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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/110

10:00 a.m., July 25, 1983

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
J. de Groote	H. G. Schneider
B. de Maulde	
	J. Delgadillo, Temporary
R. D. Erb	T. A. Connors, Temporary
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	M. Casey
A. Kafka	C. Robalino
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	L. Ionescu, Temporary
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	
F. Sangare	
	J. L. Feito
J. Tvedt	A. Lindå
N. Wicks	C. Taylor
	Wang E.

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

Asian Department: F. Le Gall, H. O. Roden, G. Szapary. European Department: L. A. Whittome, Counsellor and Director; T. R. Boote, U. Dell'Anno, P. C. Hole, L. J. Lipschitz, S. M. Thakur, H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; J. Berengaut, K. B. Dillon, M. Guitian, D. A. Lipton, P. L. Sheehy. External Relations Department: H. P. Puentes. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder, Ph. Lachman, J. K. Oh. Middle Eastern Department: B. A. Karamali, L. A. Wolfe. Research Department: W. C. Hood, Economic Counsellor and Director; A. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; L. Alexander, K.-Y. Chu, A. Salehizadeh, G. H. Spencer. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. Williams, Deputy Treasurer; D. Gupta, Q. M. Hafiz, D. V. Pritchett, O. Roncesvalles, T. M. Tran, P. van den Bogaerde, G. Wittich. Bureau of Statistics: T. Luu. Advisor to the Managing Director: E. W. Robichek. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, J. R. N. Almeida, C. J. Batliwalla, S. E. Conrado, S. M. Hassan, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz, P. Péterfalvy. Assistants to Executive Directors: E. M. Ainley, L. Barbone, R. Bernardo, J. Bulloch, M. Camara, M. B. Chatah, M. Eran, I. Fridriksson, N. U. Haque, H. Kobayashi, M. J. Kooymans, P. Leeahtam, W. Moerke, Y. Okubo, J. K. Orleans-Lindsay, G. W. K. Pickering, E. Portas, M. Z. M. Qureshi, J. Reddy, J. Schuijer, Shao Z., Wang C. Y.

1. IRELAND - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Ireland (SM/83/126, 6/14/83; Cor. 1, 7/20/83; and Sup. 1, 7/20/83). They also had before them a report on recent economic developments in Ireland (SM/83/146, 7/1/83).

Mr. Casey made the following statement:

Summary of developments and prospects

During the Board discussion of the Article IV consultation with Ireland some 20 months ago, many Directors expressed concern about the growing internal and external imbalances in the economy. In 1981 the rate of inflation had risen to more than 20 percent. The exchequer borrowing requirement (EBR) and the current balance of payments deficit had grown to about 17 percent and 13.5 percent of GNP, respectively. Economic growth was negligible in 1981, indeed negative when adjusted for terms of trade, and unemployment was increasing, reflecting both the loss of existing jobs and the rapid growth in new entrants to the labor force. The Irish economy, because of its extreme openness and high dependence on imported energy, suffered unduly from the international circumstances of the time.

The process of adjustment began in mid-1981 and has been maintained by three successive Governments through 1982 and into 1983. Significant progress has been achieved. In 1983, the rate of inflation is expected to come down to 10 percent; of this figure, some 3.5 percentage points are attributable to indirect tax increases, so that the underlying inflation rate will be well into single figures. Indeed, data for May imply an annual increase of about 5.5 percent in the underlying rate.

The EBR as a proportion of GNP will be cut to about 13 percent this year. While this ratio is still high in an absolute sense, it does represent a considerable improvement in the space of two years and is to some extent cyclical in nature. Thus, allowing for automatic stabilizers, the extent of the fiscal adjustment being sought in the 1983 budget is greater than a simple comparison of the EBR outturn for 1982 and the target for 1983 would suggest.

Perhaps the most remarkable achievement relates to the current balance of payments deficit. It will be reduced to about 3 percent of GNP in 1983 and, according to staff projections, will disappear entirely by 1987.

Measures taken to achieve these results have had inevitable costs in terms of economic activity, unemployment, and living standards. My Irish authorities believe that these costs are

essentially short term and that, as the process of adjustment continues, the economy will be better placed to benefit from the international recovery and to achieve more balance in its longer-term performance. In his 1983 budget speech, the Minister for Finance stated, "We are...facing two or perhaps three years of unremitting effort to restore a proper balance between expenditure and revenue and to lay the foundations for growth and prosperity in the future."

Virtually all the fiscal adjustment to date has been achieved on the revenue side. In 1980, total revenue including social security contributions accounted for 37 percent of GNP; in 1983, the figure is expected to be 43.5 percent. However, the tax base is narrow, which means that attempts to raise revenue typically involve increasing tax rates. This has led to rather high rates of tax, particularly for the PAYE sector. In addition, the most widely applied rate of VAT is now as high as 35 percent. While increased tax rates may have led to forced savings and thus helped the balance of payments in the recent past, it seems clear that ongoing increases in tax rates would not be appropriate. Consequently, some attempt must be made to broaden the tax base; this process was indeed initiated in the 1983 budget, but more needs to be done. However, the greatest scope for fiscal correction lies in expenditure restraint.

Government spending, expecially on transfers, debt servicing and pay, has increased sharply in recent years. Total government spending reached 67 percent of GNP in 1982 and is not expected to fall significantly below this ratio in 1983, even though capital spending is being curtailed.

Although the 1983 budget put the brunt of adjustment on the revenue side, some measures were taken to contain expenditure. In addition to cuts in capital spending, action was taken on the current side, including a reduction in pay-related umemployment benefits. Cautious policies on recruitment and pay were continued with the result that the increase in the total wage bill--including the normal allowances for increments, promotions, etc.--will be kept to a manageable level. The Government is carefully monitoring the budgetary outlook with a view to taking any actions necessary to avoid overruns on the targets.

The authorities recognize what needs to be done and have announced that expenditure adjustments will be the main focus of the 1984 budget. Expenditure restraint will have to extend beyond pay and public service numbers, although the authorities view action on the pay front to be the single most significant target, at least in the short run. The overriding feature of fiscal policy is the firm intention to eliminate completely the

current budget deficit by 1987. Further streamlining of the public enterprises and redoubled efforts at prioritizing the Public Capital Program will also be put in hand.

The main objective of monetary policy continues to be the maintenance of adequate external reserves. Since the authorities desire a more comfortable cushion of reserves for intervention and other reasons, monetary policy has been attuned to this more exacting target.

Last year's guideline for growth in private sector credit was 14 percent. However, because of weak demand and high interest rates, the actual increase in credit was only 10 percent and in broad money 11 percent.

The new credit guideline for the year to mid-January 1984 is 11 percent. The Central Bank of Ireland states that this credit guideline approximates the expected growth in nominal GNP and will be adequate to cater to the prospective demands of the private sector. Noncompliance would, as usual, result in calls for supplementary deposits from banks.

The authorities hope to move to more market-oriented instruments of monetary policy. The improved methods of intervening in the money market that are being introduced are fully consistent with this intention. The authorities have just established a procedure for the provision of liquidity to the interbank market by means of sale and repurchase agreements in respect of government securities.

Even with the EBR declining, it is desirable that a greater proportion of it be financed domestically from the nonbank private sector. This would facilitate better control over the monetary aggregates and reduce reliance on foreign borrowing. Notwithstanding the possible impact of domestic financing of the EBR, it seems reasonable to hope that a downward trend in interest rates internationally would be reflected in a broadly similar decline in Irish interest rates. Such a decline in interest rates would facilitate the elimination of the current budget deficit by 1987 and strengthen domestic investment.

There was a loss in competitiveness in late 1982 and early 1983 as a result of the appreciation of the Irish pound, reflecting the exceptional fall in both sterling and dollar exchange rates. However, following the EMS realignment in March 1983, competitiveness was restored. The strength of sterling since then will result in an improvement of competitiveness of about 3 percent in 1983. However, this decline in the exchange rate vis-à-vis sterling will increase inflationary pressures. To maintain competitiveness in 1984 will require that these pressures be contained and not be reflected in higher costs.

As a general rule, however, the authorities do not look to the exchange rate as a means of ensuring competitiveness. This view is based on well-documented reasons such as the low price elasticity of imports, the high import content of exports, the link between wage and price movements, and various psychological factors. Consequently, income restraint and high productivity growth are seen as the best means of ensuring competitiveness. In this context, there have been widespread pay pauses since end-1982, the unions have become noticeably less pushful, and productivity growth compares well internationally. One could argue, of course, that even more should be done because of the need to create jobs on a rising scale in the years ahead.

Although the gross debt service ratio rose from 11 percent in 1981 to 19 percent in 1982 as a result of rolling over some previously arranged credit, high interest rates, and currency changes, this ratio is expected to fall in 1983. It should also be noted that the debt service ratio is significantly lower when interest income on official reserves is factored in. In addition, the maturity profile of external debt is favorable, and the credit-worthiness of the country has never been in doubt. Although my authorities have strong reservations about the technical feasibility of forward-looking debt analysis, the illustrative calculations indicate improvements continuing through to 1987 in the debt service ratio and the complete elimination of the current balance of payments deficit by the end of the period.

The Government is in the course of reviewing its industrial policy to see to what extent changes are needed to cope with the more difficult international environment for manufacturing industry, the challenge of new technology, competition from new industrialized countries, and the downturn in internationally mobile investment.

The basic objectives of industrial policy, however, will not be changed. The Government remains committed to a policy of free trade and state incentives for private manufacturing investment. Measures to improve the international competitiveness of domestic Irish industry will be considered, not only in relation to input costs but also by addressing weaknesses in management, quality control, design, innovation, and marketing. Intensive efforts to attract foreign investment will be continued. Further growth of a progressive export-oriented indigenous sector is also essential to achieve sustained economic growth and increase secure employment.

Ireland relies heavily on external sources for energy supplies, although the discovery and development of natural gas some years ago eased this problem somewhat. Pricing and other

policies have encouraged conservation, however, and total energy use has declined significantly in recent years. Nevertheless, almost two thirds of Ireland's total energy requirements must still be imported.

Finally, with regard to the 12-month cycle, my authorities do not regard any of the three criteria mentioned in Fund documents as applying to Ireland. On this understanding, however, and as the 12-month cycle is being set as the standard time-scale for Article IV consultations, my authorities would not object to the application to Ireland of the annual cycle.

Extending his remarks, Mr. Casey added that some of the figures in his statement differed slightly from those in the staff report, owing entirely to recent data revisions. Figures for external trade in June 1983, which had just become available, showed either the highest or the second-highest trade surplus ever recorded by Ireland. Very good export figures had been recorded for chemicals, office and data processing equipment, and the like, suggesting that industrial production was recovering well. Indeed, the increase in external demand might compensate in part for the squeeze on domestic demand, thus easing the burden of adjustment. The staff, in SM/83/126, Supplement 1, had rightly drawn attention to the recent slippage of about £Ir 100 million in the domestic budget. Although the overrun was comparatively small, the Government had decided to offset most of it, thus indicating the determination with which the authorities were pursuing the stated goal of eliminating the current budget deficit by 1987. Their main method would be to introduce expenditure cuts both on the current account side and on the capital side. In addition, a tax increase on cigarettes and other tobacco products had been introduced and would take effect immediately.

Mr. Grosche remarked that, as a small open economy relying heavily on imported energy, Ireland had been severely hit by the increase in energy prices and by depressed conditions in its major export markets. The country had already been suffering from high structural unemployment, and the situation in the labor market had been aggravated by losses in cost competitiveness because of the severe distortions that had been introduced in the internal cost structure by real wage gains in the late 1970s. He commended the authorities for having taken strong adjustment measures, although it was unfortunate that they had been delayed until 1981.

Remarkable progress had been made, Mr. Grosche observed, particularly in the rate of adjustment and in the reduction of costs. Nevertheless, Ireland had a long way to go before achieving a balance in its economy, especially as part of the success achieved so far appeared to be due to cyclical factors.

He broadly agreed with the staff appraisal, Mr. Grosche went on. He would therefore only comment on fiscal policy and external policy, two areas of particular importance for achieving the desired adjustment. On fiscal policy, he welcomed the authorities' intention to shift the burden of fiscal restraint to the expenditure side, especially by curbing expenditures on wages and salaries. It was useful that the authorities also intended to curtail transfer payments, including those to public enterprises, which would probably have to raise charges in consequence. Hitherto, an excessive burden had fallen on taxpayers, as could be seen by the fact that the ratio of government revenues to GNP had risen to over 43 percent in 1983 from 30 percent in the mid-1970s. A further rise in the overall tax burden was clearly undesirable. However, like the staff, he believed that there was still room for improvement in the tax system and in the method of tax administration, particularly by shifting direct taxation to the self-employed, to property owners, and to other forms of wealth. At present, the heaviest burden fell on the employed. The high rate of indirect taxation tended to encourage spending across the border with Northern Ireland and to favor the growth of the underground economy. He would encourage the authorities to broaden the tax base, including the base of value-added tax, as quickly as possible.

On the external side, the adjustment of the Irish pound as part of the recent EMS alignment had offset the increases in prices that had taken place since the beginning of 1982, Mr. Grosche noted. He joined the staff in welcoming the authorities' reluctance to use exchange rate policies aggressively, and he supported the strategy of maintaining competitiveness through wage restraint.

Ireland's external debt was high by international standards and had risen quickly in recent years, Mr. Grosche stated. However, as both Mr. Casey and the staff had observed, Ireland's creditworthiness continued to be highly regarded in international capital markets. The debt service ratio was modest and likely to fall. Nevertheless, he shared the staff view that the authorities should limit borrowing abroad in order to curb the drain on domestic resources represented by interest payments on the external debt. Ironically enough, a considerable portion of foreign borrowing had been undertaken to offset the outflow of private capital. In order to avoid a continuation of the process, the authorities ought to introduce a more flexible exchange rate policy, which could also help to mobilize domestic resources with which to finance the budget deficit.

Mr. Ionescu stated that he was in broad agreement with the staff appraisal. The Irish authorities were to be commended for the determination that they had shown in the past two years to address both the internal and the external imbalances that had emerged in their accounts. While the results so far were encouraging, the authorities were clearly aware that more was still required.

The budget deficit--at 13 percent of GNP in 1983 compared with 16.6 percent of GNP in 1982--was still high, Mr. Ionescu remarked, and it would be difficult to reduce it because of increasing interest rate payments. He agreed with the staff in emphasizing expenditure restraint in view of the large share of public expenditures in the total, the inflationary impact of tax increases, and the danger of increasing tax evasion, even if he did not have much sympathy for cuts in health care payments. Second, despite the improvement in the current account, net public external borrowing had not fallen between 1981 and 1982. Domestic liquidity creation had remained high, thus allowing private capital outflows to take place. He agreed with the staff that not only should external borrowing be reduced, but also that interest rate policy should remain more flexible if the aim was to cut down on monetary financing and to reduce the budget deficit as a means of cutting back on inflation despite continuing nominal wage increases.

In addition, Mr. Ionescu continued, the continued use of public borrowing to finance the balance of payments had led to sharply increasing interest payments, thus hampering the adjustment process. While it was true that the authorities were practicing sound external debt management, particularly in terms of the maturity structure, he fully agreed with the staff that the authorities would be wise to set conservative foreign borrowing targets in order to curb the drain on domestic resources from payments on the external debt, particularly because most borrowing had been carried out at floating rates.

He had difficulty with the staff's observation at the end of its appraisal on page 16 of SM/83/126 to the effect that if there were a failure to obtain the necessary degree of wage restraint, the authorities should continue with their pragmatic approach to the management of the exchange rate as a means of completing their adjustment efforts, Mr. Ionescu stated. It would be wrong to ignore the disciplinary effect of fixed exchange rates, the very foundation of the European Monetary System, of which Ireland was a member. Ireland's trade flows had improved spectacularly, and any devaluation would be completely unnecessary if either capital outflows or the external debt service were held in check. Moreover, he fully agreed with the Irish authorities that devaluation was not a viable option for achieving gains in competitiveness; it would only have a small and ephemeral effect on foreign trade performance, while producing substantial pressure on domestic prices. The staff should take such points into account before prescribing sizable devaluations for member countries.

Finally, Mr. Ionescu observed, it was stated on page 87 of SM/83/146 that special quota restrictions applied to a number of products from state trading countries. He wondered whether such restrictions were imposed by the European Community as a whole, or whether they had been adopted solely by Ireland.

Mr. Lovato stated that he agreed with the staff appraisal and recommendations. Since mid-1981, the Irish authorities had introduced many courageous measures, thus achieving satisfactory economic results as early as the end of 1982, albeit at considerable costs in terms of activity and employment. There had in particular been an implicit reduction in the rate of inflation and an improvement in the external current account. Nevertheless, Ireland still had some way to go to complete the adjustment process, and the authorities would need to proceed with determination. It was encouraging that the measures adopted by the authorities had gained increasing popular acceptance; the new situation should help the authorities in that task.

There were two points in the staff analysis on which he wished to comment, Mr. Lovato stated. First, while fiscal policies had become progressively tighter, adjustment had taken place mainly on the revenue side. To raise the tax burden further could be counterproductive, while a reduction of public spending--implying not only a slowing down in the rate of increase but also a change in the structure--could make not only for a smaller budget deficit but also for improved demand management. Two ways in which improvements could be brought about would be to compel public enterprises to adopt a more effective pricing policy, and to bring about a better balance between the costs and benefits of social services. It was however crucial for continued success not only in the public but also in the private sector that a more realistic view of labor costs should be taken. The increases in nominal pay in recent years had been higher than in the country's main trading partners, creating a situation that was not conducive to improving either economic activity or employment.

He agreed with the Irish authorities that to gain competitiveness it would be better to avoid devaluation and to increase productivity while restraining excessive labor costs, Mr. Lovato went on. In those circumstances, it was disturbing that, as shown in SM/83/126, Supplement 1, the few pay settlements reached to date had deviated in varying degrees from the Government's recommendation for a six-month pay pause to be followed by low single-figure increases. He hoped that the authorities would remain firm on the point and would take all the measures needed to ensure that the original budget objectives were met. He also agreed with the staff that the authorities should be restrained in setting borrowing targets and should pursue a more flexible interest rate policy, which ought to help them better to control capital outflows and to bring about domestic financing of the public sector deficit.

Taking up a general point, Mr. Lovato remarked that he had seen a reference--he thought for the first time--in the staff report to the underground economy. He wondered whether the staff had any idea of the size of the underground economy in Ireland and, since the phenomenon seemed to exist nearly everywhere, whether the staff intended to devote a paper to it in order to enable Executive Directors to understand better the effectiveness of economic policy in different types of economies.

Mr. Taylor stated that he too agreed with the assessment in the staff appraisal and with the general thrust of the staff's policy recommendations. The staff report had been exceptionally readable and well presented. Much useful information had been given in a series of clear charts, and telling use had been made of the rather short table in the text. The analysis was both concise and of high quality, and he particularly appreciated the longer-term perspective.

While he could understand the doubts of the Irish authorities regarding the external debt scenarios, Mr. Taylor went on, he found the illustrative projections in Table 4 both useful and relevant. The corrective policies implemented since the middle of 1981 had rightly centered on fiscal adjustment for the purpose of reducing the exchequer borrowing requirement. The authorities were to be commended for the progress achieved so far despite the difficulties caused by the recession. Nevertheless, the borrowing requirement had amounted to 16.5 percent of GNP in 1982, and could clearly not be allowed to continue running at that level. He therefore welcomed the authorities' intention to reduce the current budget deficit further in 1983 and, if possible, to eliminate it entirely by 1987.

The burden of fiscal adjustment had so far fallen mainly on the revenue side, Mr. Taylor noted, thus probably contributing to inflationary pressures. It certainly seemed essential that henceforth the emphasis of restraint should be shifted quite decisively onto the expenditure side. He was therefore pleased that, for the first time in many years, the Government's expenditure had been contained within its target for 1982. Nevertheless, there was no room for complacency, and he saw from SM/83/146, Supplement 1, that the expenditure target for 1983 was already under pressure.

In those circumstances, Mr. Taylor observed, it was reassuring to have learned from Mr. Casey that the Government was carefully monitoring the budget outlook with a view to taking any necessary action to avoid overruns, and he welcomed the announcement that the 1984 budget was focused primarily on adjustment of expenditure. He was glad that both the staff and Mr. Casey had remarked that public sector pay restraint remained of paramount importance. If the pay settlements for 1983/84 turned out to be somewhat higher than budgeted for, he hoped that it would still be possible to keep the extra labor costs to a manageable level. Like others, he could see the need to take steps to broaden the tax base, including the value-added tax base. Not only would such an action serve to dampen wage claims by lessening the burden of PAYE--taxes paid by wage-earners--but it would also reduce the incentive for tax evasion and spending across the border with Northern Ireland. He had been glad to learn from Mr. Casey that the broadening of the tax base had been initiated in the 1983 budget; he would be interested in hearing rather more about the authorities' plans in that regard.

In view of the inevitable dampening down of domestic demand caused by the strong fiscal policy, Mr. Taylor remarked, it would be

essential for Ireland to retain as competitive a trading position as possible. The authorities were aiming to achieve their goal in that direction mainly by income restraint and by the growth of productivity, an approach that commanded considerable sympathy. Nevertheless, the forecast of a 3 percent improvement in competitiveness during 1983 seemed rather optimistic, since it implied that hourly earnings would rise only 2 percent more than those in Ireland's major trading partners, and that productivity would expand fully 2 percent faster than in those countries. It would be interesting to know whether these projections were consistent with settlements so far made in the current wage round.

It remained a matter of concern that the proportion of monetary financing of the exchequer deficit was still so high, Mr. Taylor stated. This had pushed up the foreign debt rapidly since 1980, so that it had amounted to some 60 percent of GNP by the end of 1982, and the gross debt service ratio had risen to 19 percent, an uncomfortably high figure. Naturally, if it were fulfilled, the Government's commitment to reducing the exchequer borrowing requirement should begin to lessen the recourse to external finance. In that connection, he supported the staff's suggestion that further progress in mobilizing domestic nonbank resources would be highly desirable. Nevertheless, Ireland's creditworthiness remained good, and its debt repayment profile seemed fairly well structured. The authorities would do well to follow the staff's advice to exercise self-restraint in setting foreign borrowing targets. Finally, the next Article IV consultation with Ireland should be held on the normal 12-month cycle. There had been a rather long interval since the previous one.

Mr. Tvedt stated that he was glad to see that the Irish economy had improved substantially since the previous Article IV consultation. In particular, the reduction of the current account deficit and the improvement in the current budget balance were welcome. Nevertheless, there were still a number of problems. Fiscal adjustment, for instance, had taken place mainly by an increase in taxation, with expenditures rising to unprecedented levels. Consequently, the authorities should give the highest priority to controlling expenditure in the next few years. The staff had indicated that the tax system needed overhaul, and he urged the authorities to follow the staff's advice. Similarly, the tax burden had apparently been raised unduly, and he wondered whether the rapid increase had not led to the apparent growth of the underground economy, and consequently to the increase in the item "errors and omissions" in the balance of payments.

He was rather disturbed by Ireland's large foreign debt, Mr. Tvedt commented, even though the maturity structure might be satisfactory and the debt service ratio was reasonable. The recent sharp increase in external debt should lead the authorities to adopt a careful borrowing policy and to do their best to bring down the current account deficit. The improvements of the past two years had entailed serious costs such as a slackening of economic activity and a rapid rise in unemployment.

In view of their exchange rate arrangements and the need to keep down domestic wage increases in the presence of high unemployment, he wondered whether the authorities had contemplated the adoption of any incomes policy.

Mr. Morrell said that he too was in general agreement with the staff appraisal. Since the previous consultation, Ireland had made reasonable progress in reducing the serious imbalances that had been besetting the country's economy. Nevertheless, there was still some distance to go. Economic growth had been virtually slack for three years; although inflation had been reduced, it was still high by the standards of other industrial countries, and exchequer borrowing had been very high. With government expenditure accounting for some 67 percent of GNP and excessive monetary financing of the deficit, it was clear that further measures would have to be taken to restrain expenditure.

The staff analysis made it clear that the authorities would need to broaden the tax base, Mr. Morrell observed. The wage earning sector was bearing far too high a share of the direct tax burden, while the self-employed and the corporate sectors were bearing too little. Taxation was poorly distributed, and the rates looked high even by the standards of the United Kingdom, thus surely encouraging cross-border business to the detriment of Irish enterprises.

Wage increases had been a problem in Ireland, having contributed to a loss of competitiveness and to the high rate of inflation, Mr. Morrell went on. Like Mr. Tvedt, he wondered whether the authorities had given any thought to implementing an incomes policy or even a wage/price arrangement to keep wages at a reasonable level. He was particularly interested in the industrial development policy of the Irish authorities; industrial exports had accounted for some 76 percent of all exports in 1982, compared with 64 percent in 1978. The change seemed to represent a remarkable achievement and an indication of successful diversification.

Nevertheless, Mr. Morrell noted, industrial exports seemed to have been encouraged by generous fiscal support, leading to a skewed tax system that needed to be corrected. In the circumstances, he wondered whether the corporate sector could become sufficiently profitable to bear the costs of full taxation. It was clear that many of the industries that had been developing in Ireland took the form of processing imported raw materials; and he agreed with the staff that more emphasis would have to be given to the processing of indigenous materials. He was also disturbed by Ireland's agricultural policy. Although agricultural exports had declined in relative importance, they were still significant. He had understood that Ireland was one of the beneficiaries of the European Common Market's Common Agricultural Policy (CAP). The staff had given no indication of the impact of the overall impact of the CAP on Ireland, with respect either to domestic prices or to budgetary support. If there was in fact significant

support from the CAP, he wondered whether the authorities had considered the possibility of the collapse of that policy. He asked the question because some commentators, particularly in the Southern Hemisphere, felt that the policy was bound to collapse.

In conclusion, Mr. Morrell stated that he looked forward to the next consultation with Ireland. He hoped that there would be further evidence of the needed adjustment and reform.

Mr. de Maulde said that, like other Directors, he agreed with the staff's appraisal; in particular, the authorities had demonstrated courage and determination in pulling the economy out of its difficult situation of two years previously. They had reduced the deficit on the current account of the balance of payments from 14.25 percent of GNP to 8.5 percent of GNP in 1982 and perhaps to as low as 3.5 percent of GNP in 1983. For reasons well explained in the report, it was clear that a relaxation of the present restrictive policy that had brought about such a turnaround would not be appropriate in present circumstances. Even after the recent advances, the economy remained in need of further adjustment.

In the domestic field, Mr. de Maulde went on, the public finances were still far from healthy. The authorities' intention to reduce the current account deficit in the budget to 7 percent of GDP in 1983 from 8.5 percent in 1982 seemed appropriate. After the sharp increase during 1982 in the share of government revenues as a proportion of GNP, any further increase in the tax burden appeared quite undesirable, especially in view of the structural weaknesses of the tax system. In consequence, most if not all of the adjustment would have to come from reductions in expenditure. The authorities did indeed appear already to have identified a number of fields--such as health, education, and general subsidies--where they intended to carry out cuts. Such cuts would clearly require considerable political determination, especially if the objective of bringing equilibrium into the external current account was to be achieved by 1987. The proposed cuts in public expenditures, described on page 8 of SM/83/126, were quite sobering. In particular, it was evident that a sustained rate of growth was vital to the success of the project. One satisfactory aspect of the intended program was that the real growth achieved in 1980-82, and perhaps likely to be achieved in 1983, seemed to be sufficient to underpin the efforts of the authorities in reducing expenditures. On the other hand, the information set out in SM/83/126, Supplement 1, regarding unforseen expenditure and a departure from the targets for 1983, was disquieting.

Also disquieting was the fact that recent developments in the private sector tended to indicate that government recommendations for wage settlements were not being fully observed, and that wages in the public sector also appeared to be running ahead of earlier intentions,

Mr. de Maulde noted. A reasonable outcome of the present wage negotiation seemed to be essential, as it would not be possible to return to balance of payments equilibrium unless external competitiveness were maintained.

As the Irish economy was both relatively small and almost completely open, Mr. de Maulde observed, he had to agree with Mr. Lovato that devaluation could do no more than restore past competitiveness; it could do little to improve the future position. The high current account deficits of 1981 and 1982 had reduced the authorities' room for manuever to such an extent that had such deficits been allowed to continue, they would have brought Ireland's external debt to unsustainable levels. Ireland enjoyed excellent creditworthiness, which had given the country easy access to capital markets and a feasible debt maturity structure. The authorities would do well to maintain such valuable assets, and he endorsed the staff comments on the need for a prudent attitude toward additional borrowing.

Mr. Connors said that he too was in broad agreement with the analysis contained in the staff appraisal. The Irish authorities had certainly made substantial economic adjustments since the previous Article IV consultation. Nevertheless, if they were to make lasting gains in employment and strengthen the balance of payments, they would have to improve competitiveness still further. The most likely approach would be a combination of wage restraint, gains in productivity, and exchange rate adjustment, together with other supporting policies. The authorities would have to work diligently to contain wage costs if they wished to rely on that technique. The information contained in SM/83/126, Supplement 1, was not encouraging in that respect. In view of the way in which wages had been contained in other EMS countries, it might be difficult for Ireland to make sufficient gains in competitiveness by containing wages alone.

As to fiscal policy, Mr. Connors went on, the authorities would have to reduce the public sector deficit further. Some reduction of expenditures seemed to be needed in view of the already high rate of taxation. However, there did seem to be room for improving tax administration and collection, widening the tax base, and lowering the marginal rates of taxation. In addition, the public enterprises ought to be made more efficient, implying some adjustment of prices for public sector goods.

Finally, Mr. Connors stated that his authorities saw considerable room for the adoption of more flexible interest rates and debt management policies. A move toward a more flexible monetary policy was likely to improve Ireland's debt position.

Mr. Feito stated he was in broad agreement with the staff appraisal. It was evident that in mid-1981 the Irish authorities had initiated a comprehensive adjustment effort that was still being carried out. After being badly affected, mainly by exogenous factors, the Irish economy

was presently well on the way to achieving sustained growth, once the recovery of the world economy became firmer. The Irish authorities had in fact been moving in the right direction. They were to be strongly commended for persisting in the adjustment effort through three successive governments. Significant progress had already been achieved: inflation had been halved and, although still rather high in relation to the rates in Ireland's trading partners, was expected to come down further. The achievement was remarkable, particularly because a significant proportion of the current inflation rate was attributable to indirect tax increases, meaning that the underlying rate of inflation had already fallen substantially, even if the cost has been rather high in terms of output, employment, and standards of living.

Both the fiscal deficit and the borrowing requirements of the public sector as proportions of GNP had been significantly reduced, Mr. Feito noted. While both figures were still comparatively high, fiscal policy had become quite restrictive. The staff had mentioned that the 1983 budget was estimated to imply a withdrawal of fiscal stimulus equivalent to some 5 percent of GNP, mainly by increasing taxes. Further efforts should concentrate more on the expenditure side, especially in view of the rather narrow tax base in Ireland. He was glad to have heard Mr. Casey say that some attempts were being made to broaden the tax base. Monetary policy was correctly playing a complementary role to fiscal policy, rather than acting as an autonomous restraint. The intention seemed to be to use monetary policy to support the adjustment effort without introducing an independent inflationary bias. In view of the large withdrawal of fiscal support involved in the budget, sluggish productivity, and high unemployment, such a stance of monetary policy seemed to be appropriate.

On the external side, Mr. Feito said that he had been greatly interested by Mr. Casey's comments on exchange rate policy and the means of achieving competitiveness in Ireland. He shared Mr. Casey's views, for Ireland was a small island with a small open economy, and the arguments put forward by the authorities seemed valid. In any event, with international trade stagnating or declining, he shared Mr. Ionescu's view of the need for caution regarding devaluations. In the circumstances, any major devaluation was likely either to be restrictive for the country concerned or to obtain the desired results at the expense of other countries. He therefore hoped that the Irish authorities would take steps to prevent any further rapid increase in the country's external debt. Although the gross debt service ratio was not particularly high, it had grown fast in the past two years, not only because interest rates had risen but also because the volume of debt itself had increased. While he could follow Mr. Casey's argument that the debt service ratio would be lower if the interest income accrued to official reserves were included, it seemed to him that the cost of holding borrowed reserves was rather high. It might be interesting to consider the more general question of what the appropriate level of reserve holdings should be for Ireland, in view of the present economic conditions and Ireland's access to credit markets.

The staff representative from the European Department, replying to questions, noted that a number of Directors had commented on the emphasis that the authorities had placed on tax increases rather than on reducing expenditure in attempts to reduce the budget deficit and the borrowing requirement. The authorities would certainly agree that greater reliance on expenditure cuts would have been desirable. However, they felt that in the limited time for preparing the 1983 budget, it would not have been possible to introduce major cuts in expenditure in an orderly fashion. The authorities had also consistently held the view that, because of the size of the budget deficit and the borrrowing requirement, it would have been impossible to rely entirely on expenditure cuts, so that some increase in taxation was necessary. It should be noted that the overall tax burden was not particularly high by international standards.

The authorities had no specific plans at the present time for broadening the tax base, the staff representative went on. They had received a detailed report on direct taxation from the Commission on Taxation and had started implementing some of the recommendations. Some attempts had been made to improve the indirect tax system in the past few years. For instance, the 1982 budget had included provisions for introducing a value-added tax on clothing and footwear at a rate of 18 percent. However, the proposal had been strongly opposed by interested groups and had been deleted from the revised budget finally accepted by the Parliament.

As to the financing of the borrowing requirement, the staff representative noted that domestic funding had started rather sluggishly in 1983, largely because of uncertainties about the exchange rate and the likely trend in interest rates before the EMS realignment. However, the situation had improved, and the staff had recently received figures indicating that less than 50 percent of exchequer borrowing had been undertaken abroad, compared with about 68 percent for the corresponding period of 1982 and 58 percent for 1982 as a whole. Nonmonetary financing had accounted for about 26 percent of the borrowing requirement in the first half of 1983, compared with 19 percent in the first half of 1982.

As to wage developments, the staff representative noted that the staff had little information on wage settlements in the private sector, so that it was impossible to tell whether any trend had been established. Moreover, since the return to the system of collective bargaining, the greater variations that had arisen in the size of the wage increases between industries and also from firm to firm, made it difficult to determine the average rate of increase that was taking place in the course of the present wage round. Nevertheless, there had been a few well-publicized settlements that had provided for increases substantially above the Government's guidelines. The authorities had expressed disappointment at those increases. In the circumstances, the staff would raise its forecast of wage increases in the private sector for

1983 to 11 percent or so, compared with the 10 percent mentioned in SM/83/126. On the other hand, the effective exchange rate of the Irish pound had continued to edge downward in recent weeks, so that on balance the staff would still expect some improvement in cost competitiveness in 1983.

The Irish authorities were not at present intending to introduce an incomes policy, the staff representative stated. A system of national wage agreements had operated in Ireland for a number of years, and the results had not been entirely satisfactory. In the two years before the return to free wage bargaining, national understandings had been reached; although they had contributed to some decline in the rate of increase in nominal pay, they had also entailed significant cost to the budget. In the light of that experience, the authorities would be reluctant to return to a system of national agreements or to a formal incomes policy.

Regarding exchange rate policy, the staff representative from the European Department remarked that the staff had not intended to suggest that a substantial devaluation would be helpful at the present time. The question of the size and recent growth of the underground economy, raised by Mr. Lovato and Mr. Tvedt, had been discussed extensively with the Irish authorities. While the authorities agreed that the underground economy was likely to have grown in recent years, it was impossible to give any firm quantitative estimate on its size. The authorities would probably agree with Mr. Morrell that in the past their industrial policy had not been altogther successful, although it had made a substantial contribution to diversifying the economy and establishing the industrial base. The authorities were considering measures to improve their industrial policy and were expected to announce decisions in the fairly near future.

Mr. Casey commented that Directors seemed generally to welcome the adjustment effort being made while noting that the fiscal deficit, at 13.8 percent of GNP, was still too high. One mitigating factor was that the personal savings ratio in Ireland was also high at about 24 percent. The economy was in better shape than it had been 18 months previously. The adjustment process had been initiated by the authorities in 1981, but the community as a whole seemed to have become aware of the need for adjustment, realizing that the economy was in debt externally to the tune of 60 percent of GNP and that the balance of payments, debt service ratio, and the like were giving cause for concern.

Nevertheless, Mr. Casey went on, the authorities still had the problem of trying to spread the burden of adjustment more fairly. Those who had taxes deducted at source, for instance, still felt strongly that the self-employed, farmers, and businessmen were not paying anything like their fair share, and there had been demonstrations in the street on that issue. There had also been increases in underground activities and tax evasion. Nevertheless, the stated aim of the

Government was to eliminate completely the current budget deficit by 1987. The task would not be easy, given a growing population and the dependency ratio.

The authorities recognized that it would be necessary to broaden the tax base, Mr. Casey explained. Several steps had already been taken; farmers had recently been brought into the income tax net, but it was not expected that the amount of revenue to be gathered from that source would be substantial in the near term. The 1983 budget had also widened the indirect tax base somewhat and brought in a new residential property tax. In addition, a corporation tax had been introduced, and self-employed taxpayers had been put on a current-year basis of assessment. He could not inform the Executive Board at the present time what else the authorities would do. They might be prepared to consider extending the coverage of the value-added tax, in a way that would yield more revenue, while at the same time reducing the existing high rates. Some of the options put forward by the Commission on Taxation included bringing social welfare payments into the tax net, and taxing capital gains and artists' earnings. Other hypothetical options put forward by the Commission were to reduce reliefs and exemptions, to introduce a social security tax on incomes, and even to adopt a Kaldor type of expenditure tax. All those suggestions would be examined in due course by the authorities.

Regarding the financing of the exchequer borrowing requirement, Mr. Casey explained that in 1982, monetary financing had accounted for 70 percent of exchequer borrowing. For the first half of 1983, the proportion had been slightly higher, but the trend throughout the year had been improving in the sense that the monetary component had fallen considerably from the first quarter to the second quarter. The Government's policy regarding the use of the gilt-edged market was one of obtaining the greatest possible funding from domestic nonbank souces, and the terms attached to gilt-edged securities were designed for that purpose.

Expenditure cuts would certainly be made, and several had been included in the 1983 budget, Mr. Casey continued. For instance, pay-related unemployment benefits had been substantially cut and the maximum level of benefit reduced. Cuts had also been made in a wide range of subsidies, and capital spending had been achieved in several fields relating to agriculture, telecommunications, and the like. The state enterprises had been rationalized; two of them, including the National Film Studios, had been closed down. More rationalization would continue in the future.

On the current expenditure side, Mr. Casey remarked, further improvements would be possible although, naturally, he could not state any precise measures. On the current side, unemployment benefits, health, third-level education, and food subsidies might conceivably be regarded as providing opportunities for public sector savings.

During the consultation in Dublin, the authorities had been asked whether the dramatic improvement in the balance of payments would be considered to take some of the pressure off the need to correct the public accounts in the public finances, Mr. Casey recalled. They had replied that the correction of the fiscal situation had become an end in itself.

He agreed with those speakers who had said that moderate pay increases were essential to maintaining competitiveness in Ireland, Mr. Casey went on. He himself believed that the public pay deal would be ratified by rank-and-file union members, who had been asked to accept a six-month pay pause. On an annual basis, the increase in pay for public sector workers would thus work out at a figure well below the current inflation rate and below most of the wage settlements in the private sector, although information there was rather scanty. Executive Directors should bear in mind that real disposable income had fallen consistently in recent years and was forecast to fall by another 2-3 percent in real terms during 1983. The trade unions appeared to have become aware of the harsh realities of the recession. They had also begun to understand that it was becoming easier to substitute capital for labor, especially in high-technology industries; the demonstration effect of the policies adopted in the United Kingdom might also have begun to be felt.

There had long been two models of the process of wage determination in Ireland, Mr. Casey explained. One model suggested that the motivation for wage increases had come from cost of living adjustments, while the other argued that it was the desire to maintain pay relativities that triggered wage demands. While both types of motivation might have been operative in the past, they had recently softened considerably. In general, the labor atmosphere had improved almost beyond recognition. The time was probably ripe for framing more meaningful labor legislation. He did not see pay developments in the foreseeable future posing any serious threat to competitiveness or to the public finances.

As to competitiveness, Mr. Casey noted, productivity in Ireland tended to be fairly high, because of improving technology and capital deepening. There was, however, some duality in the Irish industrial sector, and the more traditional industries tended to suffer. It was of course in the traditional industries, such as textiles, that the greatest shakeout of labor had occured. The return to free collective bargaining should help the more traditional industries because they no longer felt pressured to pay high-tech wages. In the circumstances, he did not believe that any formal incomes policy should be reintroduced. It was better to allow the private sector to face the rigors of external competition.

As to the exchange rate, Mr. Casey said that he had been agreeably surprised by the extent of the support for the authorities' position, which he had spelled out in his statement. He did not believe that

the staff was doing any more than suggesting a pragmatic approach, although even that approach might not be appealing to his authorities for reasons already stated. The EMS realignment had been an exceptional constellation of circumstances; it did not indicate any change in policy as such.

As to monetary policy, his authorities were moving toward the market determination of interest rates, Mr. Casey commented. Before the EMS realignment, interest rates in the interbank market had risen sharply, and the Central Bank had not tried to offset that by any of the means available to it for managing liquidity. The Bank had allowed the interest rates to rise in the interbank market, and finally at the retail banking level.

He certainly agreed with the comments by Executive Directors on Ireland's external debt, Mr. Casey observed. It had increased to 60 percent of GNP from 20 percent only a few years previously. The authorities did of course intend to reduce the level of outstanding debt, even though the debt service ratio itself was not very high, not only because exports were a high proportion of GNP but also because the Government had a healthy maturity profile. The Government had no debt of an original maturity of less than one year and only about 5 percent of total debt matured in less than two years. The repayment schedule was evenly spread.

Taking up specific points made by individual Executive Directors, Mr. Casey said that he agreed with Mr. Ionescu about the undesirability of cutting expenditure on legitimate health needs. The authorities in fact only intended to eliminate abuses in that area, rather than to reduce benefits that were genuinely needed.

As to the size of the underground economy, Mr. Casey remarked in passing that the Director of the Fiscal Affairs Department had recently developed a useful methodology for measuring the underground economy in the United States. In Ireland, something in the neighborhood of £Ir 100 million was spent every year in trade north of the border. The amount was not large, but the trade did seem to indicate that many sorts of goods were considerably cheaper across the border. Naturally, cross-border trade was not necessarily smuggling because of EC allowances. The Central Statistics Office made an adjustment to the gross national product of some 0.5 percent a year to take account of all underground activity. The "errors and omissions" figure, to which Mr. Tvedt had referred, probably consisted mainly of private capital flows, which were difficult to measure.

Replying to Mr. Morrell, who had suggested that new industries had benefited from overfavorable tax relief, Mr. Casey remarked that, without some tax incentives, it was likely that many industries would not have been established. In the late 1950s, there had been only a limited industrial tradition in Ireland. The aim of the authorities

at that time had been to attract industry, technical know how, and the like from abroad. At present, the technological knowledge of multinational companies was beginning to benefit industry. In general, the fiscal loss, in terms of revenue forgone, was probably not very significant. The emphasis was on increasing the value added in the industrial sector and on increasing the linkages between the various industries. The authorities intended shortly to publish a white paper on industrial policy.

Regarding the Common Agricultural Policy of the European Community, Mr. Casey said that Irish farmers had benefited from the CAP. Nevertheless, in answer to Mr. Morrell's hypothetical question, it was likely that the country would fare all right without it, if only because Ireland had a competitive advantage in agriculture, especially for grassland products. In conclusion, Ireland was a resilient economy in which internal and external imbalances could be readily corrected both by policy action and by automatic adjustments.

The Chairman made the following summing up:

Executive Directors noted with satisfaction the substantial progress that Ireland had made since the previous Article IV consultation in reducing inflation and the balance of payments deficit on current international transactions. This progress was attributed in large measure to the forceful measures that the authorities had adopted over the past two years to contain the growth in domestic incomes and to restore better balance in the exchequer accounts.

Directors, however, pointed out that the decline in the external account deficit had come about partly as a result of the weakening of economic activity, which had led to a steep rise in unemployment. Accordingly, they agreed with the authorities that the adjustment effort had to be continued in order to consolidate the improvement in the balance of payments position and enable the economy to return to a path of sustained, balanced recovery.

In commenting on the policy mix, Directors expressed the view that the emphasis placed on taxation policy had perhaps been excessive. In particular, it was felt that the increased tax burden might have encouraged tax evasion.

A further increase in the tax burden was regarded by a number of Directors as undesirable. At the same time, the authorities were encouraged to broaden the tax base, including the value-added tax base, as well as to improve the distribution of the tax burden, for example vis-à-vis the self-employed.

In general, Directors were concerned that the budget deficit and the exchequer borrowing requirement were still unduly high.

They noted that the authorities had recently taken corrective action to ensure that the budget objectives for 1983 were met, and they strongly endorsed the authorities' intention to seek the required further adjustment in public finances primarily through cuts in public expenditure. They agreed that severe restraint on current budget outlays was essential, especially with regard to public sector pay, social security benefits, and other transfer payments, including transfers to public sector enterprises.

Many Directors noted with considerable concern that, despite the improvement in the external current account, the level of foreign borrowing by the exchequer and the semistate bodies had remained large, and that the external debt was high by international standards. While recognizing that the maturity structure of the foreign debt was favorable and noting that Ireland's creditworthiness was excellent, Directors strongly encouraged the authorities to intensify their efforts at increasing the share of the public sector borrowing requirement that is financed from domestic, nonmonetary resources, through the pursuit of a more flexible interest rate policy. This, together with the envisaged reduction in the exchequer borrowing requirement, would enhance the ability of the authorities to pursue monetary policies that would be consistent with the need to control inflation and promote external adjustment.

While recognizing that the rate of increase in wages and prices had recently fallen off sharply, Directors noted that inflation was still higher in Ireland than in its most important trade partners. They stressed, therefore, that a further moderation of nominal pay increases was necessary to preserve the competitiveness of Irish industry and to allow a lasting recovery in private investment and employment. In this context, several Directors observed that the proposed pay settlement for public sector employees was not quite in line with the initial objectives that the Government had set, and they expressed the hope that no further slippage would be allowed to occur.

The decision of the authorities to devalue the Irish pound in the context of the March 1983 EMS realignment was regarded as appropriate. Several Directors sympathized with the Irish authorities on their reluctance to use exchange rate policy aggressively and supported the aim of maintaining competitiveness through wage restraint and appropriate financial policies.

It is expected that the next Article IV consultation with Ireland will be held on the 12-month cycle, which the Executive Board has set as the standard frequency for consultations with members.

2. ACCESS TO FUND RESOURCES - REVIEW

The Executive Directors considered two papers for the review of the policy on access to the Fund's resources, one on general considerations (EBS/83/132, 6/27/83; Cor. 1, 6/28/83; Cor. 2, 7/11/83; and Sup. 1, 7/18/83) and one on financial considerations (EBS/83/133, 6/28/83).

The Director of the Exchange and Trade Relations Department made the following statement:

> Questions have been raised concerning the degree of conditionality applicable to purchases in the lower tranche of the compensatory facility. Decision No. 6224-(79/135) provides that the Fund must be satisfied that "the member will cooperate with the Fund...." The work "satisfied" requires that the Fund make a judgment. The staff's understanding of the basis for that judgment, as set out in the paper on Compensatory Financing Facility - Experience with the Requirement of Cooperation (EBS/81/251, 12/30/81) is that this implies "a willingness...to discuss, in good faith, the appropriateness of the member's policies...." (page 15). Here the words "in good faith" need to be emphasized. They imply that, before bringing forward a compensatory request, management must be reasonably confident that a country does intend to cooperate with the Fund to find appropriate solutions to its balance of payments problems.
>
> While the presumption is that a member would be discussing with the Fund in good faith, there are situations where this cannot be taken for granted. 1/ At the meeting of the Executive Board on requirement of cooperation (EBM/82/42, 4/2/82), the Acting Chairman emphasized this point by commenting that there were cases where "management had told a member that it was not prepared to bring the country's request for compensatory financing below 50 percent of quota because management felt that, where the country's record of cooperation with the Fund had clearly been so unsatisfactory, there was a legitimate question about the likelihood of there being adequate cooperation in the future."

1/ On this point, the staff paper, mentioned above, noted on page 11: "There have been cases in the recent past in which the record of the member's policies was such as to raise the serious doubts whether the Fund could be satisfied, as required for the use of the lower tranche, that the member will cooperate with the Fund in an effort to find appropriate solutions for its balance of payments difficulties. In a few difficult cases it has been found preferable to discourage requests until the member provides assurances that the cooperation will in fact be forthcoming."

EBS/83/132, in the first full paragraph on page 4 describes the circumstances in which the use of the compensatory financing facility had been approved since November 1981, both up to 50 percent of quota and beyond. The distinction in conditionality between the two types of use has been maintained in recent practice as described in that paragraph. In the 22 cases that were mentioned in the "up to 50 percent" category, there were three where stand-by and extended arrangements had been in existence and in operation--one of which was a first credit tranche arrangement--three where new arrangements in the upper tranche were concluded at the time the request for compensatory financing was approved, and eight that were approved along with the Board consideration of Article IV consultations. For the remaining eight, the cooperation requirement was considered to have been fulfilled, although there were no Article IV consultations or conclusion of new arrangements at that time. 1/

Practices in the case of lower-tranche compensatory financing thus clearly contrast with those for the higher tranche where the Fund has required stricter evidence of satisfactory policies. As noted in that paper, in recent months virtually in all cases where the upper-tranche compensatory financing was used, the member either had an existing upper credit tranche arrangement with the Fund or concluded one concurrently with the use of the compensatory financing facility. The intent of the concluding sentence of the paragraph referred to above was not to eliminate the distinction in conditionality between the two tranches of the facility but to point out that under current circumstances, when payments problems are largely due to factors other than export shortfall, the use of the compensatory financing facility, in either tranche, has to be more conditional than it would have been if problems were largely due to export shortfalls. As to the following paragraph, the point that the staff intended to make was not that the only difference between compensatory financing and upper-tranche purchases is that the former is not phased and the latter are, but that when a member has at the same time obtained access to compensatory financing and to resources under an upper-tranche stand-by or extended arrangement, the difference between the two types of access is essentially the absence of phasing in one and its presence in another.

The Deputy Treasurer noted that in EBS/83/133, page 19, table 7, for access limits of 117 percent of quota per year, the figure for borrowed resources at a mixing ratio of 1:0.5 should be 9.5, not 7.5.

1/ In two of these cases, there were arrangements that had become inoperative and their status did not change at the time the compensatory financing request was approved.

Mr. Kafka made the following statement:

These notes deal with both EBS/83/132 and EBS/83/133. The assumption is that an attempt can and must be made to conserve usable ordinary resources by borrowing, not by reducing access. Private borrowing must be attempted, if necessary.

The arguments for a comprehensive limit that would be lower than the sum of the limits of the individual facilities are unconvincing. The individual limits were after all established for a good reason. One particularly worrisome aspect of such a proposal is that it would introduce an effective discrimination between those countries most likely to use the compensatory financing facility and others. For the latter, even a comprehensive limit equal only to the limit on conditional access would imply no restriction in access whatsoever, but for other groups it could. Moreover, access at 500 percent of new quotas may be high in absolute terms for those countries that have had large quota increases; for other countries--mostly poor, primary producing ones--such a limit would force a severe contraction in potential absolute access.

On the positive side, we should remember that the compensatory financing facility and the buffer stock facility are the only quick-disbursing facilities that the Fund possesses, and therefore the only thing that comes close to a bridging credit facility. As we have already said on other occasions, in these troubled times the Fund badly needs at least to preserve anything resembling a bridging credit facility that it possesses. In our opinion, it should create a genuine bridging credit facility.

We, therefore, reject the idea of a comprehensive limit for access to the Fund that is smaller than the sum of the limits of the individual facilities. Furthermore, there is no reason to change the present balance between general and special facilities, except, perhaps, to increase the weight of the latter temporarily with a bridging facility.

The evolution of the special and general facilities did not come about capriciously. The idea that balance of payments problems are often of mixed origin does not invalidate the arguments for special facilities. We have, after all, effective techniques to determine which is the self-reversing part of any balance of payments deficit, and there is therefore no danger that insufficient conditionality will be applied where a balance of payments deficit is not self-reversible. The fact that the staff is trying to make compensatory financing more conditional than the Board ever intended it to be is to be deplored, but is certainly not an argument for more conditionality. The functioning of the compensatory financing facility has been too successful to permit anyone to argue that we need to prevent

its use where it is now possible to use it in lieu of the general facilities, or to make the compensatory financing facility itself more conditional. Nor do we see any justification for phasing the compensatory financing facility or buffer stock financing facility. Finally, we see no need to establish any new limits for the compensatory financing facility or buffer stock financing facility at a lower proportion to new quotas than those of the conditional facilities.

Finally, even accepting that access close to the limit is appropriate only when decisive improvement in the balance of payments is likely at the end of the arrangement, it does not follow as a general rule that adjustment should be front-loaded. No justification for this statement is given, and none exists. Adjustment measures achieve their effects only with lags, and if one wanted effectively to front-load adjustment one would have to adopt a policy which might easily result in overkill.

On the whole, the estimates of demand for access seem at first sight not unreasonable. How are they to be financed?

The paper rightly stresses the strained liquidity position of the Fund in terms of its uncommitted usable ordinary resources. If we have correctly understood the rather intricate argument on page 22, it is that to end-April 1986 the Fund might have available at most SDR 17 billion worth of usable ordinary resources. This conclusion is again, on the face of it, neither unreasonable nor very comfortable, despite some relatively limited implicit reserves.

The further conclusion to be drawn from this is that we should conserve our ordinary resources more carefully than we have been doing so far. It would be wrong, however, for us to scale down access, if we can possibly avoid it. This means we should make additional efforts to borrow, even in the private market. This is important because of the uncertainties attached to the GAB. I agree with the Treasurer that the Fund's ability to borrow is large.

I am not convinced how much the illustrative phasedown really teaches us, but it is perhaps premature to talk of it at a time when demand for Fund access certainly does not seem to be abating.

Our position is that access limits for either conditional or less conditional facilities should not be reduced in terms of new quotas, but if they had to be reduced because of insufficient finance, despite attempts to borrow, including borrowing in the private market, the reduction could not be more than such that absolute access would be maintained unchanged for all members

under all facilities. This should be attainable. On no account would we agree to higher proportionate reduction in the special facilities.

First, on the relationship between ordinary and borrowed resources, we would favor eliminating both the catching-up and the reverse catching-up provisions, as well as equalizing the mixing proportion in all facilities. We would not agree to eliminating borrowed resources in the first credit tranche, which may be simply a cute way of raising conditionality.

We would have no objection to changing the mixing ratio to provide for more borrowing, but a strong objection to eliminating the floating of the first credit tranche. I think it makes sense for countries to maintain for emergencies their access to the first credit tranche, and we have not really seen any convincing argument against floating.

Finally, the present situation suggests strongly that the international financial community should quickly arrive at a consensus to begin an appropriate scale of allocation of SDRs.

Mr. Wicks made the following statement:

So as to concentrate on essentials and keep my intervention as brief as possible, I do not intend to deal today with some of the matters discussed in EBS/83/133, like catching-up provisions, mixing ratios in financing undrawn balances, and the floating character of the first credit tranche. Though these matters are important and must be discussed before long, they are secondary to what we see as the three main issues of:

- the figures and the approach to the new access limits;

- the case for phasing down the limits; and

- whether to have a comprehensive limit on total access.

These three headings will cover the substance of my intervention.

Before embarking on the details of our approach, I want to set out the three broad considerations which underlie our approach:

First: The scale of the Fund's future resources is still uncertain, despite the Chairman's efforts. But we can be certain today that the only prudent assumption for this discussion must be that new resources are likely to be scarce in the period immediately ahead.

Second: Our discussions of the World Economic Outlook and international capital markets have underlined the continuing need for the Fund to make, and be seen to make, an adequate contribution to financing the adjustment process. The more cautious approach adopted by the banks in their lending to the developing countries is borne out by the BIS's first-quarter figures. Strenuous adjustment programs of some debtor countries are proving socially and politically difficult to achieve. And, while the signs of recovery have become more firmly established, its durability is not yet assured.

Third: We wish to preserve, as far as possible, the traditional concepts that have served the Fund so well, such as the revolving character of the Fund's resources, the principle of uniform and fair treatment of its members, and the maintenance of a close and continuous link between the use of its resources and the balance of payments adjustment process.

These three considerations pull in different directions. To put it in terms of possible specific access limits, some of the considerations point toward figures 102/305/407 percent of quota, or even lower, while others can be interpreted as pointing toward 125/375/500 percent of quota, or even higher.

This dilemma has led us to see whether there are formulas which can bridge the two viewpoints for future access limits of 102/305/407 and 125/375/500.

One possible bridge is to soften the strigency of limits of 102/305 by providing that the 108 members with below-average increases in quota could retain their current access in absolute terms for another two years. I call this approach the "grandfather clause" route. Though ingenious, it does, in our view, have two drawbacks. Its first and most important drawback is that it seems to second-guess the agreement reached under the Eighth Quota Review by superimposing a new formula not related to the relative economic positions of members. Quotas should remain the only basic determinant of potential access to ensure the uniform treatment of members. The second drawback is that it could not provide significant additional support for countries whose quota increases are only slightly below the average. Some of these may have maximum programs but may need continued support if, for one reason or another beyond their control, their program falters.

A second possible bridge between the 102 and 125 access limits would be simply to split the difference between the two figures. This has the virtue of simplicity, and perhaps we should have to

return to simplicity at the end of the day. But while this route provides certainty and precision, it lacks the degree of flexibility necessary for the uncertain world ahead of us.

Though our minds are not made up, we therefore are inclined to favor a different approach of a third possible bridge. This is to build upon a little used feature in the existing arrangements so that there could be extra access beyond 102/305/407 in exceptional circumstances.

It may help to illustrate the idea if I am a little more specific, although the purpose of doing so is really to make the idea clear and not to commit myself to any particular numbers. The suggestion would be that for the next two years it would be possible to top up programs by, say, 25 percent of quota a year in certain well-defined circumstances. Thus, above the normal limits that might be set at 102/305/407, there would be a second tier of exceptional additional limits of, say, 25, 75, and 100 percent of quota respectively, which could be held in reserve for use later if necessary. Thus we have in mind a two-stage approach, though obviously the two stages could be compressed into one in cases of special need. These enhanced limits of 125/375 and 500, to use round figures, would normally provide the upper ceiling.

To ensure uniform treatment of members, and to guard against the possibility that exceptional treatment might become the rule, requests for this exceptional access would be objectively judged against certain agreed criteria. What should these criteria be? Here, the existing policy's definition of exceptional circumstances is helpful, but does not necessarily provide the answer. In this connection, I found the discussion on pages 6-7 of EBS/83/132 on the principles of governing the scale of use of Fund resources very helpful.

As I see it, there are two main factors to consider. The first is the ever-present need to protect the revolving nature of the Fund's resources, by ensuring that the policy conditions and performance criteria embodied in programs are sufficient to give reasonable assurance of a substantial improvement in the country's external position by the time repurchases become due. The second is the need to encourage a country to adopt the full degree of adjustment required early in a program and not wait in the hope of later obtaining an enlargement of the Fund's contribution to its financing needs.

This leads me to suggest that exceptional support should require the following three conditions to be met: first, the arrangement, augmented by exceptional treatment, must be associated with an unusually strong adjustment effort, laying the basis for

early restoration of balance of payments sustainability; second, the short-term need for balance of payments finance must be exceptionally large in relation to quota; and third, the exceptional needs must result from major unforeseen external events. We considered adding the fourth condition of a serious threat to the stability of the international monetary system. But we think that this would be overrestrictive and disqualify some countries that ought to qualify. These seem to be the main conditions, although it might be possible to clarify and define them further. I imagine I hardly need add that it would be up to the staff to interpret them consistently, and of course the Board would retain final discretion.

Some of my colleauges may feel that it is one thing to outline the conditions, as I have just done, but that it is quite another to specify them precisely enough in a decision or in guidelines to ensure their practical effectiveness and evenhandedness. Indeed, this may prove beyond the powers of that most powerful and subtle instrument, the English language. But if my colleagues think this approach worth at least thinking about, I suggest that the staff might try its hand at drafting some specific and rigorous conditions that would govern the use of the extra 25 percent.

These then are the three possible bridges to span the views of 102/305 and 125/375: the grandfather clause; simply splitting the difference; or the two-stage/two-tier approach that I have just described. I would be glad to hear colleagues' views on them, even if they feel bound to adhere to one of the opposing views.

I now turn to the question of phasing down. As I said at our May discussion, my authorities believe enlarged access is a temporary expedient. The aim should be, in our view, to establish, by the time of the next Quota Review, access limits at a level which will be sustainable in the longer term. EBS/83/133 examines various routes by which the limits might be phased down. While that material is helpful, I think we would be wrong to select the method or begin thinking of precise numbers before we see more clearly how world events are likely to develop in 1984 and beyond. What I believe we should do now is to agree on a date at which the new limits should be reviewed in the hope that the phasedown could begin at that stage. The choice of method will depend upon the circumstances then prevailing, and it is impossible now to foresee those with any clarity. I do, however, think that current adjustment difficulties make it appropriate to delay the start of any phasing down until behond 1985. We suggest that we should proceed by agreeing on one-year and three-year cumulative access limits now. These would remain fixed pending a review in two years' time. We hope that review could fix a timetable for enlarged access to be phased down.

Finally, I turn to the question of a comprehensive limit to cover access to both the conditional and unconditional facilities. At our early discussion, we were mildly in favor of a comprehensive limit. On reflection, we have reservations about a comprehensive limit. Again, these stem from my feeling that the Fund must, for the next year or so at least, retain the scope to render additional assistance to problem cases. Unless a comprehensive limit were pitched appreciably higher than the cumulative limit on program support, this scope would be narrowed.

Finally, in the interest of brevity, I have not mentioned the limits on access to the compensatory financing facility today, but I should like, with your permission, to speak again if others do so.

Mr. Nimatallah made the following statement:

In my judgment, the present review of the enlarged access policy should be guided by three important principles. The first is that it is essential to avoid an abrupt reduction in access limits if the Fund is to continue to play its role effectively. The world economic recovery is not yet firmly established. It could falter if the adjustment efforts now under way in many countries do not succeed. These efforts will depend, to a considerable extent, on continuing support from the Fund on an adequate scale.

The second principle is that the Fund has to demonstrate that it can provide effective leadership to the international financial community when major problems arise. An abrupt reduction in access limits would send the wrong signal and could weaken the Fund's standing as an agent for adjustment. This applies with particular force at present, when the Fund is acting as a catalyst in encouraging banks to continue lending to many developing countries.

Third, it should be remembered that access limits are not targets or norms, automatically available to members. They are only ceilings. As the staff points out, amounts at or near the maximum limits were granted in only one fourth of all the stand-by and extended arrangements approved in the last 18 months. But this also underlines the importance of setting the maximum limits at levels which give the Fund the capacity to meet exceptional needs, when required.

On the basis of these three principles, my preference would be to retain the existing 150/450 percent limits. If, however, there has to be a change, that change should be gradual and ensure that no member's access will be reduced in absolute terms.

The staff papers before us today start from the premise that the new access limits will be determined primarily by possible constraints on available resources. I do not believe that this is the appropriate starting point. As I have said more than once before, I think that we should start from the likely needs of member countries in the period ahead, and then make every effort to secure the required resources. For today's discussion, however, I will comment on the specific issues raised in the papers.

Looking at EBS/83/132, the staff first examines the merits of a comprehensive limit on access to all Fund facilities. I have not yet received any instructions from my authorities on this question and therefore have an open mind. In principle, however, I fail to see the compelling reasons for the suggestion, at this time, for a comprehensive limit, which would be less than the sum of the sublimits for access to the individual facilities. A comprehensive limit of this kind could make it difficult for the Fund to respond flexibly to further problems in countries that are already heavy users of Fund resources. It may be true that only a relatively few countries would be affected. However, I hate to think of the alternative if these countries convince the world of their pressing need for further Fund support but the Fund has already deprived itself of the flexibility to help.

Turning more specifically to the question of sublimits, I oppose the suggestion that access to the special facilities be reduced. My reasons are the following. One, reduction in access under the compensatory financing facility could undermine the valuable role that this facility plays for many members. Two, any reduction in access limits for the compensatory financing facility would send the wrong signal from the Fund. Three, the balance between access to conditional and to special facilities has already moved sharply in favor of conditional resources. Furthermore, the staff points out that use of the compensatory financing facility, even the first 50 percent, is becoming increasingly conditional. Incidentally, I am not sure that this is helpful to members requiring early drawings. As Mr. Kafka says, the compensatory financing facility serves a useful purpose as a bridging facility. I hope the Board will soon have an opportunity to clarify Fund policy on the compensatory financing facility in general and in this area in particular.

My authorities have noticed the systematic attempts by some Board members to erode access to the compensatory financing facility in general, and by the group of oil exporting countries, in particular. My authorities are disturbed and dismayed by the latest statements by certain members of the Board, who are trying to prejudge the possible use of this facility by certain

oil exporters. These Board members contend that requests from oil countries should be scrutinized more than others; they also suggest a priori that management and the staff should disqualify oil countries in advance on the grounds that oil shortfalls are characterized not only by temporary, but also by structural factors. We reject this and ask other members of the Board to reject that kind of attitude. This is totally against the principle of uniform treatment, and therefore we ask management and the staff to ignore such harmful and discriminatory arguments.

I thought we had settled this matter following our thorough discussion last month, when it was decided that possible requests by oil exporting countries should be treated on a case-by-case basis. Now I hear some members say although these possible requests can be considered on a case-by-case basis, they should not be brought to the Board at all because they do not fit under the compensatory financing facility decision. How can members cooperate with a Fund that discriminates? Discrimination is destructive. All we ask is that everybody should be treated the same, and that the Fund should continue to play its role effectively.

With regard to the criteria governing access in individual cases, the staff's description of the Fund's approach confirms two points that I have already made. One, that the new access limits will be ceilings and not targets. Two, that there will almost certainly be cases in the future where limits of at least 125/375 percent would be required. This would enable the Fund to respond effectively to particularly serious difficulties in individual countries. Recent experience shows how essential it is for the Fund to have this kind of flexibility. The management has used its discretion responsibly and prudently; and this should continue. There is, therefore, no need for exaggerated, detailed, or stringent criteria since they, in my judgment, would impair, and not help, the principle of flexibility.

Moving to the question of a further reduction in access limits, I believe that it would be premature to take any decision on this now. It is clear, from the analysis in the paper on "Financial Considerations," that it is extremely difficult, if not impossible, to determine an appropriate phasing down of access limits, given the many uncertainties involved. Any judgment now would be arbitrary and might have to be changed if the assumptions were not realized. This would create confusion and uncertainty for members.

It would, therefore, be simpler, and more equitable, to decide on new limits which will apply when the quota increase

takes effect, and to review those limits a year hence. At that time, the Board will have a clearer view of the extent of the world recovery and of the Fund's liquidity position, including the prospects for further borrowing.

Turning, more directly, to EBS/83/133, I have only a few brief comments. The staff's projections are, inevitably, very tentative, particularly as regards the Fund's liquidity position after mid-1986. The tentative nature of the projections strengthens my view that it would be a mistake to take a decision now on what access limits should be two or three years ahead. It does, however, seem likely that the Fund's liquidity will come under strain between January 1984 and April 1986, whatever the access limits. This underlines the need to press ahead with efforts to close the present commitment gap and to explore all the options for further borrowing.

Finally, the staff proposes a number of important technical changes designed to simplify the procedures governing the mix of ordinary and borrowed resources. The present procedures are difficult for members to understand and can produce uneven results. In principle, therefore, I could go along with anything that leads to simplification, provided that this is acceptable to all. I note Mr. Kafka's reservations about some of the staff proposals, and I ask the staff to explain more fully the implications of these proposals. I can see merit in adopting a uniform ratio of borrowed to ordinary resources. It is, however, difficult for me, at this time, to say which would be the appropriate ratio. This will depend, among other things, on the magnitude of any additional borrowing by the Fund and on the Board's decisions on access limits.

Mr. Erb made the following statement:

I will begin by summarizing the essential elements of our views on the major issues concerning the policy of enlarged access and the compensatory financing facility:

Access limits

With respect to access limits under enlarged access, we support one-year, three-year, and cumulative limits of 102, 305, and 407 percent of quota when the Eighth Quota Review goes into effect.

For the compensatory financing facility, we support a limit in the range of 65-70 percent of quota for export shortfalls and for cereal excesses, with a combined limit of 85 percent.

We seek agreement on an explicit phasedown schedule beginning in early 1985. This schedule could be modified if it is judged at the end of 1984 that world economic and financial conditions do not warrant the scheduled reduction in enlarged access. We propose that the method of phasing down be according to Method B in the staff paper. Limits of 70, 210, and 245 percent would be established in 1985, with a continued phasedown in 1986 until enlarged access is phased out.

Criteria for applying enlarged access

My authorities believe that the criteria of the enlarged access decision should be applied more rigorously. In this connection, we agree with others that the limits are limits and should not be viewed as a norm or as a target. Access within the limits must be applied in a manner that is consistent with both the temporary character of IMF financing and the conditions associated with IMF lending as specified in the Articles as well as the conditions specified in the enlarged access decision. Among the criteria of the enlarged access decision that need to be applied rigorously, I would underline the requirement that the payments imbalance must be large in relation to the country's quota. For example, where Fund resources may be committed in the context of an early adjustment program, greater emphasis should be placed on using precautionary stand-by arrangements within normal access limits rather than enlarged access.

Conditionality under the compensatory financing facility

We believe that there should be a clarification of the test of cooperation under the compensatory financing facility, since current economic circumstances may result in additional cases where an export shortfall is part of a larger balance of payments maladjustment.

Regarding the test of cooperation as it applies to the lower tranche of the compensatory financing facility, we believe that there are circumstances in which the Fund must assure itself that the country is undertaking policy adjustments to deal with its overall balance of payments problem. This is particularly important in cases where the overall balance of payments problem is severe and enduring and the country has been slow to respond with policy adjustments.

In addition, we believe there should be a codification of upper-tranche compensatory financing facility conditionality to make it clear that a program normally is expected when balance of payments circumstances warrant. Experience indicates that such circumstances are most likely to exist when there is an overall deficit that is larger than the underlying export shortfall and thus requires policy adjustments.

An alternative way of safeguarding Fund resources would be to phase compensatory financing facility drawings, as some Directors have suggested.

General comments

I would like to make more general comments regarding our current discussions. Several Directors have commented that our discussions on the policy issues are extremely important since the decisions, understandings, and guidelines to be reached later this year will provide broad direction to the lending of the Fund in coming years. In many ways, the issues being debated are the same issues that have been debated within the Fund throughout its history, including more recently during the size of the Fund discussions which preceded the quota and GAB decisions earlier this year.

As in the past, there are clear differences of view among members regarding how broadly the financial role of the Fund should be interpreted and regarding how Fund conditionality should be applied. One area, for example, where differences of view exist on the financial role of the Fund concerns the extent to which the Fund should finance structural adjustments and the type of structural adjustments which call for IMF financing. A related issue that arose today concerns the relationship between IMF financing and commercial bank financing, an issue that I am sure we will be discussing again in the future.

As I have emphasized in the previous discussions, the decisions of my authorities concerning the size of the Fund quotas and the potential magnitude of official lending through the GAB were significantly influenced by a strict interpretation of the Articles concerning the financial role of the Fund, i.e., that the financial role of the Fund should continue to be to provide temporary--and I put the emphasis on temporary--financing to a country to enable it to correct a maladjustment in its payments position. My Government also continues to attach great importance to the conditions associated with any use of Fund resources as specified in the Articles, including the condition that there be a balance of payments need, the condition that members solve their balance of payments problems in a manner consistent with provisions of the Articles, and the condition that the Fund establish adequate safeguards for the temporary use of general resources of the Fund. These two last conditions of Fund lending specified in the Articles are relevant to the way that Fund conditionality has evolved over time.

Most members have stated that the Fund's primary resource base is the resources provided through quota subscriptions with borrowing from official sources providing a useful supplement in

special circumstances. I note that the Fund's future borrowing requirements that are simulated in the staff paper are extremely large, even if the limit assumptions of 102, 305, and 407 percent of quota are used. Under those limits, the projected use of ordinary quota resources is also extremely high.

This brings me to the relationship between access limits, the resource base of the Fund, and the method of applying or interpreting the Fund's financial role and conditions as prescribed in the Articles. I would put the logic of the choices before us in the following way: given the available resource base, the more broadly the Fund's financial role and the conditions associated with Fund lending are defined, the lower the potential access limits necessary to assure that the Fund remains within the available resource base. Alternatively, and given the available resource base, the stricter the interpretation of the financial role and conditions of Fund lending, the higher the possible access limits.

I would like to express this logic in a slightly different way. Clearly the Articles provide the Fund, including the management, staff, and the Executive Board, flexibility when implementing the Articles. While it is important to retain a degree of flexibility and discretion, there are several reasons why it is also important to have decisions and guidelines that provide bounds on the degree of flexibility and discretion. First, given the differences of view that members have concerning the financial role of the Fund and the temporary character of IMF financing, I believe it is important for the Board to be more precise concerning how the financial role and conditions of Fund lending prescribed in the Articles are to be implemented. If the Fund pursues a broad range of lending objectives without priorities, however laudable the objectives may be, we will find ourselves quickly out of resources. In this connection, I believe that the area of structural adjustment financing by the Fund requires especially close attention. Second, I believe it also is important for member countries to know the circumstances and conditions associated with the use of Fund resources not only so that they better understand when Fund resources might be available to them, but also to avoid perceptions of discrimination. Third, given the catalytic role performed by the Fund, it is also important for commercial and official institutions to understand the circumstances and conditions associated with Fund lending.

Comments on staff paper

I would like to turn now to the staff paper "Review of the Policy on Access to the Fund's Resources - General Considerations" (EBS/83/132). With respect to a comprehensive limit on total

access, I agree with those Directors who are not favorably inclined toward a new comprehensive limit. I also believe that we in effect have a comprehensive limit. To formulate it in a different way would create complications that we do not need, given the already complicated nature of enlarged access.

Regarding Section III of the staff paper on the use of conditional and special facilities, I was initially worried with the section because the heading appeared to suggest that the compensatory financing facility and buffer stock facilities are unconditional. I agree with other Directors who have commented that any use of Fund resources must meet the conditions specified in the Articles. But then it becomes clear later in the section that this is also what the staff has in mind. Thus, I would like to make points of emphasis and support regarding conditionality and the compensatory financing facility.

As noted by the staff, where an overall balance of payments problem is directly related to an export shortfall that is judged to be temporary and self-reversing, there is no special problem. The conditions of Fund lending can be expected to be met without a change in the country's policies.

Where the overall balance of payments maladjustment is larger than the portion related to the temporary export shortfall, then the Fund must assure itself that the country will undertake the economic adjustments necessary to achieve a sustainable current account position and repay the Fund without being forced into policies that would have undesirable domestic and international consequences. Since the necessary economic policy adjustments are not likely to be taken all at once, the question arises as to how the Fund can reasonably assure itself that the necessary policy adjustments will in fact be taken over time.

As I noted earlier, one way of dealing with this is to have compensatory financing disbursements phased over time. This would offer some protection to the Fund and at the same time enable it to provide relatively quick disbursements.

Alternatively, the Fund must be especially vigilant when implementing the test of cooperation in such circumstances. I would argue that even within the first tranche of the compensatory financing the Fund must have reasonable confidence that the country will undertake the necessary economic adjustments and that in some circumstances this may require immediate policy actions. This is an area where judgment is necessary. I believe that such judgments must take into account a number of factors, including, for example, the size of the overall balance of payments problem after taking into account the expected reversal of the temporary export shortfall. In addition, judgment is required as to how likely it is that a

country's government will be able to deal with its underlying problems. This is not simply a question of intentions or motives on the part of officials involved, but a question of whether they are likely to execute their policy intentions.

Factors that might influence the staff's judgments should include, for example, the extent to which authorities have been responsive to dealing with their economic problems in the past. We should also examine whether the national government is taking actions that are contrary to the basic purposes and principles of the Fund. For example, is the country trying to deal with its overall problem by imposing restrictions on imports? A related question would concern how long the balance of payments has been deteriorating and the extent to which the government has responded with policy changes?

I think these are illustrative of the factors that need to be taken into account by the staff when making judgments about the test of cooperation within the first tranche. As already pointed out in the staff supplement to EBS/81/251, there have been times when the requirement of cooperation for the lower tranche of the compensatory financing facility was not satisfied by a member. Criticisms, however, have been leveled that the implementation of the test of cooperation during the past year or so has been too strict. In part, this reflects current economic circumstances in which many countries faced with temporary export shortfalls also have been found with large overall balance of payments problems requiring the staff to carefully examine whether the test of cooperation is being met in the lower as well as the upper tranche of the compensatory financing facility.

If there are perceptions that the test of cooperation is not being applied appropriately then we should come to some understanding within the Board to make it more explicit that indeed even in the lower tranche of the compensatory financing facility the conditions associated with Fund lending apply. Thus there may continue to occur cases when the Fund staff would discourage a country from making a request for compensatory financing because it has doubts whether the country will deal with its overall balance of payments problem.

Let me turn now to Section IV of the staff paper, which very usefully lays out the factors that influence decisions concerning how much access is to be applied within the access limits. This is also a subject the Board should come back to later on because I think it is important for us to try to take these concepts and express them in the form of guidelines, or perhaps in the form of a memorandum of understanding. Member countries would then be more aware of how access is applied

within the limits. I might add that the gradation of access within the limits that is outlined in this section also would be appropriate if there were no enlarged access.

Although I agree with many of the basic criteria outlined in Section IV for applying access within the limits, there are areas where I have questions about whether enlarged access should be used at all. For example, on the bottom of page 7 the staff states:

> If adjustment requires a period of several years but the member is unable to specify in advance and with sufficient precision the policies beyond the first year, a step-by-step approach involving successive one-year arrangements within a clearly formulated medium-term strategy would be envisaged but, unless the program in the first year constitutes a substantially changed direction of policy and a major adjustment effort, access would be established below the limit.

At a minimum I would add "well" before the words "below the limit." Indeed, if there are such doubts and uncertainties, I question whether enlarged access should be applied. In such cases, access within the normal 100 percent or 165 percent cumulative limits would be more appropriate.

On page 8, there is another illustration of a case where the staff is suggesting low access within the limits:

> In still other cases, relatively small access in comparison with the limits may be appropriate. This may be because the weakness of the balance of payments is such that it is questionable whether the need can be considered temporary.

In the next paragraph the staff states:

> Even if the balance of payments is so weak that no substantial improvement can be expected over the medium term, Fund financing on a small scale could be justified if the member is taking appropriate steps to deal with its situation.

These are particularly difficult circumstances for such countries, but one could ask whether it is appropriate to be applying any Fund financing let alone enlarged access. In such cases the emphasis should be on the catalytic role of the Fund, especially vis-à-vis official creditors and official donors.

To the extent that IMF resources are committed in such cases, it would seem more appropriate to use Fund resources to enhance a country's reserves or working balances or to provide Fund resources on a pure stand-by basis rather than allocating Fund resources to finance an expected balance of payments gap. That would give such countries more flexibility during the course of the year to respond to unforeseen developments and yet would be more likely to protect Fund resources and maintain the temporary character of IMF financing.

I agree with the statement in the staff paper that access at or close to the limit is appropriate where decisive improvement in a country's balance of payments can be expected by the time repurchases fall due. Although I agree with that statement, I assume that the staff also would take into account the existence of whether there was a balance of payments need and its magnitude. If the balance of payments need were not of a sufficient degree, then access within the limits should be reduced accordingly.

Phasing out enlarged access

On the issue of phasing out enlarged access, we believe there should be agreement now on an explicit phasedown schedule beginning in early 1985 in order to provide clear-cut signals to governments as well as to the international capital markets regarding future access to Fund resources.

We believe it is important to convey to the community at large that we have confidence in the adjustment programs that are under way and that we have confidence that, in the context of an improving world economy, these programs will be successful. Of course, we could modify the access limit phasedown in the future if necessary. For example an adjustment in the phasedown schedule might be necessary if the world economic situation does not improve as expected.

With respect to the credibility of the Fund in the eyes of the international capital markets, I believe that Fund credibility depends primarily on countries with Fund financial arrangements following through on the policy adjustments necessary to achieve a sustainable current account position. The credibility of the Fund also depends on the ability of the Fund to live within its official financial resources base, and in particular the Fund's quota resources.

In sum, I hope that when we come back to these issues we can develop a better understanding on the test of cooperation as it applies to the compensatory financing facility--especially in circumstances where a temporary export shortfall is part of a country's larger payments maladjustment. We should also

develop more explicit understandings with respect to the scale of access within the limits, and more explicit guidelines or understandings on when the policy of enlarged access should be applied, or not applied.

With respect to comments and suggestions that have been made by other Directors today, I also have problems with the grandfather approach to absolute access on the same grounds that others have expressed. In particular, such an approach would be circumventing the quota adjustments agreed to under the Eighth Review. With respect to the augmentation proposal, I would like to examine it a little more closely. Perhaps it would fit into the framework the staff had outlined in Section IV. I also have a problem with the proposal that the level of charges be related to the degree of conditionality applied. Such an approach would seem to suggest that the IMF should reward countries for undertaking policy adjustments necessary to achieve a sustainable balance of payments position.

The Chairman commented that he hoped that the question of the access of oil producing countries to the compensatory financing facility would not be an element of discord. The matter had been discussed at length at EBM/83/79 and EBM/83/80 (6/2/83), and he had made a clear summary of the agreement that had arisen out of that discussion. The Executive Board had accepted his summing up, and the staff was acting in a totally neutral manner along the lines set out therein. Indeed, in a few days, the Executive Board would discuss a request by an oil producing country for a drawing under the compensatory financing facility. In the circumstances, Mr. Nimatallah ought not to be disturbed by any thoughts of discrimination or differential treatment.

Mr. Nimatallah said that, while he appreciated the position put forward by the Chairman, there had been no need at all to mention the position of any specific group of countries, whether oil producers or not, during the discussion on the compensatory financing facility at EBM/83/104 and EBM/83/105 (7/18/83). Any such mention was harmful to the relationship between Saudi Arabia and the Executive Board, which he greatly treasured.

The Chairman remarked that he did not wish anything to interfere with the relationship between Saudi Arabia and the IMF. He recalled that the meeting on June 2 had held to the general understanding that requests by oil producing countries for the use of the compensatory financing facility would be discussed on a case-by-case basis.

Mr. Erb explained that he had only commented on the matter at EBM/83/104 and EBM/83/105 because there had been a section in the staff paper entitled "Forecast for Oil Producers." At that time he had said

that there should be no assumption either that oil producers would have access to the compensatory financing facility or that they would not do so; each case should be scrutinized on its merits to see whether it met the appropriate conditions.

Mr. Laske said that he too agreed with the Chairman. At EBM/83/104 and EBM/105 on July 18, he had made some remarks to which Mr. Nimatallah had taken exception. He would say again that he had never favored discriminatory treatment of any member country in connection with any of the decisions taken by the Executive Board. He had been completely in accord with the consensus reached on the treatment of oil producing countries at meetings EBM/83/79 and EBM/83/80 on June 2. All that he had done was to point to certain factors that seemed to him rather different from those obtaining in the majority of Fund members. He could not agree with Mr. Nimatallah that such matters should not be discussed in the Executive Board.

Mr. Nimatallah commented that he believed that technical matters should be left to the staff. What he found unacceptable was the suggestion that the Executive Board should provide the staff with detailed guidelines as to what to look for--or what not to look for--when a case was to be put before the Executive Board.

The Chairman stated that he understood that a consensus on how to treat requests by oil producing countries for use of the compensatory financing facility had been reached at EBM/83/79 and EBM/83/80; he therefore considered the matter closed.

Mr. Nimatallah agreed with the Chairman that the matter should be closed and he promised not to bring up the matter again unless he were provoked.

Mr. Ismael commented that, as he read EBS/83/132, the thrust of the staff's argument was, first, that there should be a reduction in the level of access to the Fund's resources on the grounds that the resources were limited, and, second, that there should be a shift toward greater relative importance for more conditional assistance and less relative importance for the special facilities. In order to achieve the second of those two objectives, the staff had suggested, on page 5 of EBS/83/132, that the Executive Directors might consider setting a comprehensive limit on access to the Fund's resources.

The staff paper began from the premise that Fund resources were limited, Mr. Ismael noted. The paper then addressed itself to the question of the amount of access that would be compatible with the given level of resources. Such an approach would certainly not take the Executive Board toward the goal of achieving those objectives for which the Fund had been established. Article I(v) stated that one of the purposes of the Fund was to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with an opportunity to correct

maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity. The starting point therefore should be to address the question of the resource requirements of the membership. Once that question was resolved, the next step should be for Executive Directors to consider the various steps that could lead to a resolution of the resource problem.

In recent years a number of developments had taken place, Mr. Ismael remarked, that suggested that there had been a large increase in the need for balance of payments financing and for the Fund to play a greater role in providing it. First, during the decade 1963-72 world trade had increased at an average of 8.5 percent a year, but in the following decade the rate of growth had fallen to just over 4 percent a year. In 1983 and beyond, it seemed likely that there would be a sharp recovery in the volume of world trade, much of which would have to be financed. Second, because of the high rate of global inflation, the unit value of world trade had increased sharply at an annual average rate of over 12 percent between 1973 and 1982. With high inflation, the financing needs for member countries had increased considerably and would continue to increase in coming years. Third, with the prolonged world economic recession and the adverse movement in the terms of trade of less developed countries, the need for balance of payments financing had increased dramatically. Fourth, the high rates of interest in the world capital markets, together with the prolonged recession, had compounded the debt servicing problems of many countries. They had also resulted in the reduction of countries' foreign exchange reserves to unacceptably low levels. Fifth, the present recession and the severe debt servicing problems of a few less developed countries had resulted in certain perverse developments in the way that lenders perceived risk in lending to all LDCs. The result had been a decline in the flow of private capital to most less developed countries.

All those developments, Mr. Ismael considered, pointed toward the need for greater Fund involvement in financing the adjustment process. If the commercial banks had discovered that the Fund was trying to bail itself out by reducing access limits at the same time as it was trying to encourage them to maintain their lending, the consequences might be quite severe for the credibility of the institution. Reducing access limits at the present time would not give the confidence that the members of the financial community needed.

Regarding the choice of new access limits, Mr. Ismael noted that the staff had made various proposals for access in terms of quota after the Eighth Review of Quotas came into effect. If those proposals were accepted, there would be 42 countries whose access in absolute terms would increase by less than 10 percent. In other words, for one third of the Fund, the quota exercise would not be very meaningful.

Given the nature and magnitude of the problems faced by many Fund members, if the Fund had the necessary resources to play an effective role in the adjustment process, it would be sensible to retain the existing access after the Eighth General Review came into effect.

He had noted with great interest the staff argument on page 22 of EBS/83/132 in favor of setting a new comprehensive access limit of 100 percent for ordinary resources, in place of the present 175 percent, Mr. Ismael observed. The staff had argued that while at first sight the reduction might entail a cutback in the absolute amount of access to Fund resources, in fact it would be much less because only a few countries ever gained the right to absolute maximum access.

He maintained, Mr. Ismael went on, that the Executive Directors should retain the present access limits in percentage terms precisely for the reasons given by the staff. If it was true that only in a few cases would member countries gain maximum access, it would make little difference to the Fund's liquidity whether the present limit of 175 percent of quota was maintained or whether it was reduced. The important thing was to give confidence to member countries and to private lending institutions that the Fund remained committed to providing balance of payments financing to members.

The second issue raised by the staff, Mr. Ismael recalled, was the desirability of establishing a comprehensive limit for access to all facilities. As the staff had stated on page 5 of EBS/83/102, the motive behind the proposal was to reduce the relative importance of special facilities and to preserve the relative importance of more conditional assistance. As special facilities had been developed in the Fund for specific and desirable purposes, and as they had been found useful by the Fund membership, he could not agree to any proposal for setting a comprehensive limit that would reduce access to them. Finally, the staff paper did not explore new initiatives that might be taken to obtain additional financing for the Fund. His chair took the view that the Fund should consider other additional borrowing, including market borrowing, if it were necessary to do so. The most urgent attention should be given to the resumption of further allocations of SDRs to members encountering financial problems.

Mr. Feito commented, first, that the topic of access to the Fund's resources was bound to touch on many aspects of the workings of the institution. Despite the efforts of the staff, there were many important issues that would need further study before a conclusion could be reached. He could not agree to any decision being taken at the present meeting, and it seemed to him that some of the issues ought to be brought before the Interim Committee for further guidance. All his remarks should be treated as preliminary.

Second, Mr. Feito remarked, like Mr. Nimatallah and Mr. Ismael, he had been rather concerned about what appeared to be one of the basic tenets of the staff documents. The passage that disturbed him

read: "The present paper does not discuss the factors which would guide Executive Directors in their decisions regarding the total supply of resources to the Fund; instead, it presents a framework within which decisions can be taken on limiting the demand for resources to an aggregate level of supply which is policy determined." In the first place, the demand for Fund resources was no less policy determined than the supply thereof. Logically speaking, the staff should have presented a framework within which decisions could be taken on adjusting the supply of Fund resources to a level of demand that was itself policy determined. His own feeling was that the papers before the Executive Directors were biased in that they constrained the role of the Fund by imposing financial limits and in effect by making access limits a form of rationing mechanism, without any regard to the proper role that the Fund should play in the present world circumstances. His chair had made the point during the review of the enlarged access policy in May 1983 (EBM/83/71 and EBM/83/72). The approach that his chair had then suggested was to attempt, first, to determine the proper role of the Fund in given circumstances; second, to decide on the financing that the Fund would be expected to supply in such circumstances; and, third, to consider the ways and means of obtaining sufficient financing to meet the needs.

He would of course agree that the financial resources available to the Fund were not infinite, Mr. Feito went on; it would therefore be necessary to introduce some restraint on access to the Fund's resources. It was also true that there would have to be a discussion of the means of providing new resources for the Fund in due course. Neither of those circumstances justified the one-sided approach to access adopted by the staff in the two papers before the Executive Board. Quite the contrary; precisely because of the possibility of the emergence of a gap between needs and resources, the staff ought to have adopted an approach that not only included estimates of demand and its impact on Fund liquidity with present resources, but also gave attention to possible ways of significantly enlarging those resources if necessary.

Since the discussion of the size of the Fund in the 1980s, Mr. Feito observed, attention had been drawn to the need for a number of countries to obtain a viable external debt structure. A more coordinated approach to the problem of access to the Fund's resources could have lent conclusive support to the view that one of the lessons of the recent past had been that a Fund endowed with adequate resources was an essential assurance for member countries against unforeseen financial disruptions, as well as a crucial element in bolstering the stability of the international financial system. Such a study could have provided a tentative answer to the question of what would have happened if, at the time of the outburst of external problems, the enlarged access policy had not been in place. It would also be necessary to answer the question of what would happen if, for whatever reason, there was another outbreak of external indebtedness or similar problems, and the Fund did

not have sufficient resources. At the same time, the staff could have studied the need for the Fund to provide some sort of bridging facility, perhaps along the lines suggested by Mr. Kafka, namely, strengthening the compensatory financing facility and other special facilities.

Taking up the specific points made by the staff, Mr. Feito said that, even with the Fund's admittedly inadequate current resources, access limits to its resources in terms of quotas should remain at the same level as at present. Moreover, the cumulative limit for access should remain at four times the annual limit, as at present. He saw no reason to establish a comprehensive limit along the lines suggested by the staff. As the staff had said, the maximum access by any country to the Fund's facilities stood at 675 percent of quota, with sublimits for different facilities. Thus, the arguments in favor of introducing a comprehensive limit were really no more than an attempt to introduce an overall limit that would be smaller than the sum of the partial limits.

He could not follow the staff in its argument on page 2 of EBS/83/132 that "few, if any, members could contemplate simultaneously reaching maximum access under all facilities at present; under a comprehensive, albeit lower, limit, access unused under one facility could to some extent be used under another," Mr. Feito stated. As Mr. Ismael has already pointed out, if it was true that practically no member would simultaneously reach maximum access under all facilities, there seemed to be no need to change the limit on the basis of liquidity considerations only, since the relatively large overall limit was rarely reached. As to the argument that unused access under one facility could be used under another if there were a comprehensive limit, the fact that the comprehensive limit would be made up of partial limits would make the argument invalid. Even if overlapping individual limits were established for certain facilities, the possibility of transfer from one to the other could be enjoyed only at the expense of a lower limit for each individual facility and for access as a whole. Furthermore, he failed to see any justification for transferring resources from one facility to another that was different in nature and origin, and that had differing degrees of conditionality or different purposes.

The second point that he wished to make regarding the undesirability of a comprehensive limit, Mr. Feito explained, was that it was questionable whether it was appropriate to mix all the Fund's facilities under one umbrella. Each of the facilities was different in nature. The so-called conditional facilities were designed for financing general balance of payments problems that were at least in large part related to inadequacies of domestic policies. The special facilities, on the other hand, as their name indicated, were designed to solve special problems with special origins. In fact, the compensatory financing facility had been designed to help countries deal with problems that were self-reversing and caused by circumstances largely beyond the

control of the authorities; similarly, the buffer stock financing facility was designed to allow countries to carry stocks while international prices were low. Mixing such varied facilities under one access limit did not seem at all reasonable. The staff itself had indicated that there would be important operational difficulties, and he believed that many other problems would become apparent if such a system were brought into effect. For instance, the purchase procedure was likely to become obscure if part of the access could be obtained by drawing on a different facility, depending on the way in which the limits were fixed.

In passing, Mr. Feito remarked that he had become seriously concerned that the staff seemed to be advocating stronger conditionality in the use of resources under the compensatory financing facility. Indeed, as he had said at EBM/83/104 and EBM/83/105 on July 18, 1983, there had already been troublesome cases in which the hardening of conditionality had already been put into effect. From that meeting, it should be clear that most Directors were opposed to any change in the conditionality of the compensatory financing facility; the staff should adhere closely to the Board decisions bearing on the issue. The staff argument that "under current circumstances, use of the compensatory financing facility cannot be considered unconditional, as would have been the case had export shortfalls been the sole cause of payments difficulties" was both unwarranted and unconvincing. If a country was to benefit from the compensatory financing facility, the causes of the export shortfall had to be reversible and beyond the control of the authorities. If any other maladjustment existed, it would have to be brought on by other circumstances, and would have to be dealt with outside the compensatory financing facility. Such a state of affairs should however in no way negate the desirability of drawings under the compensatory financing facility. Neither should it be grounds for any change in the facility's present character.

The comments by the staff on the requirement of cooperation for purchases under the compensatory financing facility at the beginning of the meeting made sense to him only if they were intended to mean that there was no scope in present circumstances for the compensatory financing facility, Mr. Feito commented. In other words, in most cases the problems were due to factors other than export shortfalls.

If it could not be proved that the export shortfall was beyond a certain figure, Mr. Feito went on, the country would be unable to draw on the compensatory financing facility, or the drawing would automatically be scaled down, under the existing provisions; no purpose would be served by attaching more conditionality to the facility. He was by no means certain that in current circumstances payments problems were largely due to factors other than export shortfalls. Without taking up Directors' time, he would only remark that the recent downturn in the volume of international trade and in prices would seem to throw doubt on the validity of the staff view, unless the matter were seen very narrowly.

There was certainly no need for additional conditionality in connection with drawings under the compensatory financing facility. Nor was there any need to change the present access limits for the compensatory financing facility in relation to quota, even when the new quotas came into effect.

On page 4 of EBS/83/132, Mr. Feito noted, the staff had indicated that the ratio of potential access under conditional facilities to that under special facilities had fluctuated over time as the various limits had been modified. With the introduction of the supplementary financing facility and the enlarged access policy, there had been a decisive shift in favor of conditional resources. In April 1978, the relation of regular to special facilities had been 1.65:1, while it now stood at 6:1.75 (600 percent of quota for conditional facilities and 175 percent of quota for special facilities). Consequently, a further shift, as suggested by the staff, would not be justified. On the contrary, a swing back in the other direction would seem more appropriate.

His previous comments on a comprehensive limit on total access applied equally to the staff's remarks in Section II of EBS/83/132, Mr. Feito explained. Even if it became necessary to change the access limits on liquidity grounds, he could not support any change that would reduce the present absolute amount of access of any member. In particular, access to the compensatory financing facility should remain 100 percent of quota. In any event, before any change in access on liquidity grounds became acceptable, he would require further exploration of ways in which to increase the Fund's resources. Two possibilities should be considered: going to the private financial markets and advancing the date of the Ninth General Review of Quotas.

As an aside, Mr. Feito said, it became more apparent every day that there was a serious need for a substantial allocation of SDRs.

Taking up the topic of whether a decision should be taken on a reduction of the access limit at the present time or whether it should be left to the next annual review of the enlarged access policy, Mr. Feito commented that the form in which the issue had been presented was rather biased. In some parts of the paper, the staff talked about a further reduction, thus implying that there should be one reduction forthwith and another later. More substantively, while it was certainly true that the enlarged access policy was temporary, the conditions that had brought it into being still existed, perhaps even in an aggravated form. There was certainly no need either to change the policy at the present time or to take a decision at the present time on what the policy should be in the future.

The financial considerations set out in EBS/83/133 required more reflection that he had had time to give them, Mr. Feito indicated. In principle, he would favor eliminating both the catching up and the reverse catching-up positions between ordinary and borrowed resources.

While he could go along with equalizing the mix in the proportions of all facilities, he would prefer to study that matter further. He could not go along with eliminating the floating of the first credit tranche or to eliminating the use of borrowed resources in that tranche.

Mr. de Groote made the following statement:

We have been provided with two papers of remarkable content. Each of them deals, in its own way, with possible changes in accessibility for members to the Fund's resources, "changes" meaning in this context most often reductions, in absolute or relative terms. In proposing such changes, the staff implicitly reduces the Eighth General Quota Review to one limiting interpretation, closing hereby the door for other, and in my view preferable, interpretations that would stress the responsibilities and role of the Fund. Before entering into the details of the staff's proposals, we have to consider therefore more fundamental options: Does the quota review constitute a merely internal operation, its only intent being an improvement in the liquidity position of the Fund? Or does it serve an external purpose as well, by reinforcing the role of the Fund in the functioning of international payments? The two papers at hand today give a positive answer to the first question without justifying it and completely disregard the second. Their only concern is with the liquidity of the Fund: the Eighth General Quota Review is entirely seen in function of that concern. This approach has led the staff to produce a numerous amount of quantitative estimates and simulations under different alternatives in terms of access limits, phasing down, and financing mixes. What we get is a never-seen collection of varying views in what looks like a veritable kaleidoscope of liquidity constraints. Each time you turn it around, the picture changes in yet another way. The views we get, artistic as they may be, are limited however by the content of our object. We get out of it what was put into it. In today's kaleidoscope, only particles representing a reduced use of Fund resources are allowed to enter the composition. In a way, much of the exercise is therefore tautological. The lower the access limits, the lower the commitments of the Fund, and hence the higher the liquidity. Or else, the access limits are ineffective, but why then do we need them anyway? In a variety of twists and turns, the Fund's accountants succeed, particularly in the second paper, in presenting this simple logic in complex ways, all of them illustrating the underlying premise of liquidity preservation.

The starting point of the staff is the probable commitments, as foreseen by the area departments, under alternative access limits. Little attention is being paid to what will happen in all these cases when lower access limits may actually become effective. Take any table out of the two papers, for instance Table 1 from the second document: we are shown a demand for Fund

resources by developing countries ranging from SDR 10 billion to SDR 19 billion. What does this range of variation imply? More adjustment? More commercial bank financing? Should we not rather try to answer first a more fundamental question, relating to the role the Fund has to play in the international monetary system in the years ahead? The accounting view contained in the document should be translated into economic terms, before it can guide the Board in reaching a sound decision. We should look at the world economic situation and the role of the Fund in particular. The role of the Fund indeed is at stake in our discussion. This is a different level of debate, much more in line with our discussion on the Eighth General Quota Review.

The primary role of the Fund is to preserve the stability of the international financial system. One way to serve this purpose consists in making resources available to members in need, as required explicitly by Article I(v). A sound liquidity position of the Fund therefore is crucial, as it serves the dual purpose of preserving the confidence of individual members with regard to possible access, as well as the confidence of the international financial community that the Fund will be able to prevent systemic shocks or assist in their smooth absorption. Once this view is adopted, it is no longer a priori obvious which concept of liquidity is most appropriate or in which range the optimal liquidity ratio has to be set. More fundamentally, liquidity is only a means to reach the aims for which the Fund is responsible, and only one. Adequate access to the Fund's liquidity is another. Preserving liquidity does not make sense, if the liquidity is insufficiently accessible.

The adequacy of access should be looked at in reference to the current economic situation and its possible evolution. More specifically, we have to assess the possible role of the Fund in the different scenarios, as put forward in the available forecasts, such as the World Economic Outlook medium-term scenario. This more fundamental side of the problem seems to be ignored in the documents before us.

The World Economic Outlook, in line with other forecasts such as those by the World Bank and Morgan Guaranty Trust, does not foresee a sharp drop in the current account deficits of the group of developing countries in the years up to 1986, the period under consideration in our papers. On the other hand, private financing seems more uncertain than ever; the latest BIS statistics offer on that point the alarming indication that private credit creation has almost dried up in the beginning of this year. The success of the Fund's action last year clearly shows that the Fund has to play a delicate but crucial role as catalyzer and that it generates multiplier effects in obtaining

the necessary private financing. The latest World Economic Outlook even claims that each dollar of Fund's credit may have attracted four times that amount in new commercial financing. Bearing this in mind, I do not see how the Fund could convince the banks to expand their lending to developing countries, at even moderate rates, when the Fund itself would have to reduce its own lending to those countries. As many Directors have already stressed in our previous discussions on the enlarged access policy, the Fund, in doing so, would give the wrong signals both to the countries and to the international markets; "wrong" in the sense of creating the expectation that the Fund's unique role in assisting adjustment will be reduced and that member countries will accordingly have to follow more deflationary policies, likely to generate further reductions in trade, employment, and income. The starting point for any relevant discussion on access should therefore be the needs of the members and of the system, not in first line the availability of Fund resources.

My position on the specific points submitted by the staff largely results from the general views that I have just presented on the role of the Fund's liquidity in enabling this institution to perform its task.

First, with regard to access limits in general, I would strongly argue that the necessary adjustments, after the quota increase comes into effect, should maintain at least the present nominal level for each member. A 125/375 percent limit seems to satisfy this requirement as a lower limit. For some countries, this will mean an increase in access, which should normally be the result of a quota increase anyway. With regard to the further phasing down of access limits, I share the concern of other Board members about the enlarged access policy's possibly becoming permanent. This policy should remain temporary, but not any less temporary than the continuing world economic recession and the severe balance of payments problems of Fund members. To stress its temporary character, we could envisage establishing an annual review as soon as the Eighth General Review of Quotas becomes effective. Such access limits do not mean laxity in terms of conditionality. On the contrary, conditionality can be applied as strictly as before, if the Fund has the necessary means to support its action, in inducing members to follow its recommendations and in convincing other sources of financing to act jointly with the Fund to provide the resources indispensable for allowing the adjustment to take place.

Second, I fail to be convinced by the proposal for a comprehensive limit, as it will reduce the role of the Fund in yet another way. Such a limit would create a confusion concerning the apportionment of the use of resources between conditional

the apportionment of the use of resources between conditional and nonconditional credit. Moreover, the Fund should be able to change the ratio between the use of conditional and nonconditional resources at any time according to the needs of the moment. If the total of sublimits equals the overall limit, the Fund would also introduce an implicit discrimination against industrial countries because they are not supposed to use a number of special facilities.

Third, with respect to the use of the compensatory financing facility, the staff has gone too far in its interpretation of the Board's guidelines on conditionality regarding this facility, especially in the lower tranche. During the meeting on the compensatory financing facility, Mr. Joyce formulated appropriate guidelines for applying conditionality to the compensatory financing facility in a flexible manner.

Fourth, concerning the scale of access in individual cases, I can endorse the staff's views to make more explicit the determination of the magnitude of access in function of the strength of each program, as well as the balance of payments situation at the moment when repurchases fall due.

Fifth, concerning the use of ordinary and borrowed resources, I agree with the staff's proposals for simplifying the present procedures that determine the mix between regular resources as opposed to the different categories of borrowed resources. As to the mix between regular and borrowed resources, I do have a strong preference for a one-to-one ratio in order not to exhaust the ordinary resources too rapidly. I can also support the staff's proposal about the floating of the extended facility above the quota level.

Sixth, it might be useful to consider linking inversely the level of charges to the degree of conditionality for the special facilities and, for the same reason, financing part of the semiautomatic drawings on the compensatory financing facility by borrowed resources.

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Our position on the different techniques for dealing with the Fund's liquidity impels us to look for appropriate means to solve the Fund's financing problems for the years till 1986, and after, all the more so because the Eighth General Quota increase cannot, in our view, be exclusively used to strengthen the financial position of the Fund. Other means to strengthen the financial position of the institution have to be considered, such as the reduction of the quinquennial period for quota reviews, borrowing on the markets, and SDR allocations. On that latter point, may I again repeat our view that a change can

be introduced in the use of the allocation, by having the understanding accepted by all members that this new allocation would be used, on the basis of a designation plan, only for conditional credits in Fund-supported programs. All other mechanical aspects of the present SDR system would remain unchanged, and no amendment would therefore be required.

The Executive Directors adjourned at 12:50 p.m. and agreed to continue the 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/83/109 (7/22/83) and EBM/83/110 (7/25/83).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/32 through 83/34 are approved. (EBD/83/192, 7/18/83)

APPROVED: February 1, 1984

LEO VAN HOUTVEN
Secretary