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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/107

3:00 p.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	
J. E. Ismael	Jaafar A.
R. K. Joyce	
	C. Robalino
G. Laske	
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	
J. J. Polak	
A. R. G. Prowse	K. G. Morrell
	H. Alaoui-Abdallaoui, Temporary
F. Sangare	E. I. M. Mtei
	J. L. Feito
J. Tvedt	
N. Wicks	
	Wang E.

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

Also Present

C. F. Schwartz, Special Consultant. African Department: A. G. A. Faria. Asian Department: R. J. Hides, G. Szapary. European Department: L. L. Perez, H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Director; S. J. Anjaria, G. Belanger. Fiscal Affairs Department: P. S. Heller. Legal Department: W. E. Holder. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell. Western Hemsiphere 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, P. D. Péroz. Assistants to Executive Directors: H. Arias, R. Bernardo, J. Bulloch, M. Camara, L. E. J. Coene, T. A. Connors, M. Eran, C. Flamant, I. Fridriksson, N. U. Haque, M. Hull, H. Kobayashi, P. Leeahtam, W. Moerke, V. K. S. Nair, Y. Okubo, J. K. Orleans-Lindsay, G. W. K. Pickering, E. Portas, J. Reddy, Shao Z., Zhang Z.

1. UNITED STATES - 1983 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting their consideration of 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, 6/6/83).

Mr. Hirao observed that recent indications that the U.S. economy was solidly on the road to recovery were welcome, not only for the United States itself, but also for the world economy as a whole. Major advances could be seen in three areas: consumer spending, housing starts, and inventory swings. Underlying those advances was the gradual restoration of consumers' confidence in the strength of economic activity, probably brought about mainly by the recent decline in inflation rates. The recent strength of consumer spending suggested that the pent-up demand of the past two years was finally being released. The cyclical movement in business inventories, namely, the completion of inventory liquidation, must also have been contributing to the recovery. Progress in tackling some of the structural rigidities, most notably in wage determination, would be important in underpinning the recovery.

The monetary restraint maintained throughout the past three years had undoubtedly been the major factor contributing to the marked slowdown in inflation rates, for which full credit should be given to the U.S. authorities, Mr. Hirao continued. He agreed with the staff that the stance of monetary policy should continue to be geared to the primary objective of avoiding the rekindling of inflationary pressures, so as to lay the foundation for transforming the incipient recovery into sustained growth. In that respect, the renewed assurance given by Mr. Volcker that the Federal Reserve Board would maintain its anti-inflationary stance over the medium term was encouraging.

One difficult issue at present was how to measure the appropriateness of monetary policy, Mr. Hirao commented. As noted in the staff paper, it had become increasingly difficult to interpret movements in M-1 because of institutional changes and other factors. In that respect, he broadly endorsed the authorities' intention to place reduced emphasis on M-1 and greater weight on M-2 and M-3, as well as to give substantial weight to broad economic and financial developments. Among those developments, it might be appropriate to place more emphasis on the level of interest rates. According to the staff, the U.S. authorities were reportedly of the view that the use of interest rates as intermediate targets for the conduct of monetary policy would not be advisable. He fully understood their reluctance to use that instrument in view of their past unhappy experience with high inflation. Indeed, there were surely serious risks in holding an incorrect nominal rate target for any length of time during an inflationary period. It would have proved extremely difficult to keep interest rates at an appropriate level in a period of high inflation, but with inflation having been brought under control, it might be possible and useful to employ interest rates as one of the broad targets. The authorities were at present faced with the risk of having to tighten or loosen monetary conditions further than they intended because of the difficulties in interpreting monetary aggregates. The task might become much easier if the role of interest rates as a broad operating target in the conduct of monetary policy were reinstated.

It could hardly be denied that high interest rates during the past few years had been the inevitable price that had to be paid in the fight against deep-rooted inflation, Mr. Hirao went on. But he would question the need for them when inflation was under control and economic recovery had yet to be fully consolidated. The arguments against high interest rates included the possibly adverse impact on interest-sensitive sectors of the domestic economy; housing starts had already fallen by 2.9 percent in the previous month, leading to some concern that rising mortgage rates might lead to retrenchment in residential construction. It had also been recognized that high interest rates in the United States had wider implications, limiting the scope of financial policy in other industrialized countries by putting pressure on exchange rates. A heavier debt service burden had been imposed on the developing countries as well. In that respect, the flexible policy stance taken since the summer of 1982 by the U.S. monetary authorities was welcome. He hoped that the authorities would maintain a pragmatic stance, and continue to take due account of developments both at home and abroad.

Moderation in wage increases had also been an important factor in the progress made against inflation and the recovery in economic activity, Mr. Hirao reiterated. Following the completion or near-completion of the inventory adjustment that had taken place during the past two years, there had been times when economic recovery had seemed to be imminent. However, promising indications had been frustrated and the incipient recovery thwarted each time, mainly because confidence in the economy had not been adequately restored. That lack of confidence could be attributed to the then still high inflation and rapidly rising wage rates. Thus, he hoped that the recent encouraging moderation in wage increases would continue and lay the foundation for sustained noninflationary economic recovery.

Improvements in the evolution of wages might be interpreted as indicative of success in the Administration's efforts to tackle structural rigidities, Mr. Hirao went on. But a number of structural problems remained, including inadequate profit margins, although the latest data suggested some widening of those margins. The structural difficulties meant that business did not have such bright prospects as during the recovery phase in the 1960s. A growing number of economists were taking the optimistic view that the U.S. economy would achieve sustained growth over the next several years, without inflationary pressures. He would like to join them in that view, but there were structural weaknesses to be overcome first.

One of those weaknesses was public finance, as in Japan, Mr. Hirao said. It had been amply demonstrated in the staff paper that the elimination of the fiscal deficit was the most urgent task confronting the U.S. authorities. A number of Directors had already suggested several options for dealing with that difficult problem. He would simply underscore the importance of tackling it, and of doing so by taking the proper long-term perspective and by showing perseverance. One indication that the persistence of high interest rates in recent years had had a considerable impact on fiscal expenditure was the rapid increase in the ratio of interest payments to GNP, from 1.2 percent in the early 1960s, to 2 percent in 1980, and 2.8 per cent in 1982.

On exchange rate policy, Mr. Hirao considered that stress should be placed on coordinated intervention, which could have a far greater impact than intervention by a single country, because of the psychological effect on the market. In that connection, he had noted the interesting information on page 26 of SM/83/152 about the increase in bank liabilities to private foreigners, which had risen by $64 billion in 1982 following a rise of $42 billion in the previous year. Inflows from Latin American and European countries, as well as from international banking centers, seemed to have been the major contributing factor. As stated in the staff report, it was not easy to measure to what extent the large real appreciation of the U.S. dollar since 1980 reflected those developments. He was nevertheless inclined to suspect that capital inflows of that magnitude might have had a considerable effect on exchange rates. He would welcome any comments that the staff might care to make on future trends in capital inflows.

On a more technical plane, Mr. Hirao noted the report in the staff paper that the U.S. authorities forecast a current deficit of about $30 billion in 1983, which was larger than the staff's estimate by about $5 billion. Second, with respect to the statistical discrepancy in the U.S. balance of payments--which had registered a record surplus of $41 billion in 1982--it was indicated on page 27 of SM/83/152 that certain current account transactions were increasingly being recognized as having gone unrecorded, even though the customary assumption was that the discrepancy reflected mostly errors and omissions on capital account. He would be interested to have the views of the staff or Mr. Erb on that point, especially on its policy implications.

Finally, referring to trade policy, Mr. Hirao welcomed the authorities' intention to resist protectionist pressures and to observe the principles of free trade. In that respect, like Mr. Laske and others, he found the most recent actions of the U.S. authorities to be cause for concern. It was important for industrial as well as for developing countries to do their best to maintain free trade, in a period of growing protectionism, and he shared the staff view that the United States would need to play a central role in that endeavor.

Mr. Teijeiro said that he shared most of the views in the staff appraisal. The major success on the inflationary front and the rate at which the economy was growing could be considered satisfactory from the domestic point of view. However, the threat of some negative elements, like the fiscal deficit and the international repercussions of the present situation, led him to be less optimistic about developments in the U.S. economy.

Without any doubt, Mr. Teijeiro went on, the most worrisome element was the fiscal deficit and the inadequacy of existing plans to deal with it. The deficit was absorbing a great proportion of available financial savings. The problem was especially troubling because the effects of the recession had borne particularly heavily on by profits, thereby diminishing the possibility of self-financing investment. Corporate tax relief had been a highly positive feature of the tax reforms that had been implemented. However, the effect on business investment would have been more beneficial if the reduction in corporate taxes had been accompanied by an increase in consumption taxes in such a way as to prevent the negative impact of fiscal deficits on interest rates. The expectation of higher future profits brought about by the change in corporate taxation helped to explain why business investment had not fallen as much as might had been expected, given the degree of unused capacity and the high level at which real interest rates had stayed.

Moderation in the behavior of wages would be essential if the current recovery was to be reflected largely in an improvement in current profits, Mr. Teijeiro observed. Only then could savings be expected to grow at a higher rate than investment demand, thus helping interest rates to return to more normal levels in real terms. However, a significant reduction in real interest rates could not be expected without major action on the fiscal side. The growth in expenditure in terms of GNP, even allowing for cyclical factors, indicated that the first priority in reducing the deficit was to restrain spending, and at the same time avoid crowding out the private sector. As for the alternative of tax measures, the staff had rightly emphasized the possibility of increasing consumption taxes, and maintaining the incentives to capital formation that had been gained by reducing taxes on profits and personal incomes.

In light of the overall structural problem of high real wages and lack of profits, which was affecting the U.S. economy somewhat but other industrial economies more, Mr. Teijeiro asked whether the prescription for dealing with fiscal deficits should not go beyond eliminating the structural deficit. The persistence of anti-inflationary policies would make it extremely difficult to achieve nominal wage levels that would in the short run yield the necessary adjustment in real wages. The way in which fiscal policy could help to tackle the structural problems was by increasing fiscal savings sufficiently to contribute to a restoration of overall savings, which could again be done by increasing taxes on consumption and reducing consumption expenditures.

As for monetary policy, Mr. Teijeiro remarked, there could be no doubt about the serious difficulties of interpreting current monetary developments and making an appropriate policy judgment. However, the authorities seemed to be placing too much importance on some indicators, which could be leading to a wrong interpretation. Of special concern was the significance placed on the narrowly defined monetary aggregates. The broader of M-3 continued to expand at a declining rate, the increase in M-2 or M-1 seemed to indicate demand-determined shifts induced by the change in the relative yield between assets entering into the definition of M-2 and M-3.

Another important source of doubt about the current stance of monetary policy was the behavior of deposits in the offshore dollar market, Mr. Teijeiro commented, where there was evidence that after the debt crisis had arisen, the growth of Eurodollar deposits had slowed down significantly. If the shift of deposits from offshore markets to the U.S. market became marked, a stronger argument could be made for paying more attention to the behavior of the broad monetary aggregates, including the offshore markets.

Several factors suggested that the authorities were maintaining their restrictive stance of monetary policy, particularly with respect to broad money, Mr. Teijeiro considered. He shared the view that there was no room for a relaxation of monetary policy, but the coexistence of tight monetary policy with expectations of a relaxation could be costly in terms of maintaining or increasing the level of interest rates. In that sense, statements by government officials that relied on partial indicators might be particularly damaging.

With respect to protectionist measures, recent developments were truly disappointing, Mr. Teijeiro continued. His worries were well reflected in the staff appraisal, where it was noted that "unless the United States gives clear evidence of support for free trade through its policy actions, there is great danger that protectionism will continue to spread around the world. The staff is concerned that the use of trade measures by the United States to induce other countries to open their markets in the present world situation would lead to an escalation of trade barriers rather than to their reduction."

There had been continuous talk about the economic recovery of the industrial countries as a precondition for solving the debt problem, Mr. Teijeiro noted. But he was becoming increasingly concerned that the linkages between those elements were going to be weak in the short run. It was usually argued that the recovery of the industrial world depended, among other things, on the capacity of developing countries to maintain their imports, a dubious argument. The reduction of demand for the exports of industrial countries, associated with the current difficulties of developing countries, was not a global reduction in aggregate demand but a redistribution of the capacity to spend. Smaller loans to less developed countries meant more credit for other countries. Higher interest payments by debtor countries meant higher income for asset holders in creditor countries.

The significant shift in the capacity to spend was operating through various channels, Mr. Teijeiro added. First, there had been a change in the terms of trade for commodities. For the United States alone, the improvement in its terms of trade from 1980 to 1983 was equivalent to roughly 2 percent of GDP, or about $60 billion. Second, the industrial countries, as net asset holders, had gained from the movement from negative to highly positive real interest rates. There were statistical difficulties in consolidating a net external asset position for the industrial countries, or even for the United States alone, but the level of debt of developing countries, coupled with the change in the real interest rate that had occurred three years previously, gave an approximate idea of the magnitude of the transfer of spending capacity. To complete the picture, the increase in spreads resulting from the renegotiation of debt should be mentioned. It would be interesting if the staff could develop some measures of net external asset positions that would allow estimates to be made of the redistribution of spending capacity.

The third channel through which a shift in spending was taking place, Mr. Teijeiro observed, was direct and financial investments. The worsening in economic and political conditions was discouraging both increases in loans and direct investment abroad; changes in the tax treatment of profits must also be an important element.

In sum, Mr. Teijeiro said, a significant reduction in real wages, as a precondition for recovery of the U.S. economy, seemed to have been negated by the improvement in the terms of trade, the increase in income from net external assets, tax incentives for investment, and the inflow of capital from abroad. Other industrial countries had also benefited from changes in the terms of trade and from their net asset position, but the structural problems underlying the profitability of business in those countries were of such a magnitude that the prospects of a sustained recovery were much weaker.

To conclude, Mr. Teijeiro doubted whether the U.S. recovery would be followed immediately by the recovery of other industrial countries and by an improvement in the situation of less developed countries. The arguments that he had adduced suggested the likelihood of quite dissimilar developments, with other industrial countries experiencing a much weaker recovery and with less developed countries facing a continuous adjustment effort and thus recession. Although he joined the staff in commending the U.S. authorities for their constructive role in dealing with the debt problem, he could not avoid looking at current U.S. macroeconomic policies from the point of view of the indebted countries. His hope was that in 1984 it would be possible to praise the U.S. Government for having tackled its macroeconomic problems in such a way that crucial variables, like interest rates and the terms of trade, had returned to more normal levels, and protectionist tendencies had been reversed.

Mr. Alhaimus observed that the economic policies of the U.S. authorities were of obvious interest to member countries, given their impact on the world economy. An inflation-free recovery of the U.S. economy was the focus of attention, and although inflation seemed to be under control, the recovery seemed less certain. There were encouraging signs, such as the buoyancy of investment relative to GNP in the past two years, and an increase in profits in the first quarter of 1983, but both the staff and the U.S. authorities were cautious about drawing overoptimistic inferences. The revised staff forecasts presented in the supplement to the staff report were much more encouraging.

On fiscal deficits, Mr. Alhaimus said, he shared the staff's concern over the potentially adverse effects of imbalances of such magnitude. The staff in its report and Executive Directors in their discussion had both been concerned in the main by the crowding out of domestic private investment in the United States and its potential for affecting the credibility of a prudent monetary policy, leading thereby to renewed expectations of inflation. The possibility also existed, as a consequence of large fiscal deficits, of demand for credit in the United States affecting the already constrained supply of international credit. He had taken note of Mr. Erb's remark that the impact of the restructuring of the tax system on investment and incentives would become apparent only after several years, but as such policies were being pursued in a major economy, they should be subject to more analysis and follow-up.

Referring to monetary policy, Mr. Alhaimus observed that the staff had noted that the targets for M-1 in 1982 had been exceeded by sizable margins, forcing the Federal Reserve to attempt to maintain stable growth rates for M-2 and M-3. The targeting of growth rates for monetary aggregates was a consequence of the authorities' assumption that monetary policy should be aimed at restraining the growth of nominal demand. That assumption, which presupposed the existence of a stable and predictable relationship between nominal GNP and monetary aggregates, was however open to question, based on the staff's discussion of unusual declines in the velocity of money, and of M-1 in particular. It was well known that the targeting of key economic variables by means of monetary aggregates led to volatile monetary behavior. The need to avoid such volatility was illustrated in Appendix I of the report on recent economic developments, in which empirical evidence was presented on the real consequences--for unemployment--of unanticipated money growth. Some had maintained the view that a stable, steady, and preannounced monetary policy was desirable because of its ability to minimize both the threat of inflation and the threat of policy-induced uncertainty in the economic environment. But since attempts at targeting monetary aggregates were leading to volatility in the money supply, the question was whether, as some theories suggested, a stable, preannounced growth rate in the monetary base, which was more directly under the control of the Federal Reserve, might not be a more beneficial policy.

The poor record of the United States as an aid donor for many years had once again been noted by the staff, which had pleaded for reversing the trend, Mr. Alhaimus noted. Such concerns had been repeatedly expressed in the Executive Board. For many reasons, the U.S. argument that flows of private investment were effective substitutes for official development assistance was not quite convincing. The impact of aid on the export performance of the United States was well known. Aid would also be more effective if it was extended through multilateral instead of bilateral channels. The skewed distribution of bilateral aid had been mentioned frequently; to some, it was of great concern because certain larger recipients of such aid had used the resources for the purpose of directly and adversely affecting the economies and prospects for economic development of other Fund members. He would appreciate additional information from the staff on the composition and distribution of ODA, which he hoped would be included in staff reports in the future.

Finally, Mr. Alhaimus said that he shared the concern about the use by the United States of trade barriers to counter the protectionist tendencies of other countries. Such a policy could lead to a universal escalation of hindrances to trade. The demonstration of a firm U.S commitment to free trade would be important in rolling back measures that were impeding trade elsewhere. As was well recognized, one important way of assisting developing economies in their development efforts was to improve the access of their products to the markets of industrial countries.

Mr. Tshishimbi stated that his constituency attached great importance to Article IV consultations with the United States. First, they were the only opportunity for the Fund to exercise surveillance of a major Fund member that did not use Fund resources; and, second, after so many years of economic slump, the rest of the world was anxious to see a satisfactory recovery in the U.S. economy, due to the significant impact of economic developments in the United States on the economies of other countries, both industrial and developing.

The U.S. authorities should be commended for achieving their major objective of reducing inflation, Mr. Tshishimbi remarked. That achievement had however been costly in terms of output growth, productivity, capital formation, and unemployment, which in December 1982 had reached its highest rate in the postwar period. He noted with satisfaction that the economy was gradually moving toward recovery. Output and employment had picked up. The staff had indicated in the supplement to SM/83/135, and Mr. Erb had confirmed in his introductory remarks, that the recovery of economic activity was likely to continue at an even more vigorous pace for the rest of 1983 and in 1984.

As the economy expanded, however, it was not certain that the progress recorded so far in fighting inflation would be sustained, Mr. Tshishimbi went on. He agreed with the staff that if monetary policy did not adequately contain the pressures coming from fiscal policy, inflation might gather new momentum. The authorities faced a real dilemma: how to ensure a lasting economic expansion without encouraging inflationary expectations. The temptation was to continue to follow the restrictive monetary policy that the Federal Reserve Board had pursued in the recent past and that had put upward pressure on interest rates, severely deepening the recession. Yet a relaxation of monetary policy embodied the risk of rekindling inflation.

Therefore, it was in the fiscal area that the authorities would have to exercise strong discipline and control the size of the federal deficit, Mr. Tshishimbi added. As the staff had rightly pointed out, the present deficit and the prospect that it would be maintained at about the same level in the years ahead constituted an unsatisfactory situation, especially for domestic and world financial stability. He hoped that the authorities would continue to search for a realistic plan to cut the federal deficit, estimated at more than $200 billion a year at present. He shared the staff's view that with a deficit of that size, the budget was absorbing all private savings, leaving few resources for productive investment. It was paradoxical that at a time when most economists, including the Fund's own staff, were recommending an increase in taxation to finance the budget deficit, the authorities still gave the impression of working in the opposite direction by pledging to continue to reduce taxes.

Although monetary policy had greatly contributed to the restoration of price stability, Mr. Tshishimbi remarked, concerns persisted about the highly judgmental conduct of monetary policy and the uncertainty surrounding the interpretation by the authorities of monetary aggregates. The staff's view was that monetary policy should continue to aim at restraining nominal demand, and be accompanied by a major change in the fiscal position; that would be a signal that an anti-inflationary monetary policy could be pursued together with other measures in order to improve the economic environment and sustain the recovery over a long period. He agreed with that evaluation.

The uncertainty about the conduct of monetary policy and the persistence of fiscal deficits had led to doubts about the future direction of interest rates, Mr. Tshishimbi commented. He was not sure that there would be a significant decline in interest rates in the near future; if they were allowed to rise, a major crisis in the financial markets might emerge and adversely affect developing countries, especially those already heavily indebted. Such a crisis would be unavoidable unless the U.S. authorities adopted policies signaling their intention to break the cycle of inflationary expectations.

Achieving the desired degree of stability and growth in the world economy would depend significantly on the trade and exchange rate policies pursued by the United States and its industrial partners, Mr. Tshishimbi continued. The exchange value of the U.S. dollar had appreciated in real terms in the past three years. He was convinced that fiscal policies had been a contributing factor. However, he supported the staff's view that the authorities should participate in coordinated intervention with other countries to counteract disorderly exchange markets and ensure greater exchange rate stability. He also strongly supported the staff's view about the dangers that protectionism by major industrial countries like the United States posed for the free trade system. In that connection, he joined other Directors in urging the U.S. authorities to play a leading role in removing trade barriers that were restricting international trade.

Finally, Mr. Tshishimbi noted that he shared the staff's concern about the record of the United States as an aid donor. Concessional development assistance by the United States had declined steadily relative to that of other industrial countries. Like other Directors, he urged the authorities to begin to reverse that trend, and welcomed the constructive role played by them in dealing with the debt problems of developing countries. He also encouraged the Administration to pursue its efforts to convince Congress to ratify the legislative proposals relating to financial assistance to multilateral financial institutions, including the Fund. Therein lay the only road to world economic stability.

Mr. Ismael said that he was in broad agreement with the thrust of the appraisal in the staff report for the 1983 Article IV consultation with the United States. Since the state of the U.S. economy determined the health of the world economy, it deserved the attention of the Board. Thus, he submitted that in the exercise of their domestic policies, the U.S. authorities should give due recognition to the consequences of those policies for the rest of the world.

He was gratified to note that the U.S. authorities recognized the need to ensure a proper balance between monetary and fiscal policies so as to encourage growth without inflation, Mr. Ismael continued. However, the very magnitude of the persisting fiscal deficit was limiting the scope for reducing those deficits. In his view, the fundamental fiscal imbalance stemmed mainly from the excessively rapid growth of expenditure since 1979, which had not been offset by revenue measures. But that imbalance was largely structural in nature, and could not be viewed as either temporary or cyclical. In the circumstances, appropriate measures should be taken to cut fiscal expenditures substantially in order to have a more direct impact on the deficits. With respect to revenue measures, he agreed with other Directors that corrective fiscal action was needed.

While he could go along with the staff's call for a proper mix of policies, including a relatively tight monetary stance to restrain the growth of nominal demand, Mr. Ismael expressed reservations about the value of such a stance as a means to fight inflation, irrespective of the consequences for interest rates. The brake had to be applied judiciously, especially in the face of evidence that the increase in prices in the United States had moderated substantially during the past three years. There were indications of slack in the economy, and unemployment was at record levels. The growth of wages had decelerated, and signs of a pickup in investment had been visible only during the past quarter. The application of monetary restraint at the present time could adversely affect, through higher interest rates, consumer spending on durables and construction, and abort the present recovery. It was not only the danger of inflation and inflationary expectations that should be stressed, especially when recovery was urgently needed by all. An urgent call for budgetary cutbacks would be more advisable.

He was seriously concerned at the tendency of the United States to restore protection by trying to limit imports, Mr. Ismael stated. He also endorsed the staff view that unless there was clear evidence of policy action supporting free trade, there was a danger of retaliatory measures' being introduced by others in response, thereby contributing to the continuing drift toward protectionism. He shared the opinions expressed by Mr. Prowse and Mr. Malhotra on U.S. agricultural policy, particularly in view of the importance of developing the agricultural sector in international trade.

The expansion of international trade, the mobility of capital across national boundaries, and floating exchange rate regimes, had made it necessary to recognize the global interdependence of countries, particularly the more advanced economies, Mr. Ismael went on. In the United States, larger fiscal deficits and high interest rates, tackled by means of a restrictive monetary stance, would jeopardize a sustainable economic recovery and the success of global debt rescheduling. The mismatch of policies among the various major countries had already played havoc in foreign exchange markets. Therefore, he warmly supported the call for closer cooperation among the major countries in the conduct of economic and financial policies. He also supported the staff's call for coordinated intervention by the United States and other countries in order to counter disorderly developments in exchange markets.

He also had to express his concern over the decline not only in the quantity but also in the quality of aid by the United States, which appeared to favor bilateral assistance, Mr. Ismael said. He urged the United States to take up again its rightful role of assisting less developed countries.

In conclusion, Mr. Ismael noted with satisfaction from the supplement to the staff report that the recovery in the United States was becoming more vigorous. Like Mr. Prowse, however, he was worried about the weakness of the underlying fundamentals, in terms of sluggish investment and lower profitability, which could undermine the medium-term prospects for a sustainable economic recovery.

Mr. Wang noted that economic recovery was under way in the United States. Inflation was being brought down to a relatively low level, and real GNP was projected to grow by 5.5 percent during 1983, compared with a decline of about 1 percent during 1982. However, a strong inventory performance, which was crucial to a sustained recovery, was still lacking. The rate of unemployment remained high, and the ever growing federal budget deficit had not been effectively checked. Those were all uncertain factors making the present recovery vulnerable, and they would have an adverse impact on the economies of other countries. To ensure a sustainable recovery, it was important for the United States to adopt a proper mix of fiscal and monetary policy, which would consistently produce noninflationary growth, improved investment, and higher employment.

The important role of the United States in the world economy meant that the trend of U.S. economic policy often had a direct or indirect impact on other countries at large, Mr. Wang added. Therefore, in formulating their economic policies, including monetary and exchange rate policies, the U.S. authorities should not only take their own interests into consideration but should also pay due attention to the interests of other countries, especially the developing countries.

As far as trade policies were concerned, some new protectionist measures had been introduced by the United States since the 1982 Article IV consultation, Mr. Wang noted. Experience showed that protectionist trade measures adopted by one country could trigger off an escalation of retaliatory measures by other countries, and thus be detrimental to the world economy. Furthermore, widespread protection had aggravated and was certain to continue to aggravate the debt service problems of heavily indebted developing countries, which were at a stage when improved access to the markets of industrialized countries was vital if they were to enhance their debt servicing ability by increasing exports. In the hoped-for efforts by more and more countries to reduce or eliminate protection, the United States should play a central role.

With respect to its relations with the developing countries, Mr. Wang concluded, the United States had had a poor aid record for many years. He agreed with the staff that the U.S. authorities should start to reverse that trend, by making a clear commitment to international aid. In the present interdependent world economy, such a move would be beneficial to both developing and developed countries alike.

Mr. Robalino stated that the present review of recent economic developments in the United States was extremely important because of the powerful influence of the U.S. economy on developed and developing countries. In present circumstances, the authorities' policy decisions should be cautious and propitious to the achievement of a sustainable growth of the economy.

Noteworthy progress had been made in reducing the rate of inflation, Mr. Robalino observed. Factors such as the recent severe recession that had undermined the world economy, the decline in oil prices, and the anti-inflationary policies of the U.S. Administration, had contributed to that achievement. Nevertheless, there had been implications for economic activity that had produced the high rate of unemployment and kept real interest rates high, thus making more painful the adjustment process of many countries, especially developing countries.

Referring to monetary policy, Mr. Robalino noted that the growth of M-1 had deviated somewhat from the intended course, which could lead to fears of another surge of inflation. The introduction in the market of new financial instruments did not fully explain the evolution of M-1, and only an approximate interpretation of developments in the monetary aggregates was possible. He encouraged the authorities to maintain the monetary aggregates at a level consistent with a low rate of inflation.

The sizable federal budget deficit was of major concern, Mr. Robalino considered. A widening of the fiscal deficit could damage the process of economic recovery in the United States and hence the upsurge of economic activity that developing countries needed, especially those with high debts. The U.S. Administration should take additional measures to reduce its fiscal deficit. He supported the staff's recommendations concerning the necessary adjustment to be undertaken by the authorities. Unless action were taken, the demand of the U.S. Government for credit to finance its fiscal deficit would keep interest rates at high levels and would hinder recovery in the United States and in other countries, placing an additional financial burden on the developing countries. He firmly shared the opinion that large deficits would raise the exchange value of the U.S. dollar by attracting foreign capital from around the world, weakening the competitive position of the United States. The anti-inflationary framework should be kept in place, not just to maintain credibility but also to produce a lasting recovery. A shift to a more expansionary fiscal policy would carry the risk of rekindling inflation.

As a matter of emphasis, Mr. Robalino mentioned that the Managing Director had pointed out in his address at the Sixth Session of UNCTAD that "persistent large deficits could generate uncertainty about future policies, add to inflationary expectations, and thereby put further upward pressure on interest rates."

As for trade policy, Mr. Robalino noted, the staff had reported that the U.S. Administration had the intention of avoiding protectionist measures. It had not been fully successful, as some additional measures had been introduced since the previous Article IV consultation, thereby threatening the process of trade liberalization. To reach a lasting recovery, an indispensable factor would be a firm decision to avoid new protectionist trade measures and gradually to eliminate existing ones. Only in that way would the countries most affected by such restrictions not just improve their trade balance but also alleviate the enormous financial and economic difficulties that they faced.

Finally, Mr. Robalino said, the provision of aid by the United States to developing countries had not been adequate. Foreign private investment would not suffice for the poorest countries, and could not replace the flow of aid. Poor countries needed more financial assistance, not less.

The Associate Director of the Western Hemisphere Department in responding to specific questions by Executive Directors, informed Miss Le Lorier that the third phase of the tax cut was estimated to result in an increase in the borrowing requirement of the U.S. Treasury by about $15 billion in the second half of 1983, an annual rate of somewhat in excess of $30 billion. As for her concern about the staff's suggestion that the U.S. authorities should stand ready to tighten reserve provision, he noted that, as Mr. Polak had commented, the interest rate effects coming from other sources could not be undone by the use of monetary instruments. More specifically, on the possible need for a tightening of monetary conditions, he pointed out that the staff and the U.S. Administration had revised their forecasts of nominal demand upward. Although different views could be taken about the course of the growth of nominal demand in 1983 and 1984, the figures being mentioned, particularly for 1983, were large enough--a growth rate exceeding 9 percent, or even approaching 10 percent in the case of the U.S. Administration's forecast--to call for a review of reserve provision at the present time.

In response to Mr. Laske, the Associate Director said that the idea of introducing a value-added or similar tax had been under discussion in official circles in the United States for some time. There should be no legal impediments to introducing a class of taxation of that type; the exploration of the idea so far had focused on the clear identification of merits and demerits of such taxes, taking advantage of the experience of other countries with such systems.

In reply to Mr. Wicks, the Associate Director expressed the view that the clash between large fiscal deficits and private credit demand was already occurring and the fiscal problem had to be tackled without delay. There were two difficulties with the concept that fiscal policy could be changed as private demand gained in strength. First, there was the problem of how to fine-tune such a policy and, second, the large current and prospective deficits were already creating conditions that were inhibiting interest-sensitive private spending, notwithstanding the existence of economic slack.

As for Mr. Wicks's question about the liquidity of the corporate sector and its implications for the economy, the Associate Director remarked that profit margins and rates of return on assets were probably somewhat stronger at present than they had been in similar phases of the business cycle in the past. On the other hand, by conventional measures such as the ratio of short-term debt to long-term debt, liquidity would appear somewhat weaker than in similar situations in the past, although conditions had been improving as the funding of short-term debt had been proceeding; in the recent past, there had been marked increases in issues of long-term bonds and stocks. A broader point to note was that even if the corporate sector were reasonably well endowed with liquid resources, its attempt to use them on a significant scale in present circumstances would clash with public credit demands. In analyzing the whole process of savings and investment and the competition between private and public credit demands, the staff considered that a weakening of fiscal policy that stemmed from reductions in corporate taxation might be offset to a significant extent by increases in business savings.

The outlook for investment in the short run was somewhat better at present than the staff had thought earlier, as indicated in the supplement to the staff report, the Associate Director continued. However, on the basis of the analysis by the staff, there seemed to be no way in which investment could remain strong for more than a limited time unless fiscal policy were changed significantly. Given the link between the rate of capital formation and the sustainability of output growth, failure to adjust fiscal policy would cast doubt on how long the ongoing recovery could continue.

Replying to Mr. Prowse's comment, the Associate Director observed that the staff had in fact emphasized the medium term, particularly with respect to its discussion of fiscal policy. The discussion had focused on whether a sustained recovery of the economy was possible, given the fiscal prospects foreseen by the staff.

In responding to Mr. Lovato, who had referred to the ongoing rate of inflation and the expected rate of growth as a means of gauging the stance of monetary policy, the Associate Director said that he did not consider that the implementation of monetary policy along that line would be stabilizing. The problem in the past had been the tendency to direct monetary policy at achieving a certain growth of output that, ex ante, did not seem unreasonable. But the end result had been an acceleration in nominal demand that had given rise to escalating inflation.

Taking up Mr. Joyce's question concerning the advisability of adhering to a target for M-1 in a period of high fiscal deficits, the Associate Director repeated that, as Mr. Polak had said, monetary policy could do nothing about interest rates that were rising because of pressures from the fiscal side or from the strengthening of private demand for credit. The authorities could only hope to use monetary policy to lower the rate of inflation, with the goal of stabilizing it at a relatively low level. Adherence to monetary targets had been useful in that regard, but of course it would not guarantee desired results in the event of instability in the relationship of money to income. Some thought had been given to greater use of the broader aggregates, as Mr. Teijeiro had suggested, but those were subject to various difficulties of interpretation, as Federal Reserve officials had emphasized.

In response to Mr. Joyce's question on the effect that the international liquidity situation might have had on the Federal Reserve's policy, the Associate Director recalled that the U.S. authorities had referred to the international liquidity situation as one of the elements they took into account in determining their monetary policy.

It was difficult to distinguish with accuracy the cyclical and structural components of the budget deficit, the Associate Director remarked in response to Mr. Joyce. The U.S. Administration had attempted to make such an assessment, and considered that perhaps half of the current deficit was structural and half cyclical. The staff felt somewhat more certain about changes in the structural deficit in recent years than it did about its level, but it was evident that it was large and threatened to increase.

As for the possibility of accommodating an apparent change in the demand for money, as suggested by Mr. Feito, the Associate Director noted that it was a matter of assessing the risks in a situation of great uncertainty. Consideration could be given to accommodating such a demand shift, if there was no doubt about its occurrence and extent. However, recent history showed that the risks that had been taken generally had paid too little attention to the problem of inflation, he recalled.

On Mr. Hirao's question about the outlook for capital flows, the Associate Director said that the large shift in net direct investment in the recent past might or might not be indicative of a trend. As discussed in the report on recent economic developments, a number of temporary factors had influenced such flows in the past few years.

As for the statistical discrepancy in the U.S. balance of payments, and its policy implications, the Associate Director noted that for some years the discrepancy had registered a positive inflow and that there were reasons to believe that current transactions might be involved. Reference was made in the report on recent economic developments to some of the recent findings with respect to the statistical discrepancy. The main issue was whether the statistical discrepancy was representing what might be relatively stable flows. As for the forecasts of the current account deficit, the difference between the staff and the Administration, to which Mr. Hirao had referred, was very small. The Administration's forecast was based on slightly higher GNP growth than the staff had used in developing its own forecast.

A question had been raised by Mr. Teijeiro about the rationale for doing more than just eliminating the structural fiscal deficit in the United States and thereby having the Federal Government contribute to national savings, the Associate Director recalled. To the extent that the difference between growth rates in the United States and other countries was due to inadequate savings in the U.S. economy, and if--after everything possible had been done to remove disincentives and impediments to savings--the volume of savings was still inadequate from that standpoint, the issue of moving the budget into a structural surplus might well come to the fore. A decision to seek such a strengthening of national savings would seem to require addressing the question of the distribution of benefits from investment between present and future generations; the answer to that question would be affected by the availability of profitable investment opportunities.

As for Mr. Teijeiro's concerns about the effect of U.S. interest rates on other countries, the Associate Director said that the basic problem would seem to be related to the fiscal deficit. Mr. Teijeiro had also suggested that U.S. policy actions had had a particular bearing on the terms of trade. If prices were not being seriously distorted by protectionism or other such factors, the terms of trade were probably reflecting mainly cyclical influences; even with better economic performance all round, he would not expect oscillations in the terms of trade to be eliminated.

In reply to Mr. Alhaimus's question on the composition of the overseas development assistance of the United States, the Associate Director of the Western Hemisphere Department explained that the information required was not easy to assemble in a consistent way. He would take up that issue, and any other questions of fact, with Executive Directors subsequent to the Board discussion.

Mr. Prowse said that he had found no reference in the staff assessment of fiscal policy to the level of profits or to the level of investments during the 1970s or to the prospects for the future. He recognized that the broad effects of large deficits on capital formation in the private sector had been discussed, but he would have liked to see more specific emphasis on the level of investment, especially the decline of manufacturing capacity, and on the fact that such a decline reflected a fall in rates of return over a longer period, and prospectively into the future as well. The staff report should have focused more attention on those elements as the fundamental underpinnings of growth in the U.S. economy.

Mr. Erb remarked that he could agree that a clash between monetary and fiscal policy, and the crowding out of the private sector, might be taking place at present, in the sense that if the fiscal deficit were lower, interest rates might be lower, and so might the rate of real economic growth. He would pose another question stemming from the crowding-out argument. There was reasonably strong growth in expenditures on consumption and housing, but he was not sure that investment expenditures were lagging that far behind the normal level for the phase of the recovery. Thus, he wondered where the staff would expect to see a greater response in the private sector, in terms of real investment demand, if the Government were borrowing less.

The Associate Director of the Western Hemisphere Department considered that the response would come from such interest-sensitive areas as housing, business fixed investment, and some of the consumer durables. Like Mr. Erb, he felt that, given the degree of economic slack, interest rates seemed rather high, once all the necessary adjustments had been made, and thus believed that interest rates were having their impact at present. In addition, it was clear that the prospect of an increase in the structural deficit in the absence of significant further action had to be affecting the willingness of the business sector to make plans for increased spending for capital formation. Perhaps the key point was not that business fixed investment did not look particularly weak at the present stage of the cycle, compared with the past; rather, what was being sought was a strengthening of investment, and it was important that that objective not be put in jeopardy.

Mr. Erb remarked that his own judgment, which was close to that of Mr. Prowse, was that both monetary policy and fiscal policy were expansionary, and that real economic growth over the near term would be higher than expected by either the U.S. Administration or the Fund staff. Mr. Hirao had wondered whether greater emphasis should not be given to interest rate targeting in the setting of monetary policy, based on the high degree of success in bringing down inflation. He himself was not so sure about the permanency of that success, which might be reversed quite easily, since it took a long time for inflationary expectations to be completely dispelled. In addition, it was essential to avoid repeating the mistakes of the past 15 years, and the repeated attempts by officials to explain why the growth of money was strong and, in some cases, why it should be even stronger in the face of an economic recovery. At such times, the desire to avoid interest rate increases in the short run frequently led to an excessively expansionary monetary policy. The latter was often not recognized until after the fact. Thus, experience indicated that pressures to pursue a more expansionary monetary policy should be avoided, and that the Federal Reserve should err on the side of caution, while at the same time taking into account the institutional changes that were taking place.

The international liquidity situation had clearly influenced U.S. thinking and decision making, Mr. Erb said in response to Mr. Joyce's question, in much the same way as the domestic situation had had an effect on the views of the Federal Reserve, as well as those of the Treasury Department and other officials of the U.S. Government. But there was the issue of timing to be considered. Strong growth in the United States and in Europe and Japan would lead to export growth in countries with debt problems, but probably not until well into 1984. Over the intervening six to nine months, there was a danger that if a strong rate of growth were accompanied by a strong demand for credit within the major industrial countries, it might be even more difficult to meet international demands for credit in that shorter period. Thus, considerations of international liquidity argued in favor of a steady and slow recovery rather than a surge in economic growth and a sudden, sharp rise in interest rates.

The fiscal problem was broader than the problem of the deficit by itself, Mr. Erb added. The deficit was a result of the inability, within the United States, to come to terms politically with the appropriate composition and rate of growth of government expenditures, and also the means of financing that expenditure growth, creating not only pressures in the financial markets but uncertainties for the future because it was not known how the U.S. Government would respond to developments over time. Would taxes be raised? If so, which taxes would be raised? Would expenditure growth be cut? If so, which categories of expenditures would be cut? Those factors added to the uncertainty and would affect the growth of investment in the longer term. While those problems were not unique to the United States, they were especially acute there, and they would not be resolved until well beyond the 1984 election. As Mr. Polak had commented, fiscal policy was not likely to change for another year and a half or two years. The Congress was not likely to make major changes in taxation before the end of the current session. The best that could be expected was adjustment in line with the Administration's tax package, which was not enough, as the staff had pointed out.

As for whether the U.S. representatives' view on exchange rate intervention, as reported by the staff, was consistent with the statement of the Ministers of the seven major industrial countries on exchange rate intervention, Mr. Erb considered that it was. No one who had participated in the discussions of the working group on intervention or in the series of discussions among the Deputy Ministers preceding the Ministers' meeting could have expected a different response from

U.S. intervention policy than had taken place. Certainly, there was a greater willingness on the part of his authorities to discuss regularly with other countries exchange rate developments, underlying policies, and whether or not the conditions were appropriate for joint intervention.

The concept of disorderly markets was of course vague, Mr. Erb noted. In the past, when there had been a consensus between the United States and other countries on the existence of disorderly markets, it had been at times when the authorities had been able to make a clear judgment that the exchange rate had moved too far and that underlying policies were moving in a direction compatible with the pattern of intervention. That had been the case in early 1975, in 1978 vis-à-vis Japan, and later in 1979 vis-à-vis Germany. But over the past year, the necessary conditions had not been present, because whenever other countries had discussed the possibilty of intervention by the United States, it had too often been in the context of their desire for flexibility to pursue a slightly more expansionary domestic policy.

The study of exchange rate market intervention seemed to have confirmed that, in the very short run, intervention could work to offset any shift in monetary policy, but that the consequent differences in monetary policy would come to dominate the exchange rate, Mr. Erb observed, so that conceivably the dollar might end up by being even stronger than it had been at the time of the original intervention. Mr. Polak had indirectly made that point in suggesting that a reduction in U.S. interest rates would result in a reduction in foreign interest rates, without there being much of an effect in the exchange rate. That was clearly what had been happening. At times, the United States had moved toward a more expansionary policy, which had resulted, late in 1982, in a slight decline in the dollar, but one that had in effect been brought to a halt because other economies were moving onto a more expansionary path at the same time. The study had also made clear that intervention per se could not deal with exchange rate swings of the type to which Miss Le Lorier had referred, relating to the movement of capital flows. A greater convergence of underlying economic conditions in the major-currency countries would be the way to avoid such exchange rate swings in future.

The United States was willing, Mr. Erb said, to play a leadership role in demonstrating a commitment to free trade, but it could clearly not do so unless other countries, developing as well as industrial, also moved in the same direction. The initiatives taken by the United States during the past year in certain areas had not met with any great enthusiasm. As for the recent trade measures with respect to specialty steel and motorcycles, which had been discussed in the staff report, he would reiterate the response of the U.S. Government that those steps had not been taken precipitately, but had been based on thorough investigation.

Every effort should be made to deal with the large errors and omissions recorded in the overall balance of payments position, Mr. Erb stated, agreeing with Mr. Polak. The collection of data could be improved in many repects, but there was a constant problem in finding out what business was being transacted in order to keep track of the underlying data. Indirect estimates suggested that unrecorded movements of capital might amount to about $2 billion. It might be necessary to obtain the support of other countries in order to ensure that the data collected reflected the facts. As the Associate Director of the Western Hemisphere Department had remarked, the differences between the staff's forecasts of the current account deficit and those of the U.S. authorities were not significant, given the high degree of uncertainty that normally underlay those forecasts.

Aid was a large subject, Mr. Erb noted, and support for it in the United States had been influenced by many factors. It was appropriate for the staff to report on the flows of foreign assistance and the aid policies of any country in the context of a consultation and surveillance, but he questioned whether it was appropriate to go further by advocating higher levels of expenditure on foreign assistance, or even to comment on the particular composition of a country's expenditure, which the Fund usually left to a member's own choice. More fundamentally, advice in that respect might be counterproductive in the context of a member's consultation. In a general context, the Fund could certainly point to the need for additional aid flows, but in the context of a consultation a certain perception of a conflict of interest might be created if, say, the Fund advised the United States to reduce the growth of government expenditures and the fiscal deficit, while at the same time encouraging the U.S. authorities to increase their expenditures for a particular group of member countries.

Mention had been made by Mr. Wicks of the focus in the staff report on U.S. domestic economic policy, Mr. Erb noted. Certainly, other countries seemed to want to discuss the impact of U.S. domestic policy, an aspect that was covered in the Article IV consultation discussions with the United States. But the more general question raised was whether enough attention was paid in the United States to economic developments abroad. Policy measures that would be desirable from the domestic perspective would also be desirable from an international perspective; there was no great conflict in that respect. Therefore, it was appropriate to analyze as deeply as possible the domestic rationale for such policy measures because while domestic policymaking was influenced by international considerations, the policymakers had to come to terms with the impact of the domestic policies at home.

In conclusion, Mr. Erb commented that the clear analytical and empirical views of Executive Directors on the U.S. economy, and their specific policy advice and judgments, modified nevertheless by their recognition of some of the unknowns and uncertainties, would be of value to him in conveying the views expressed to his authorities.

The Chairman made the following summing up:

> In the discussion of the staff report for the 1983 Article IV consultation with the United States, Executive Directors agreed with the thrust of the staff appraisal. They commended the U.S.

authorities on the progress achieved in the fight against inflation and emphasized the need to consolidate this progress in order to create the basis for a strong and durable expansion. They noted, however, that there were certain areas of concern, particularly the persistence of large fiscal deficits. Directors stressed the particular importance of U.S. economic policy at this juncture and drew attention to the consequences of U.S. policy decisions for the international community.

Directors noted that economic recovery was under way following an extended period of stagnation during which unemployment had risen to high levels. While Directors were encouraged by the recent strengthening of economic activity, they were concerned about the durability of the recovery and in particular about the outlook for capital formation. Many Directors stressed that steady growth in private investment was essential to a healthy expansion of the economy.

Directors expressed the view that the monetary policy pursued in recent years had made a major contribution to the reduction in inflation, and they emphasized the need for continued vigilance in this area. Directors observed that the setting of appropriate target ranges for monetary growth and the assessment of movements in the aggregates had been complicated by the uncharacteristic behavior of velocity and by far-reaching changes in financial technology and regulation. Directors said that, given recent monetary developments and in view of the need to provide protection against a rekindling of inflation, the Federal Reserve would have to follow a cautious course. A number of Directors noted that there was increasing evidence that demand was gathering strong momentum; they observed that M-1 had been growing very rapidly for several months, and they were not convinced that shifts among assets resulting from financial deregulation had been the main factor in this regard. Under these circumstances, they suggested that the Federal Reserve should stand ready to tighten reserve provision. It was remarked that an increase in interest rates in the short run would work to obviate the need for larger, longer-lasting increases at a later date. Directors noted the problems posed for the conduct of monetary policy by the budgetary situation, and it was observed that monetary policy could not undo the interest rate consequences of high fiscal deficits. A number of Directors, however, expressed concern about the adverse effects that a substantial rise in U.S. interest rates might have on the recovery of the U.S. economy and about the situation of developing countries facing debt servicing difficulties.

In the area of fiscal policy, it was the unanimous view of Directors that existing deficits and the prospect of continuing large deficits even as the economy recovered were the main obstacles to a satisfactory economic performance in the United States. Directors stressed that the persistence of such deficits was bound to limit capital formation and productivity growth over the medium to longer run by exerting upward pressure on real interest rates. A number of Directors felt that the rapid increase in government debt and the large absorption of net private savings implied by the prospective deficits could well lead to a situation in which achievement of the joint objectives of low inflation and sustained growth would not be feasible.

Some Directors also expressed concern that large deficits might result in the preemption of foreign savings. More generally, it was emphasized that a tightening of fiscal policy, by producing a more stable U.S. economic and financial situation and by reducing credit market pressures, should contribute to the stability and growth of the world economy. For these reasons, there was a broad consensus that decisive and specific steps must be taken without delay to bring down the deficit.

Directors expressed the view that dealing with a fiscal problem as large as that confronted by the United States would require both considerable restraint on the expenditure side and substantial efforts to raise revenue. The emphasis placed by the Administration on expenditure restraint received wide support. However, Directors observed that, in spite of this emphasis, the ratio of federal outlays to GNP had increased in the past two years, even allowing for cyclical influences. It was thus felt that a substantial effort also was required on the side of revenue in order to solve the fiscal problem. It was noted that it should be possible to raise revenue in ways consistent with the preservation of incentives for capital formation; specific reference was made to the possibility of focusing on consumption taxes, including energy taxes, and on reducing tax expenditures, including interest deductibility, that have adverse effects on private savings and on resource allocation.

Some Directors observed that the appreciation of the dollar since late 1980 had weakened the competitive position of U.S. producers and had contributed to protectionist pressures. It was noted that this might lead to a deterioration of the current account of the U.S. balance of payments, and concern was expressed that it might lead to a large swing in the external value of the U.S. dollar. It was also noted that the interpretation of the current account balance had been complicated by the emergence of a large, positive statistical discrepancy in the U.S. balance of payments. It was observed that balance of payments data left much to be desired, and the need for efforts to improve the quality of these data in the interest of proper policy analysis for the United States and the world economy was emphasized. This was a matter of importance for the conduct of the Fund's surveillance responsibilities. The need to improve the statistical base of the U.S. balance of payments was stressed in the context of the obligations undertaken under Article VIII.

Directors noted the importance of a stable dollar for the international monetary system. In this connection, some Directors observed that a tightening of fiscal policy in the United States would help to create conditions conducive to an orderly correction in the exchange value of the dollar, to the extent that it had been boosted temporarily by pressures from the fiscal side. Several Directors referred to the conclusions of the study on intervention policy conducted by the seven major industrial countries, and generally felt that participation by the United States in coordinated intervention with other countries could, under appropriate circumstances, serve a useful purpose.

Directors referred to the Administration's efforts to reduce the burden of regulation and its emphasis on market forces. They expressed disappointment that U.S. goverment policies in certain areas had not adhered to free market principles. In the area of agricultural policy, some Directors expressed concern about the high target and support prices for several commodities that had given rise to a large demand-supply imbalance and to growing budgetary outlays.

As regards foreign trade policies, Directors supported the Administration's objective of maintaining an open U.S. market and of countering protectionist pressures in the United States. They were disturbed, however, by certain restrictive actions recently taken by the United States, and particular reference was made to recent actions in the area of specialty steel. Directors emphasized the dangers posed by the intensification of protectionism and urged the Administration to demonstrate its commitment to free trade by rolling back the measures that had restricted international competition. More generally, they expressed great concern about the use by the United States of trade restricting measures as a means of inducing other countries to open their own markets, since this could well lead to an escalation of trade barriers, rather than to their reduction.

Directors acknowledged the constructive role played by the United States in dealing with the debt problems of developing countries, while noting the impact on the indebted countries of the high interest rates stemming in part from the inappropriate fiscal and monetary mix in the United States. At the same time, Directors observed that the record of the United States as a donor of aid to developing countries had been poor; they stressed that it was important for the United States to increase its foreign economic assistance, particularly toward the least developed countries and in a multilateral framework.

Directors emphasized the high importance of early completion of action by the United States on the increase in its quota.

It is expected that the next Article IV consultation with the United States will be held on the standard 12-month cycle.

2. GUINEA - 1983 ARTICLE IV CONSULTATION - POSTPONEMENT

Mr. Sangare mentioned that the staff report for the 1983 Article IV consultation with Guinea had been circulated the previous day, together with a proposal that the three-month period for the completion of the consultation be extended (EBS/83/148, 7/19/83). In view of the need for him to travel to some of the countries that had elected him, and in view also of the forthcoming Board recess, he asked Executive Directors to agree to discuss the report on August 5.

The Executive Board then took the following decision:

The Executive Board agrees to extend the period for Executive Board consideration of the staff report for the 1983 Article IV consultation with Guinea until August 5, 1983.

Decision No. 7472-(83/107), adopted
July 20, 1983

APPROVED: January 19, 1984

LEO VAN HOUTVEN
Secretary