such as the present role of the dollar as a "haven" currency. The level of capital flows into the United States was much larger than the current account deficit, and the market might well react with a vengeance at some time in the future, and the fall in the dollar could be disruptive. A concerted effort to smooth out such fluctuations in the exchange rate and in capital flows--both before and after the impact of the current account deficit on exchange rate expectations materialized--was warranted. Her comments about the need for careful assessment of the present evolution of monetary aggregates in terms of their underlying longer-term strength should not be interpreted as opposition to the merits of an appropriate tightening of monetary policy some time hence. Her only reservation stemmed from the view that the consequences of such a move--which was a second best solution--deserved careful consideration.

The staff's frank remarks about the need quickly to reverse the declining trend in official development assistance (ODA) and the importance of countering protectionist measures were welcome, Miss Le Lorier said. The latter recommendation, which was addressed not only to the United States but also to its main industrial partners, could not be overemphasized; the staff had rightly made the case that protectionism could trigger retaliation from other countries affected by specific trade restrictions. Unfortunately, recent decisions by the U.S. Administration in certain areas of sensitivity to European producers had not improved the outlook for a rollback of trade barriers. Her authorities hoped that the recovery in the United States, and in the other main industrial countries, would create conditions for a return to the more favorable trade relations on which much of the prosperity of all Fund members had been based for the past 30 years or more.

Mr. Laske considered that the economy of the United States was performing well at present. A relatively strong revival of activity was under way, and projections for real growth in 1983 had recently been revised upward. That news was welcome, particularly since a healthy U.S. economy based on more stable cost and price developments than in the past was of the utmost importance to the world economy. Although the world recovery appeared more assured at present than it had been at the time of the most recent World Economic Outlook discussions, uncertainties about the durability of the recovery could not be overlooked. The reasons for those uncertainties had been clearly spelled out in the staff appraisal, which he fully supported.

Monetary policy had greatly contributed to the reduction in inflationary pressures, but fiscal policy had not been particularly helpful, Mr. Laske remarked. When the present Administration had taken office, the elimination of the Federal Government's budget deficit had been established as a medium-term goal. To achieve the target, marginal income tax rates had been reduced in the expectation that such a move would serve to strengthen savings and private investment and lead to adequate tax revenues. The intention had been to cut back government expenditure in order to reduce the absorption of resources by the public sector and to create more room for private investment. Unfortunately, the plan had not worked as well as had been hoped. It was possible that the current recovery was based on the belated private sector response to the tax relief that had been granted in three installments; however, it could be argued--as the staff had done--that the decline in inflation and the slight easing of monetary policy since the middle of 1982 had been far more influential in that respect. That line of reasoning was strengthened by the fact that, thus far, the recovery had been based mainly on a pickup in inventory accumulation, stronger sales of durable consumer goods, and greater activity in residential construction. Business investment, unfortunately, had failed to show a significant rebound.

Contrary to earlier intentions and expectations, the budget deficits of the Federal Government had shown no tendency to decline, Mr. Laske observed. Instead, they had become larger from one fiscal year to the next and, given present policies, any decrease in future was likely to be only marginal in absolute amounts. What was worrying was not so much that the deficits had reached a level of 5-6 percent of GDP but that they were siphoning off 80 percent or more of private net savings. Hence, little was left for the financing of productive investment. Owing to the strong competition of public and private borrowers in the credit markets and the reduced sensitivity of the public borrower to the level of nominal interest rates, rates in both the short- and long-term end of the market were being kept very high, which hampered business investment. The huge credit demands of the Federal Government stood in the way of a sustainable recovery of output and growth. It would be regrettable if the economic revival were to be short-lived because of the authorities' failure to come to grips with the deficits. The fiscal problem in the United States had both a domestic dimension and important international repercussions. The resulting high interest rates had led to strong capital inflows, a strong dollar--which some eminent economists believed to be overvalued by as much as 20 percent--and had also forced other monetary authorities to keep their domestic interest rates higher than they considered desirable for the sake of recovery in their own economies.

A resolution to the budget problem was being sought by the U.S. authorities, but reliance so far had been almost exclusively on expenditure cuts, notwithstanding the tax increase package that had been agreed in 1982, Mr. Laske commented. He agreed that emphasis should be placed on checking expenditure growth; indeed, that was the approach adopted by his own authorities for dealing with the high structural deficit in Germany's budget. However, the U.S. authorities had taken an almost negative attitude toward revenue measures as a complementary way of reducing the deficit; they had cited past experience, which showed that greater revenues were normally used to increase spending. While that might be true, experience also showed that, when restraining expenditure was more difficult than expected and failed to balance the budget, revenue action became unavoidable.

He had no specific suggestions for tax or revenue measures in the United States, Mr. Laske continued; however, as a guiding principle, any revenue increases should aim at avoiding the detrimental repercussions of high deficits, particularly the hampering of private savings and investment. The staff had mentioned two possible tax measures: the adoption of specific taxes on consumption, and the scaling down or elimination of exemptions from income taxation. It had not elaborated on its suggestion for adopting consumption taxes, however, and he wondered on what sorts of income or transactions such taxes could be levied. As was well known, practically all European countries had used the value-added tax, which provided a relatively large share of budget revenues for those countries. He wondered whether the introduction of a value-added tax in the United States was a feasible way of securing greater revenue and whether it would be practical from a constitutional point of view as well as from a fiscal and economic point of view.

Increasing energy taxes as a way of raising revenue had been ruled out by U.S. officials during the Article IV consultation discussions, Mr. Laske recalled. It was not of course illogical to allow the benefits of declining oil prices to accrue to consumers when the cost of rising oil prices was being passed through to them as well; however, energy taxation in the United States was relatively modest by international standards, and taxing energy use more heavily would support conservation, which continued to be essential even though oil prices were relatively weak at present. In sum, it was urgent for the U.S. authorities to consider revenue-raising measures immediately; it would not be helpful to rely solely on the stand-by tax measures, which would be activated only if the estimated deficit for fiscal year 1985/86 threatened to exceed a certain percentage of estimated GNP.

The conduct of monetary policy in the United States was particularly difficult at present, Mr. Laske considered. Deregulation in the financial field had produced a multitude of new investment instruments and had created difficulties for the interpretation of the monetary aggregates. At least as problematic, however, was the enormous borrowing need of the U.S. Treasury, which had prevented interest rates from moving more in line with the deceleration of inflation; indeed, the very existence of the borrowing need kept inflationary expectations alive. The Federal Reserve had responded to the situation by tightening conditions in the money markets somewhat, with the not altogether surprising effect of raising market rates. According to press reports, the most recent auction of Treasury bills had resulted in yields that had been the highest since September 1982, suggesting that the previous decline in rates might be over. Rising interest rates were not helpful to either U.S. recovery or to economic recovery in other industrial countries, and they were particularly hard on the stabilization efforts of highly indebted developing countries. Still, it was difficult to see what other options had been open to the Federal Reserve, given that it had not been prepared to risk the hard won progress made in reducing inflation to relatively acceptable levels.

The dollar had displayed surprising strength in the exchange markets for some time, Mr. Laske observed. As he had noted earlier, academic economists believed the dollar to be overvalued, but their view was somewhat "lopsided," since it was mainly based on purchasing power parity theory and gave little weight to the impact of interest rate-induced capital movements on the exchange rate. The dollar's strengthening was nonetheless remarkable, as it coincided with a progressive deterioration in the trade account and in the current account of the balance of payments. The Chairman of the Council of Economic Advisors had recently noted that the widening external U.S. deficit had enabled other countries to achieve a stronger expansion than might have been possible without U.S. demand for foreign goods and services. The observation was a valid one, although the staff had also been correct in noting that the growing deficit in foreign trade intensified the pressure for protectionism in the United States. The latest evidence of the protectionist trend was the decision of the U.S. authorities to impose quotas on specialty steel products, an action that was difficult to reconcile with the commitment to free international trade that the U.S. representatives had confirmed to the staff mission. It was also at variance with the communiqués issued following the Williamsburg Summit and the Ministerial Meeting of the OECD. His authorities were gravely concerned and disappointed about the latest protectionist step by the United States, which undermined the credibility of the U.S. position on international trade and further increased the danger of a retaliatory escalation in protection.

Like others, Mr. Laske commented, he had noted that the record of the United States in the provision of foreign aid was not particularly impressive and should be improved. However, it was equally important, primarily for the poorest of the developing countries, for the United States to keep market access open to their products. Without such access, it would be far more difficult to keep the world economy on an even keel and to provide the basis for a return to growth and reduced unemployment.

Mr. Wicks considered that fiscal year 1982/83 had been a year of achievement in economic policy in the United States, and the authorities should be commended for their success in reducing inflation and interest rates over the period while encouraging economic recovery. More needed to be done, however. First, it was important to ensure that reductions in inflation and interest rates could be sustained. Second, the U.S. economy should be managed in a way that did not create difficulties for the rest of the world. Third, because the long-term good health of the U.S. economy was crucial to a healthy world economy, the private sector should be given an opportunity to tap the limited pool of private savings for new investment. Finally, the world needed assurances that the United States remained dedicated to the preservation of an open world trading system.

The key element in the achievement of the aims he had mentioned continued to be the level of the structural budget deficit, Mr. Wicks remarked. Real interest rates were still too high; nominal rates were edging up, and there were expectations that they might go higher still. The existing and prospective budget deficit in the United States was an important determinant of those interest rate movements. Without a sizable reduction in the deficit, monetary policy would continue to bear too great a burden in the fight against inflation.

He had expected that his own view of the relationship between interest rates and budget deficits might have differed from that of the U.S. Administration, Mr. Wicks continued. However, while there remained a number of influential people in the Administration who were arguing that the relationship between interest rates and budget deficits was not clear, the Secretary of Commerce had been quoted in the New York Times as saying that, "if the deficit is not reduced, Fed financing demands will begin to crowd the interest sensitive sectors out of the credit markets, jeopardizing the prospects for further recovery of residential construction." The Secretary of Commerce had of course been focusing only on residential construction, but his remarks could apply equally well to many other sectors of the U.S. economy. The ways of lowering the deficit--including revenue measures such as higher taxes and the elimination of tax exemptions--had been widely discussed. There should be cuts in government expenditures, but if those reductions could not be achieved, there was no reason for not increasing taxes. Early action by the authorities would help give confidence to the population that the deficit would be reduced.

As the recovery proceeded, corporate credit demand--which was currently flat--was likely to revive and would create further upward pressure on interest rates, Mr. Wicks said. He would be interested in hearing the views of Mr. Erb and the staff on when the clash between public and private sector demand for credit would become acute. In that regard, he wondered whether the U.S. authorities believed that capital expenditure in the corporate sector might be more buoyant than had been projected by the staff. The staff paper cited recent tax incentives as one reason why the decline in investment expenditures over the past two years had not been as steep as might have been expected; the implication was that, when investment in plant and industry began to recover, it might grow more rapidly than anticipated. He also wondered whether there was any evidence to suggest that the corporate sector was abnormally liquid at the current point in the business cycle; if so, the so-called "credit crunch" could be postponed for some time.

The massive federal demand for credit and the expected growth in private sector demand for credit posed an acute dilemma for the Federal Reserve Board's operation of monetary policy, Mr. Wicks considered. The Federal Reserve seemed to have been placed in a position of making a difficult choice between the risk of renewed inflation later on and higher or rising interest rates at present, which could weaken the recovery in the United States in the shorter term while adding an extra dimension of difficulty to the international debt problem. He would appreciate some comment from Mr. Erb on what choice the Federal Reserve would make.

It was admitted by all that, partly because of institutional changes, it was difficult to interpret monetary conditions in the United States, Mr. Wicks noted. In the circumstances, the authorities had been right to show flexibility by taking many factors into account in judging the monetary aggregates. He agreed with the staff's suggestions that two factors needed to be monitored carefully, namely, the changing behavior of income velocity and the recent tendency of M-1 to grow rapidly. The staff had judged that the rapid growth of M-1 could not be fully explained by the shift between different types of accounts; indeed, the distortions to M-1 growth from the movements into money market accounts might be rather smaller than some believed. On balance, he could accept the view of the staff that immediate action on interest rates might alleviate a need for larger, longer-lasting increases later on; however, any sudden increase in rates could have damaging consequences for the international community. In that regard, he reiterated a suggestion made on other occasions that Article IV consultation reports for certain countries should contain a section on the effects of the country's domestic policies on its neighbors and trading competitors.

With regard to external policy, Mr. Wicks supported the staff's assertion that action to reduce the fiscal deficit could help to provide an orderly correction of the exchange rate. The large and growing current account deficit should put downward pressure on the dollar, but it was important that any dollar realignment should take place in an orderly fashion. Hence, he was happy to hear that the U.S. authorities fully accepted the conclusions of the Jurgensen Report, which allowed a modest role for coordinated intervention to smooth short-term fluctuations if major currencies were under temporary pressure.

The strong dollar and the consequential loss of competitiveness was already leading to increasing protectionist pressures in the United States, Mr. Wicks observed. The recent decisions relating to the import of cars from Japan and specialty steels did not bode well, particularly when set against a background of a widening trade deficit. He fully endorsed the view of the staff that the U.S. authorities had a special role to play in upholding a liberal international trading system; and in that respect, the staff might have been more critical of U.S. policies to date. He had been intrigued, for example, by the justification for the high level of auto "dumping" and countervailing duties; the U.S. authorities had stated that "such actions did not involve a serious risk of retaliation." To use the absence of a risk of retaliation as justification for such measures suggested a ambiguous approach to trade policy, which should be avoided.

The section of the staff paper on the outlook for the U.S. economy was helpful, Mr. Wicks considered. However, as in the recent World Economic Outlook paper, he had missed any analysis of the mechanisms and sources of the recovery. The staff might have examined, for example, how lower interest rates could contribute to the recovery. He noted from Supplement 1 of SM/83/135 that the Administration had made an upward revision in its projections for real GNP growth, and he would not be surprised if the figures were to be raised even further. It was unclear, however, to what extent the projected increased growth reflected a balanced recovery based on a revival of corporate spending as well as increasing household expenditure. The supplement to SM/83/135 showed that business fixed investment was thought to have increased very little in the first half of 1983 and was expected to register only a modest increase over the year as a whole. He would be interested in hearing further details on the component of business fixed investment.

For the medium term, Mr. Wicks said, he shared the staff's concern about the sustainability of the upturn in the absence of corrective fiscal action. The history of economic forecasting suggested that many projections were never realized. Moreover, there appeared to be agreement that there was a real danger that a failure to deal with the short-run problems might make the achievement of medium-term objectives that much more difficult. The Federal Government's absorption of a large proportion of private sector savings ran the risk of starving corporate America of the funds needed for investment to increase productivity growth, on which the health of the U.S. economy ultimately depended. In sum, therefore, it was important to reach agreement soon on how to tackle the budget deficit. Without such action, there could be no expectation of sustained noninflationary growth in the United States or the world economy.

Mr. Prowse stated that, like others, he could broadly agree with the staff appraisal of the economic situation and policy of the United States. The U.S. authorities should be commended for their success in countering inflation and restraining wage increases, and he welcomed the generally healthy growth of the U.S. economy, some features of which should be noted. The growth thus far appeared to have been achieved through a willingness by consumers to spend more. Retail sales had risen for the past four months, which had reduced inventories; that, in turn, had led to an attempt to rebuild stocks, so that factory production had risen. Higher sales and improved production had contributed to better profits and job prospects. At the same time, there was no evidence of any new surge in prices; indeed, the wholesale price index for the first half of 1983 had declined modestly by 0.2 percent, and it was possible that production of primary products--wheat, in particular--would help to hold down prices in the short term.

Given the positive factors he had mentioned, Mr. Prowse continued, the staff's forecast of a fairly modest recovery might need to be revised upward. Unfortunately, that possibility served to underline the staff's concerns about the shortcomings that had been perceived in the stance of

U.S. economic policy. It seemed clear from a medium-term perspective that the recovery--which had arisen from consumer spending, a restoration of stocks, some monetary easing, and lower oil prices--probably could not be sustained on the basis that had given rise to it. It was not known how long the restocking process would continue, and it would not be appropriate to count on a further fall in oil prices. In the circumstances, continued recovery would depend on more fundamental developments. What was required at present was an increase in profit and investment. The major countries had experienced inadequate levels of investment for a long period and, unless those levels could be restored, the economies in question would be unable to maintain appropriate levels of growth and employment. It might not be a coincidence that, of the seven largest OECD economies, the one with the highest unemployment rate--namely, the United Kingdom--had experienced the lowest investment rate for a number of years, while the country with the lowest unemployment rate--Japan--had had the heaviest investment over the period.

The generally low level of investment among the industrial economies had been associated with the marked increase in real interest rates and very low nominal rates of return on manufacturing, Mr. Prowse continued. The difference between those rates was called by some the "pure profit rate," which had been declining over the past decade. Indeed, the pure profit rate in the United States in 1982 had been only about 4 percent, less than one fourth of the rate achieved ten years previously. Inadequate investment performance was thus reflected in inadequate profitability, particularly for the major industries in the United States such as automobiles, iron and steel, and oil.

According to the staff appraisal, the key problem for the United States was to sustain growth without rekindling inflationary expectations, Mr. Prowse remarked. Unfortunately, there had been certain departures from the requirements that would be consistent with that objective. The lack of action to adjust the current fiscal stance and, to a lesser degree, the monetary stance, had led to a significant risk that the U.S. recovery would start strong, but would not be sustainable. With regard to monetary policy, notwithstanding the difficulty of interpreting factors underlying the monetary aggregates in the United States, he shared the staff's concern about the recent rapid growth in those aggregates and believed that the Federal Reserve should stand ready to tighten monetary policy and accept the interest rate consequences of that action as the pickup in activity continued to strengthen. He acknowledged some tightening of monetary policy in recent weeks, but he was worried somewhat by the testimony of the Chairman of the Federal Reserve Board before the National Banking Committee on July 14, 1983 in which it had been suggested that the Federal Reserve might be reluctant to take sufficiently tough measures on monetary policy. Of course, there were constraints on what the Federal Reserve Board could do to raise interest rates or tighten monetary policy; the international debt situation was one of those constraints. Nonetheless, firmer action at present could avoid the need for more drastic action later in the cycle. In passing, he suggested that there might have been a tendency for the U.S. authorities to exaggerate the problems of conducting monetary policy in the United States.

Even given the problems of financial intervention and the cyclical swings in velocity, Mr. Prowse said, there seemed to be unwarranted uncertainty about the adequacy of monetary policy and the ability of the authorities to implement it. The Federal Reserve had claimed that there were serious risks in targeting interest rates, a view that his authorities could endorse; at the same time, however, the Federal Reserve had stated that, in conducting monetary policy, it would look at monetary aggregates "as guides for arriving at the appropriate level of interest rates." It appeared from that statement and from the relative stability of the Federal fund rates during much of 1983, that the Federal Reserve in practice had been inclined to pay regard to desired targets for interest rates, notwithstanding the resultant danger of an easing in monetary conditions. In his view, interest rates had been a significant factor in the decision-making process, which had led to a possibly unintended easing in policy.

On fiscal policy, Mr. Prowse agreed with the staff that a major reduction in the deficit was required to avoid a revival of inflationary expectations and a choking off of recovery in private sector investment. The large deficit had indirectly contributed to the maintenance of the value of the U.S. dollar above the level that it would otherwise have sustained, which had hurt exports and import-competing industries within the United States. Despite evidence of the relationship between interest rates and deficits in the past, there was nothing to show that the present and prospective fiscal deficits were not a factor in keeping real interest rates higher than they would otherwise be. The relevant consideration was whether or not the financial markets believed there was a link, regardless of what the past evidence showed. The U.S. Administration had in his view attempted to underplay the importance of that issue, although the Chairman of the Federal Reserve had not; indeed, he had noted that "the problems for monetary policy in meeting the needs of the economy are vastly complicated by the present prospect that huge deficits will preempt so much of our credit and savings as the recovery proceeds."

There was no policy path that could resolve the economic and financial effects of excessive deficits in a growing economy, Mr. Prowse commented. The current budget outlook, until corrected, could only serve to encourage skepticism about future prices and interest rates while narrowing the room for flexibly conducting monetary policy at present. However, given the perceived difficulties of reducing domestic public expenditure, and notwithstanding the Administration's emphasis on doing so, the ratio of federal outlays to GNP had continued to increase under the current Administration. With the commitment to increase defense spending, it was difficult to see how the budget problem could be resolved unless additional revenue measures were implemented; in that context, he agreed with the staff that any such measures should be consistent with the goal of preserving incentives for saving and capital formation. Like others, he found it disappointing that the Administration had failed to take the opportunity offered by lower oil prices to raise energy taxes. Still, emphasis must remain on reducing government expenditure. Without offering any specific suggestions for expenditure cuts, he noted that the Farm Subsidy Bill in the United States had been about $22 billion in 1982/83, up from only $4 billion in 1980. On the revenue side, a review of the U.S. tax structure would be desirable. The Administration should not only consider energy taxes and value-added taxes, it should also look at the possibility of reducing the number of exemptions and deductions for income tax purposes.

With regard to the external account, Mr. Prowse said that he doubted that the emergence of the large current account deficit would have an early effect on the value of the U.S. dollar. The strength of the dollar evidently depended primarily on domestic policies; and if the United States continued to run large budget deficits in conjunction with somewhat tighter monetary policy--which he would propose only as a second-best solution--real interest rates and, hence, the real effective value of the dollar seemed likely to remain relatively high.

He also had some concern in the area of trade policy, Mr. Prowse continued. The record of the United States with regard to protection was not a bad one; indeed, the United States had traditionally been a leader in the cause of multilateralism and freer trade. It was all the more important, therefore, for the Government to remain committed to that leadership role in the interest of multilateralism. Unfortunately, there had been a perceptible drift away from the commitment to free international trade, particularly in the area of agriculture. He endorsed the view of the staff that all major industrial countries should demonstrate their support of free trade by taking bold action to roll back measures restricting freedom of their markets; it was to be hoped that the continued recovery would give impetus to such action. Like Mr. Wicks, he had hoped that the Article IV consultation with the United States would have provided an opportunity to examine the effects on other economies of domestic policies in the United States. He had been concerned about the renegotiation of bilateral agreements on textiles and garments, which evidently suggested a retreat from multilateralism; he was also worried about the development of preferential trading arrangements for special-group countries, notably with respect to sugar, and recent discussions on possible reciprocity legislation were troubling.

Mr. Lovato observed that, given the size of the U.S. economy and the international repercussions of its domestic policy, it was most useful to discuss the economic outlook and policy stance of the United States, especially since the current recovery, if it gained momentum, could spread to the rest of the world.

In reviewing the present outlook, it was worthwhile to recall briefly the events of 1981/82, Mr. Lovato continued. A recovery in the United States had been projected since early 1981, but the initial upswing had soon reached a turning point, giving way to a renewed slowdown by the end of the year. An analysis of the factors affecting the preceding phase of recovery might be useful in evaluating the strength of the present one. Three conditions had been deemed necessary for a recovery in 1981/82. The first had been a fall in inflationary expectations, following the effective decrease in the rate of growth of the GNP deflator. The second had been the expansionary stance of monetary policy, and the third had been the containment of the fiscal deficit within the preannounced targets for the following years. What had happened, in fact, was that the monetary aggregates had expanded less rapidly than targeted, and the fiscal deficit had soared to $57 billion in 1981 and to $110 billion in 1982. Although inflation had decelerated, industrial production had fallen in both years; GNP had risen by 1.9 percent in 1981 but had fallen by 1.8 percent in 1982, and unemployment had reached 10.8 percent in December 1982. The overshooting of the initial monetary and fiscal targets had proved to be the determining factor in crippling the emerging recovery. The experience of 1981/82 should provide some indication about the conditions that needed to be met in order for the current economic recovery to be consolidated.

The staff seemed more optimistic about the current recovery than it had been about the earlier one, Mr. Lovato noted. However, it also shared some of the doubts of others about the U.S. policy stance. Most macroeconomic aggregates seemed to point toward a recovering economy: industrial production and capacity use had steadily increased since January 1983; moreover, investment, corporate profits, and productivity were slowly improving. The role of fixed capital formation was crucial to the recovery, and the staff had rightly stressed that point in its report. During the brief recovery of 1980-81, fixed investment had increased at a slow rate for a short period of time, and the cyclical upswing had been given impetus only by an inventory buildup and rising residential investment. At present, fixed nonresidential investment seemed to be moving slowly and was expected to rise only moderately in the second half of 1983, and the upturn was focused mainly on inventories, house building, and consumer durables. The tax incentives and the deregulation of some specific markets might have had some positive effects on capital accumulation, but the upward pressure exerted on interest rates by the fiscal deficit had restrained the expansion of new capacity. Furthermore, real wages had begun to increase again after three years of stagnation, and the real exchange rate of the dollar could hurt the exposed sector of the U.S. economy.

One of the main factors that could undermine the recovery was fiscal policy, Mr. Lovato considered. Although direct causal links between deficits and economic activity had not been established, there was a broad consensus that a sounder fiscal balance was a prerequisite for sustained growth. The mounting public debt, necessary to finance the fiscal deficit, was presently absorbing a major part of private savings, which were themselves decreasing as a proportion of income. In its latest report, the Bank for International Settlements had estimated that the percentage of private savings absorbed by the public sector net borrowing requirement had jumped from 5 percent in 1981 to 20 percent in 1982. The existing deficit and those forecast for the next few years had three major consequences for the U.S. economy. First, they drained resources from private investment, thus raising real interest rates and hampering capital accumulation. Second, the high level of real interest rates affected the exchange rate of the dollar, which tended to appreciate as a result of capital inflows. Finally, the deficits tended to engender expectations of higher future inflation, as a result of the possible monetization of the debt, which again contributed to the maintenance of high nominal interest rates. Ultimately, the fiscal deficits would impose on monetary policy the burden of determining the optimal short-run tradeoff between inflation and unemployment. A change in the U.S. policy mix between fiscal and monetary policy was therefore recommended. Since it was difficult to see how a restrictive fiscal policy could be advocated in times of high unemployment, it was necessary to discriminate between the cyclical and structural components of the budget. It appeared that the current fiscal deficits were due essentially to the structural pattern of tax revenues and government spending, which had a depressing impact on the economy.

If fiscal policy represented an obstacle to economic recovery, monetary policy did little to pave the way toward recovery, Mr. Lovato considered. In 1982, there had been a sharp fall in velocity, and the monetary authorities had determined to accommodate that reduction by allowing M-1 to exceed the preannounced targets. The justification for that action was that there had been a major shift in portfolio composition and that the monetary aggregate M-1 could no longer be calculated appropriately, so that greater judgment needed to be used in setting the intermediate targets. The tendency had continued throughout 1983, and the authorities had thus far chosen to ignore any overshooting of the targets, although they had reassessed their anti-inflationary commitments. At present, the U.S. monetary authorities were faced with two choices: either to reject the intermediate targets for M-1, accommodating changes in velocity, or to maintain the targets, offsetting the excesses at the beginning of the year.

The choice to drop M-1 as a major target had been taken because of the difficulty of controlling that aggregate during recent months, Mr. Lovato observed. However, it should be recalled that the choice of an intermediate target depended also on the long-run stability with respect to the final target. It was unclear whether any other target could effectively fulfill the requirements. More information should also be provided by the U.S. authorities on the long-run stability of M-2 and M-3 in relation to the final targets and on the reason why the expansion of those two aggregates had remained within the targets.

The other choice that the authorities had was to maintain the initial targets, Mr. Lovato continued. However, with a stable inflation rate at about 4 percent and a forecast increase in output of 5.5 percent, an intermediate target for M-1 of 4-8 percent seemed far too restrictive to allow for economic recovery. Velocity would have to rise, necessitating an increase in interest rates, which would further jeopardize the tendency toward a steady recovery. The financial markets had repeatedly noted the negative impact on investment decisions that were associated with the uncertainties surrounding monetary policy.

From an international point of view, the latest rise in the dollar was tending to "crowd out" the expansionary effect of the fall in the price of oil, Mr. Lovato remarked. The result was that the United States was the only beneficiary of the oil price reductions, and serious obstacles remained in the way of a generalized reflation in the industrial world. The appreciation of the exchange rate was not without consequences for the U.S. economy itself. The loss of competitiveness of U.S. producers seriously affected the domestic economy, as repeated calls for additional tariffs and quotas, being voiced by local and sectoral interests, were leading to increased barriers to foreign competition to which U.S. industry was exposed. The proliferation of trade-restricting practices was most worrisome from an international standpoint, and he could fully agree with the strong views that had been expressed by the staff on that matter. He hoped that his comments would not be interpreted as a criticism of the achievements of U.S. economic policy, especially with respect to the reduction of inflation. However, it was precisely because the United States had reduced inflation that it could, given the high level of idle capacity, do more in order to reduce the public sector deficit, interest rates, and protectionism. Such action would help to support the emerging recovery of the U.S. economy as well as the badly needed adjustment of international imbalances.

Mr. Schneider said that, like others, he could agree with the views expressed in the staff appraisal. The staff had correctly singled out the broad and pervasive effects of large and persistent budget deficits on the U.S. economy, particularly as they affected interest rates and the sustainability of the present economic recovery. He agreed that "convincing evidence that the Government was dealing with the fiscal deficit in the medium term would play an important role." In that regard, the medium term was far closer than the U.S. Administration would like, as evidenced by the fact that the stand-by tax package designed for the fiscal years following 1985 had not impressed the financial markets. Rapid action would be required to head off the strangulation of interest-rate sensitive sectors by a new rise in interest rates that could easily delay the recovery of investment originally expected for early 1984. The high real interest rates resulting from the large fiscal deficit had two important negative effects: first, they were the main reason for the current strength of the dollar, and thus ultimately were responsible for the rise in protectionist pressures; and, second, they were a major obstacle to recovery in other industrial countries as well as in the United States.

He was perhaps more certain than the staff of the existence of a direct relationship between high interest rates in the United States and the appreciation of the dollar, Mr. Schneider continued. There was, of course, no scientific proof of such a link, but there was a great deal of evidence in Appendix X of SM/83/152. Still, if the high rates continued for too long, they could easily lead to balance of payments disequilibria among the industrial countries of a magnitude sufficient to trigger a sudden reversal in the trend of the dollar's value. The potential danger of a rapid decline in the dollar would be even more harmful than the strong appreciation of the recent past. Of course, it was almost impossible to make precise forecasts about such a fall because there were a number of uncertainties. One important one was related to the real magnitude of the U.S. current account, which was dominated by a large "errors and omissions" entry. The high level to which the dollar had appreciated had not only affected the competitiveness of U.S. exports but had simultaneously furthered import penetration of the U.S. market, leading in turn to strong protectionist pressures. Despite continued lip service to the cause of avoiding or at least reducing protectionism, the record of the current U.S. Administration in engendering free trade was not satisfactory. The United States was of course not the only sinner, but it had employed doubtful arguments in attempting to justify protectionist measures. Moreover, it was difficult to accept the notion that the United States should attempt to police the situation for other countries; the matter should be dealt with in an appropriate multilateral framework even though the United States, as the world's dominant economy, had a heavy responsibility for what happened in the rest of the world.

The high level of U.S. interest rates was also hampering economic recovery in other countries by keeping their interest rates higher than was warranted by their own economies, thus retarding recovery, Mr. Schneider continued. The effect was only partly offset by larger exports to the United States from those countries.

The international repercussions of current U.S. economic policy had been touched upon only lightly in the staff appraisal, Mr. Schneider recalled. He welcomed the effort to assess the international impact of domestic policies; however, given the importance of the U.S. economy for the rest of the world, the matter should perhaps have been given more elaborate treatment in the staff report. Finally, it was disquieting that the U.S. share of foreign aid to multilateral institutions was shrinking. In particular, it was regrettable that the United States, which had been the main supporter of the multilateral approach that had brought tremendous benefit to the world at large in the postwar period, was beginning to drop its commitment to multilateralism in favor of a narrower bilateral approach.

Mr. Joyce, noting that the U.S. economy had begun to recover, agreed with the staff that the key policy issue facing all industrial countries, including the United States, was how to ensure lasting economic expansion without reigniting inflationary pressures. There were, of course, differences of opinion about what constituted the major risks--for example, renewed recession or renewed inflation--as well as about the best policy mix to attain the chosen objectives. The staff's reference to the difference of opinion between the Federal Reserve Board and the U.S. Administration on the interpretation to be given to the monetary aggregates was both interesting and important. The Federal Reserve Board took the view that institutional changes had made the interpretation of the monetary aggregates--particularly M-1--less straightforward than in the past, which had led the Federal Reserve to look toward a wider range of economic indicators. The Administration, on the other hand, seemed to take the view that, until the case for structural change was proven, the Federal Reserve Board should continue to use M-1 as the main indicator. His own views were similar to those of the Federal Reserve Board. Canada had experienced problems of interpretation of the monetary aggregates and, as a result, the Bank of Canada had found it necessary to reduce its reliance on M-1. Still, he was concerned about the significant risks associated with the effort to force M-1 back on the narrower target path.

Demand for money in the United States was relatively interest inelastic, Mr. Joyce continued; hence, a sharp rise in interest rates would be needed in the short run to force M-1 back on the target path. One result of such a rate increase might be a sharp reduction in the expected rate of inflation, which could in turn lead to a fall in long-term interest rates, although such a development was by no means guaranteed. Moreover, a sharp increase in interest rates could risk a renewal of international liquidity strains and/or a choking off of the domestic recovery. In the circumstances, he would appreciate hearing from Mr. Erb more information on the Administration's continued preference for the use of M-1, particularly in view of the observed institutional changes. Generally speaking, his own authorities were concerned that adherence to M-1 targets in the United States, against a background of high fiscal deficits, could lead to a sharp increase in rates of interest, similar to those that had occurred in the last half of 1980. Finally, in discussing the factors that the Federal Reserve Board took into account in setting monetary policy, the staff had mentioned liquidity strains in financial markets, both at home and abroad. He would be interested in knowing the extent to which the staff believed that the international liquidity crisis had had an effect in shaping U.S. monetary policy other than through the trade effects on output.

Turning to fiscal policy, Mr. Joyce observed that the Chairman of the Federal Reserve Board, in testifying before a Congressional committee, had remarked that continuing large fiscal deficits constituted the gravest threat to the achievement of sustained economic recovery. That viewpoint was apparently shared by most participants in the current budget debate in the United States. It was disconcerting to note from the projections in the budget for fiscal year 1984 that, without any changes in tax or expenditure policies, the deficit would exceed 6 percent of GNP through fiscal year 1988. The only clear conclusion that could be drawn from such projections was that urgent revenue and expenditure measures were required to bring down the deficits, both in 1984 and beyond. He thus welcomed the authorities' strong commitment to reducing off-budget outlays and the borrowing activities of government enterprises. In that regard, he would appreciate hearing the staff's assessment of the total funding requirements in fiscal year 1984 for on-budget and off-budget components, government-assisted borrowing and borrowing by government-sponsored enterprises.

Another matter of concern was the relationship between the large prospective deficits and the rate of private savings in the United States, Mr. Joyce commented. According to SM/83/152, private savings in the period 1970-82 had averaged just over 6 percent of GNP. The most recent Economic Report to the President indicated that fiscal deficits did not always completely crowd out private investment; the authors of the Report estimated that the funds available for private investment would be reduced by one half to three fourths of any budget deficit. It would be helpful to know whether the staff agreed with that general proposition. If the outlook was for potentially large and continuing fiscal deficits, the danger existed that net private investment might be crowded out during the recovery period, a development that could lead to a situation in which the attainment of the joint objectives of lower inflation and steady growth would not be feasible. Data contained in the supplement to the staff report seemed to support those concerns. While the problem might be partly dealt with by additional capital inflows from abroad and by higher private savings resulting from presumably higher rates of return to savers in the United States, increased capital inflows would have adverse effects on investment possibilities in other countries.

The Administration had placed much of the blame for the current fiscal deficit on the unexpected severity of the recession, Mr. Joyce noted. It would be useful to hear staff views on the share of the deficit that was in fact cyclical and the share that could be described as structural. As a final note on fiscal policy, he wished to commend the U.S. authorities for the significant measures taken in 1982 to reform the social security system. Those steps should go a long way toward restoring the financial soundness of the system through the balance of the twentieth century.

On external policy, Mr. Joyce agreed with the view that the continued strength of the U.S. dollar could not be attributed to any single variable. Different factors, including the questions of political stability or instability in other countries, appeared to have exerted a strong influence at various times, and it was not at all clear which of those factors would be of prime importance in future; nor was it clear that a change in the mix of U.S. monetary and fiscal policies would necessarily lead to a weakening of the dollar. Admittedly, the lower interest rates that could be associated with a correction of the fiscal deficit could lead to increased outflows or reduced capital inflows. However, if fiscal tightening was perceived as leading to an improvement in the longer-term structural characteristics of the U.S. economy, or if lower deficits reduced fears of future monetization of fiscal deficits, then the attractiveness of the dollar might well be increased. From an international point of view, therefore, it was questionable whether anyone should worry about the continued high U.S. fiscal deficits, especially if the exchange rate implications were not clear. His own feeling was that there was good reason to be concerned about the deficits, both in the United States and abroad. Tighter U.S. fiscal policies were likely to result in a more stable U.S. economy, which in turn would lead to increased stability and continued growth prospects for the world economy. Of course, the stability and growth of the world economy was dependent on the policies pursued by major industrial countries, not only the United States. In that regard, he welcomed the participation of the

United States in the intervention study and its adherence to the recent commitments entered into at Williamsburg with respect to the harmonization of economic policies by the major industrial powers.

In the area of trade, the U.S. Administration had been fairly successful so far in containing protectionist tendencies, Mr. Joyce considered. Certainly, it had been at least as successful as many of those who had been quick to criticize the U.S. authorities in that respect. Nonetheless, there was a growing danger--especially if current account deficits continued to increase--that the protectionist pressures would grow to the point at which they could not be adequately contained. The staff's presentation of U.S. trade policy measures was fairly balanced, with an indication that there were certain sectoral policies that had trade-distorting effects. However, the report seemed to overlook the problems associated with so-called "horizontal" policy measures, such as the Surface Transportation Assistance Act. Those measures could be as damaging or even more damaging than the specific sectoral protectionist measures. He was also concerned about the recent imposition of import restrictions on specialty steel. If there were concerns in the United States about the subsidization or "dumping" of specialty steel products into the U.S. market, he would propose that the authorities deal with the situation through countervailing duties rather than by imposing sweeping import restriction measures.

The record of the United States on official development assistance--particularly if military assistance was excluded--compared unfavorably with that of other aid donors, Mr. Joyce said. His authorities were particularly concerned about the difficulties encountered by the United States in fulfilling its obligations under IDA-VI. The current policy of stretching IDA-VI into an additional year had obliged many major donors to provide special contributions so that IDA could remain viable. Also, the stance of the United States had hurt progress on the IDA-VII negotiations.

The United States should be commended for the progress it had made in recent years in bringing inflation under control, Mr. Joyce continued. The measures to achieve that reduction had been taken at a great cost to the U.S. economy and to the rest of the world, but they had set the basis for a sustained and strong economic recovery. It was in the interest of all to ensure that that recovery was not aborted as a result of erratic policy judgments within the U.S. Administration. The U.S. authorities should undertake additional structural adjustments, especially in the fiscal area, to avoid either a sudden halt in the world economic recovery or a future resurgence in inflation.

Mr. Polak agreed with other Directors and the staff that the measures taken thus far to reduce the budget deficit in the United States had been inadequate. Moreover, major action on the deficit could not be expected at least until after the 1984 elections, which meant continued high interest rates, in particular for the longer maturities, caused both by crowding out and by the lingering inflationary expectations. The serious effects of the deficits were well known: they led to a distortion of exchange rates, endangered a lasting expansion, and kept down the investment component of output.

Indirect taxation should not be excluded from the corrective budget measures to be considered, Mr. Polak continued. He recognized the risk that tax increases conceded too early could lead to greater expenditure, but such a risk was not necessarily unmanageable. Besides, without substantial tax increases, budget deficits would remain far too high. Moreover, because there was little willingness to reduce military expenditure and expenditure on social services, government expenditures overall would remain high and would be paid for mainly by reduced investment in the United States and, to some extent, through capital inflows that reduced investment abroad. As it was clear that such a result was unacceptable, the case for increased taxation was strengthened, and the reluctance of the Administration to push for increased taxes was unfortunate.

Fiscal policy as presently conducted in the United States also created problems for monetary policy, Mr. Polak considered. Higher interest rates were undesirable, both at home and abroad, but monetary policy could not undo the interest consequences of the budget deficit without rekindling inflationary expectations and thus raising interest rates still further. He could therefore agree with the recent effort of the Federal Reserve Board to tighten monetary policy slightly. However, monetary policy should continue to be conducted in a flexible manner, given the problems of relying mainly on control of M-1. The staff had expressed the hope on page 20 of SM/83/135 that it would soon be possible to resume targeting of monetary aggregates on transactions balances, but he doubted that that hope would be realized. With the introduction and spread of interest payments on transactions balances, any clear distinction between those balances and precautionary or savings balances would disappear. In his view, that was a major element in the explanation of the decline in velocity.

On the external side, Mr. Polak continued, it was possible that some decline in the value of the dollar might occur in the future, given the large and rising current account deficits. While predictions about the trend of the dollar were difficult to make, it was important to be prepared for a downward move at some time in the future and for the risk that such a downward move could lead to overshooting of targets. The possibility of a fall in the dollar called for international consultation on measures that could be taken to avoid such overshooting. If downward adjustment was brought about by a decline in interest rates--the result that might be expected when strong measures were taken to reduce the budget deficit--other major countries would generally be in a position to mitigate the exchange rate adjustment by lowering their own interest rates accordingly.

He agreed with the staff that the recent tendency to employ protectionist trade measures as an incentive to induce other countries to open up their markets carried a great risk for a free trading system, Mr. Polak commented. The United States should resume its leadership position in the fight for freer trade of goods and services.

On a technical matter, Mr. Polak said that he wished to call into question the meaning of the current account deficit in the United States, particularly given the $41 billion undocumented surplus in the U.S. balance of payments under the item "errors and omissions." Clearly the balance of payments statistics produced by the United States were not up to the standard required in the current situation of the world economy, and he was happy to note in that respect that an interagency group in the United States was working toward improving reporting procedures. It should be emphasized that such improved procedures were a matter of concern to the Fund, and he hoped that the Chairman, in his summing up, would convey that concern to the U.S. authorities.

Mr. Sangare said that he could join others in commending the U.S. authorities for their success in controlling inflation. Given the vital role played by the United States in the world economy, the recent signs of recovery and economic activity should, if continued, lay the groundwork for economic growth in other parts of the world. Unfortunately, apart from the positive development on the inflation front, the policy mix adopted by the United States in its fight against inflation had resulted in a variety of problems; beyond the domestic impact on output, the increase in interest rates in the United States and the anti-inflationary policy pursued over the past two years had had an adverse international effect on other countries, including almost all developing countries. It had exacerbated their external payments problems through its upward pressure on interest rates and had compounded their debt servicing problems. A more balanced policy mix in the United States was thus called for in order to promote growth in employment, reduce interest rates, stimulate domestic demand, and stabilize commodity prices, thereby enabling developing countries to benefit from the expected global recovery.

It was notable that monetary policy had borne an excessive burden in the disinflation process in the United States, Mr. Sangare continued. It had exerted an upward pressure on interest rates and a downward influence on capital formation, thus constraining future growth. He did not think that further increases in interest rates should be used to prevent growth in aggregate demand because they would have an adverse effect domestically on private investment and growth. Internationally, higher interest rates in the United States would further reduce the import capacity of developing countries, thus making their external debt position even worse. Furthermore, the appreciation of the U.S. dollar vis-à-vis other major currencies--which had adversely affected U.S. competitiveness and its trade balance--would only be strengthened by higher interest rates. In his view, a reduction in government expenditure and the fiscal deficit--rather than an increase in interest rates--were the appropriate means of controlling aggregate demand in the current situation.

In the fiscal area, the prospect of continued large deficits was the main obstacle to a satisfactory economic performance in the United States, Mr. Sangare said. By monopolizing private savings and exerting continuous pressure on the interest rate, the fiscal deficit had a detrimental effect on private investment at home and had international implications through its absorption of considerable portions of international savings, which were attracted by the high interest rates in the United States. Moreover, through the pressure it exerted on interest rates, the fiscal deficit had significantly contributed to increased debt servicing problems for developing countries.

With regard to trade policies, Mr. Sangare welcomed the declared intention of the U.S. authorities to counter protectionist pressures and promote free trade. However, the policies adopted in some areas had often been inconsistent with those objectives. In general, the policy of using restrictive measures to induce other countries to reduce trade barriers could only lead to a further intensification of protectionism through retaliation and should therefore be deplored.

On the international front, Mr. Sangare remarked, his authorities welcomed the active commitment shown by the U.S. Administration in encouraging Congress to approve the share of the United States in the Fund's quota increase. Unfortunately, official development assistance was being reduced at the same time. Noting that the United States had had a poor record as an aid donor for many years, his authorities hoped that the Administration would appreciate the important role that concessional aid could play in assisting developing countries and would make a meaningful and appropriate contribution to the sixth and seventh replenishments of IDA while maintaining or increasing contributions to other multilateral agencies.

Mr. Feito, in accepting the staff's policy recommendations, considered that the Fund's surveillance power should forcefully be employed in order to induce the correction of economic imbalances or inappropriate policy mixes in countries, like the United States, where the almost inexhaustible availability of external financing might postpone the implementation of adequate measures, thus placing a heavy burden of international adjustment on other, less wealthy, countries. The main policy issue for the United States and for the world economy was how to nurture and preserve the incipient recovery, which seemed to be gaining momentum, without reigniting inflation. Sustainable and stable growth would undoubtedly require steadily increasing private capital formation; in that regard, the combination of tight money and large fiscal deficits seemed not to be the proper strategy for promoting investment. High real interest rates resulting from that combination of policies would sooner or later choke off investment and other interest rate-sensitive expenditure items. They would also, because of the high price of the U.S. dollar vis-à-vis other currencies, lead to increased imports relative to GDP and accompanying protectionist pressures in the United States.

The positive price effects on the world economy of high interest rates in the United States--assuming no increases in protectionist pressures and barriers--were more than offset by the negative income and wealth effects, Mr. Feito considered. For the rest of the world to benefit from an increased propensity by the United States to import, the level of national income in the United States would have to be greater than at present. Moreover, even if the trade balance of the rest of the world improved, the beneficial effects would be outweighed by the harm caused by high U.S. interest rates on other components of the balance of payments of the rest of the world.

As noted by the staff, if estimations about the future public sector deficit should prove to be correct, the increase could soak up all net private savings, Mr. Feito continued. That would mean that net private investment in the United States would have to be fully financed from external savings, taken from the rest of the world. Other countries would then have less money available for imports, which would mean reduced exports by the United States. Such a pattern, if continued, could greatly distort resource allocation around the world, inter alia, because it would turn many developing countries and other capital importers into capital exporters in order to finance the U.S. budget deficit.

A stable and sound economic growth in the United States was a necessary condition for reversing the perverse effects associated with the current pattern of international balances, Mr. Feito said. For that condition to be fulfilled, the economic recovery in the United States should be accompanied by growing volumes of international trade, which, in turn, would require the elimination of protective barriers. In that regard, he welcomed the staff's remarks on U.S. foreign trade policy. A reduction in the budget deficits would induce lower interest rates, thereby stimulating investment and making room for additional savings to match the increased demand for loanable funds that would follow. Unless substantial progress was made in reducing the fiscal deficits, fiscal and monetary policy would clash, thus triggering interest rate increases and aborting the incipient economic recovery. He shared the staff's views on the actions necessary to reduce the deficit, particularly the emphasis on both expenditure restraint and revenue raising efforts.

With regard to monetary policy in the United States, Mr. Feito noted the indication by the staff on page 20 of SM/83/135 that, because of the lack of reliable indicators that could readily be used to monitor developments in the monetary field, it was difficult to assess whether monetary policy was in fact on the intended track. The staff had drawn the conclusion that the lack of a suitable guide gave rise to the risk that monetary policy might turn out to be easier than would otherwise be consistent with a moderate growth in nominal demand and that a further tightening of monetary policy was therefore required. In his view, the argument might be made the other way, in the sense that the lack of a suitable guide for monetary policy might give rise to a policy that was tighter than required for strengthening the economic recovery, so that a more expansionary stance could be needed. The staff had pointed to the rapid increase in M-1 to suggest that the risk of excessive monetary growth was real, but he was not convinced of the danger. There seemed to be evidence of a decrease in the nominal income velocity of all monetary aggregates, which appeared to be associated with an increase in the precautionary demand for real balances. If so, there would be no harm in relaxing the stance of monetary policy. In the face of an increase in the precautionary demand for liquid assets, a correct response by the Federal Reserve Board would be to accommodate the increase, despite the resulting acceleration in the growth of the money stock. The greater growth of the stock of money would not fuel any inflationary pressures if it was accompanied by decreasing velocity; quite the contrary, an increase in the demand for liquid assets coupled with a tighter money supply could easily lead to increasing interest rates.

Mr. Tvedt welcomed the considerable progress made in recent years in reducing the rate of inflation in the United States and noted that his authorities were encouraged by the growing number of economic indicators suggesting that recovery was underway. However, the strength and durability of the recovery--which had begun from a very low level of activity--remained uncertain.

As noted by the staff, the federal budget deficit was large in relation to private domestic savings, Mr. Tvedt continued. While the size of the deficit was due to the recession to a great extent, a tightening of fiscal policy was necessary. That tightening should be undertaken with due regard to a cyclically adjusted budget deficit, and he agreed with the staff that measures should be taken on both the revenue and the expenditure sides. In that regard, it should be possible to implement tax measures consistent with the preservation of incentives for capital formation. Without such a shift in fiscal policy, there was a risk of a renewed rise in the interest rate level, with adverse consequences for the recovery and further detrimental effects on the international economy.

A lowering of interest rates could lead to an orderly adjustment of the exchange rate for the U.S. dollar, the current level of which led to greater domestic pressure for protectionist measures, Mr. Tvedt said. The rate of inflation in the United States had been reduced to a relatively low level and, with a change in fiscal policy along the lines suggested by the staff, a money supply growth somewhat above the current target figures should not give cause for concern.

A substantial increase in the U.S. external current account deficit was expected in 1983 and 1984, Mr. Tvedt observed. As had been mentioned during the World Economic Outlook discussions and by Mr. Schneider and Mr. Polak during the U.S. consultation discussion, the United States had a large positive "errors and omissions" item in the balance of payments, part of which was presumably due to unregistered current account transactions. Hence, there was great uncertainty surrounding the U.S. current account position, and improved balance of payments data were called for. Some deterioration in the U.S. current account position should have a stimulating effect on international economic growth, and the upswing in the United States could contribute to a resolution of the serious balance of payments problems faced by many developing countries, particularly many Latin American countries.

His authorities hoped that the United States would participate actively in coordinated intervention to counteract disorderly exchange market conditions, Mr. Tvedt said. In that respect, he had been encouraged by Mr. Erb's remarks, although he hoped that "disorderly market conditions" would not be defined too narrowly. He also hoped that the U.S. authorities would remain committed to a liberal trading system; he was concerned about certain recent protectionist tendencies. Finally, he could support the staff's recommendation that the unfavorable trend in official development assistance by the United States should be reversed. The level of official assistance provided by the United States had been quite low by international standards for some time.

Mr. Malhotra, noting his general agreement with the staff's analysis and appraisal of the U.S. economy, commended the authorities for their success in reducing inflation and welcomed the recent strong signs of recovery in the U.S. economy. It was not yet clear what factors had led to those positive developments; even the U.S. authorities were being modest on that point and had indicated that it was too early to assess the impact of policies pursued thus far on different areas of the economy. The staff would no doubt have an opportunity in future to analyze in greater depth the contribution of various factors to the recent developments and to assess whether those developments signaled a stable recovery. It would be interesting, for example, to assess the combined effect of the fiscal deficits and the easing of monetary policy in recent months. An understanding of the correlation of the two could help in the evolution of an appropriate stance of both fiscal and monetary policies.

A major uncertainty on the economic scene concerned developments in interest rates, Mr. Malhotra continued. Of late, interest rates had firmed up again, and he noted that the staff was recommending a tightening of money supply and suggesting that the U.S. authorities should face the consequences of higher interest rates. He shared the views of Miss Le Lorier, who felt that it would be necessary to consider in depth the implications of the staff's recommendation. Apart from the effect that a tightening of monetary policy would have on investment in the United States, significant effects would be felt in the developing world, especially in those countries that were major debtors. Moreover, unemployment in the United States, while it had showed some signs of declining, remained high, and there was no strong evidence that investment was picking up. As the staff had suggested, the major reason for the turnaround of the U.S. economy appeared to be the move toward the replenishment of inventories.

He had noted the staff's concern that policy action in several areas of the economy might be inconsistent with the attainment of agreed objectives, Mr. Malhotra remarked. Perhaps the complexity of the U.S. economy and political process made it difficult to implement quickly policies that would lead to an early realization of economic objectives. However, it was agreed by all that effective action should be taken soon in the area of fiscal policy as budget deficits had grown rapidly in recent years. There seemed to be problems related to the way in which expenditure was structured; as he understood it, around two thirds of the federal expenditures were on account of entitlements and interest payments, which were mounting because of the Government's high borrowing requirements.

While agreeing that it was important to cut expenditures, Mr. Malhotra said that it was equally important to adopt revenue raising measures. The U.S. Government was itself aware of the need for increased revenue but was unwilling to take action in that area until the "outer years," as it felt that taxation might retard recovery of investment. Was the problem related to the taxable capacity of the population? In developing countries where incomes were low, sales taxes of 10-20 percent were not uncommon as a way of raising resources, and he wondered why a highly developed country like the United States could not augment revenue through indirect taxes. He understood, of course, that when revenues were raised there might be a tendency for government expenditures to rise, but that was by no means a problem that was unique to the United States. Indeed, such a tendency should be more pronounced in societies where consumption levels were low and where unemployment was typically high, with the government as the major employer. There were other alternatives for increasing revenue. For example, the United States had been rather slow by international standards to raise energy prices, even though it had succeeded in greatly reducing oil consumption.

It was difficult to pronounce conclusively on the links between budget deficits, interest rates, and the exchange rate, Mr. Malhotra remarked. However, there was growing agreement that the relationship among those elements was very close and that, if investment should pick up in the U.S. economy while the budget deficit remained high, there was little hope that interest rates would decline, which, in turn, would have implications for the already high exchange rate of the dollar. Furthermore, without a fall in U.S. interest rates, many other developed countries would also be forced to keep their interest rates high in order to prevent larger capital outflows. For all those reasons, early reduction of the fiscal deficit was of crucial importance.

On a related matter, Mr. Malhotra recalled some disturbing suggestions in the staff paper regarding policies on access to the Fund's resources, a matter that would be discussed later in the month. One suggestion was to provide only reduced access unless a major part of the necessary adjustment was planned to take place in the very first year of a program. He wondered why weaker economies should be expected to undertake strong adjustment measures even before a financing arrangement was negotiated with the Fund, while stronger economies could afford to take necessary measures only in the "outer years."

Turning to trade matters, Mr. Malhotra agreed with the staff that, while the United States might have had a better record than many other developed countries in attitudes toward a liberal trading system, it was important for the United States to reduce what protectionist measures it had adopted. While the major problems in the trade area were between developed economies, protectionist measures taken by them had had a serious impact on exports of developing countries. Still, quite often undue pressure was put on developing countries for opening up their economies; the real constraint of most developing countries was lack of foreign exchange resources rather than an unwillingness to import from the developed world.

He agreed with the staff and some other Directors that the record of the United States regarding official development assistance had for some years not been an impressive one, Mr. Malhotra said. That was a matter for regret as the United States had played a major pioneering role in the postwar years in promoting development assistance. Its approach had apparently changed as the authorities no longer considered official development assistance to be the most effective way of transferring resources and tended instead to stress the importance of private capital investment. It should be remembered that most developing countries, particularly the low-income developing countries, used official assistance to improve their infrastructure. Having been personally involved in discussions with prospective foreign investors in his own country, he had noted that they always inquired about the level of infrastructure facilities. It was unrealistic to expect foreign direct investment in countries with inadequate infrastructure. He recalled that the Managing Director of the Fund had stated that one of the factors making adjustment more difficult for many countries had been the relative de-emphasis of official development aid in recent years.

Given the difficulties that had been experienced in the implementation of IDA-VI, Mr. Malhotra urged stronger support for IDA-VII. He pointed out that, in the context of burden sharing among IDA contributors, a strong U.S. commitment to IDA was all the more essential. He appreciated that there could be difficulties in convincing the Congress. However, it was important for the Administration itself to be convinced that official development assistance had an important role to play; reduction of emphasis on official development assistance by the Administration might have sent negative signals to the Congress.

Finally, Mr. Malhotra said, he was struck by the increase in subsidies to support agriculture in the United States. Coming from a country in which approximately 70 percent of the people were dependent upon agriculture, he was amazed at the power of the agricultural lobbies in the developed countries where farmers typically constituted only around 6-7 percent of the population. Referring to the high cost of the Payment in Kind scheme, he wondered whether there was not a better way of tackling the problem of agricultural imbalances than paying farmers for not growing food at a time when there was so much hunger and malnutrition in the world.

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

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/105 (7/18/83) and EBM/83/106 (7/20/83).

2. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/189 (7/15/83) is approved.

APPROVED: January 19, 1984

LEO VAN HOUTVEN
Secretary