NOT FOR PUBLIC USE

04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/155

11:00 a.m., November 16, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	w. B. Tshishimbi
	G. Ercel, Temporary
	X. Blandin
	M. Teijeiro
R. D. Erb	J. C. Williams, Temporary
M. Finaish	
	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
	C. J. Batliwalla, Temporary
	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
	O. Kabbaj
	E. A. Ajayi, Temporary
	J. L. Feito
J. Tvedt	
N. Wicks	T. A. Clark
Zhang Z.	

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; F. d'A. Collings, M. Sidibé, A. C. Woodward. Asian Department: B. B. Aghevli, R. C. Baban, U. Baumgartner, D. A. Citrin, R. G. Di Calogero, X. Vongsathorn. European Department: L. A. Whittome, Counsellor and Director; J. Prust. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; M. Allen. G. Belanger, H. W. Gerhard, M. Guitian, S. Kanesa-Thasan, D. A. Lipton, C. M. Loser, J. R. Marquez-Ruarte, R. L. Sheehy, P. M. Thomsen. External Relations Department: A. F. Mohammed, Director; B. Nowzad. IMF Institute: A. H. Gantt. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, Ph. Lachman. Middle Eastern Department: Z. Iqbal. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; M. Goldstein, O. E. G. Johnson, A. Lanyi. Secretary's Department: A. P. Bhagwat. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: J. R. N. Almeida, S. El-Khouri, K. A. Hansen, H.-S. Lee, Y. Okubo, P. D. Péroz, M. Z. M. Qureshi. Assistants to Executive Directors: J. Bulloch, M. Camara, M. B. Chatah, L. E. J. Coene, M. Eran, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, H. Kobayashi, A. Kone, P. Leeahtam, J. K. Orleans-Lindsay, G. W. K. Pickering, E. Portas, M. Rasyid, C. A. Salinas, A. A. Scholten, D. I. S. Shaw, Wang C. Y., A. Yasseri.

1. SINGAPORE - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Singapore (SM/83/217, 10/26/83). They also had before them a report on recent economic developments in Singapore (SM/83/223, 11/2/83).

Mr. Jaafar made the following statement:

As generally expected, real growth in 1982 was lower than in previous years as a result of the global recession. Although depressed external demand severely dampened manufacturing production, growth of real GDP--at more than 6 percent last year--was still relatively strong. The economic upturn in the United States and other major countries is expected to revive this sector sufficiently for the economy to attain 6-7 percent growth this year.

To counter the impact of the external recession, the authorities took a more expansionary stance in 1982 and 1983, mainly in public sector spending on housing. The 1983/84 budget envisaged a deficit of S$3.3 billion, equivalent to 10 percent of GDP. However, on the basis of budgetary patterns as well as developments so far in 1983, another traditional surplus is expected to materialize, albeit a small one. The financial operations of the public sector have continued to exert a substantial contractionary impact on liquidity, in part because of large sales of government bonds to the Central Provident Fund (CPF), a main reservoir of domestic savings in Singapore. For example, net private saving from the CPF and the Post Office Savings Bank was equivalent to 12 percent of GDP in 1982/83.

The balance of payments has remained strong, with international reserves expected to exceed five months of retained imports by the end of 1983. The traditional deficit on current account, which is expected to narrow this year, is as usual more than compensated for by a substantial inflow of capital, particularly from direct foreign investment. Such investment reached a peak of US$2.1 billion in 1982. This year, owing to the recession and high levels of investment in previous years, it is estimated to reach US$1.2 billion.

Inflation continued to moderate, with the increase in consumer prices not exceeding 4 percent last year. A further reduction is expected in the current year, reflecting the strength of the Singapore dollar and lower inflation abroad.

It has been official policy to promote a strong and stable Singapore dollar. The pursuit of money supply targets or domestic interest rates is regarded by the authorities as inappropriate in the wide-open Singapore economy, with completely free capital movement. The authorities, however, remained committed to the twin objectives of promoting external competitiveness and insulating the economy from imported inflation. The recent modest appreciation of the Singapore dollar has not in their view been a major factor in the performance of exports last year. The major source has been the protracted global recession and the restrictive trade measures adopted by Singapore's major trading partners.

The authorities are also committed to the policy of economic restructuring toward more capital-intensive and high value-added industries. This policy is a reflection of the need to rationalize the use of scarce labor resources; the labor market has tightened considerably since the 1970s owing to the robust and rapid growth of the economy. A package of measures to upgrade the quality and productivity of the labor force as well as to provide an incentive to investors to switch to capital-intensive and skill-intensive industries was implemented in 1979-82. The three-year wage scheme, which ended last year, was part of this package.

Preliminary results of this policy have been encouraging. The staff data indicated that the share of high value-added industries in manufacturing during 1979-82 rose to 49 percent from 41 percent, while output of "high-tech" industries has expanded significantly. Similarly, fixed assets and real value added per worker as envisaged in investment commitments have doubled during the period.

It is too early to gauge the success of the wage policy as an instrument to promote restructuring, although some fears have been expressed that high wages in recent years may have had adverse effects on investors' attitudes, inflation, and export competitiveness. The evidence showed that the impact on inflation has been minimal. Higher wages have been accompanied by increased contribution to the CPF, an effective pension plan in promoting compulsory savings. Nonetheless, the performance of the manufacturing sector last year is of concern. The lower productivity and high wages have contributed to higher unit labor costs and lower profitability. This result is however not conclusive, as 1982 is considered an exceptional year for Singapore, where the practice of labor hoarding in anticipation of the economic upturn contributed significantly to the negative growth in productivity. In general, Singapore has not lost much of its external competitiveness, because its major competitors were experiencing higher costs due to inflation. A major factor remains the global recession and protectionism abroad.

The establishment of the Skills Development Fund to upgrade the skill of workers is a logical consequence of the high productivity plan. The Fund is financed by employers' contributions, currently at 4 percent of the wage bill.

> Finally, a few words should be mentioned about Singapore's continuing development toward a financial center. The growth of the Singapore Asian Dollar Market has been phenomenal since its inception in 1968. Removal of the remaining exchange controls and other restrictions has further enhanced Singapore's position as a major financial center. Total assets of the market have expanded markedly from US$30 billion in 1968 to US$100 billion by May 1983. The authorities encouraged its development through the provision of various financial and fiscal incentives. The intention is to make Singapore into a financial supermarket offering a wide variety of sophisticated financial services to the region.

Mr. Yamashita agreed with the staff's conclusion that the Singapore economy served "as an excellent example of the virtues of financial prudence and free trade." In 1982, the growth of the economy had finally slowed from the high rates registered in previous years to a rate of more than 6 percent, still a remarkable achievement in the midst of a worldwide recession; the authorities were thus to be commended for their skillful economic management. He had been struck in particular by the strength and resilience of fiscal policy in Singapore, which had led to a surplus in the overall budgetary position in a number of past fiscal years. The importance of avoiding an erosion in that healthy fiscal balance could not be overemphasized.

The staff had judged that financing of the stepped-up public housing project and the building of a rapid mass transit system would not pose a problem, Mr. Yamashita observed. In that regard, he had been interested to note from Table 6 of the staff report that development expenditure had fallen short of the budgeted amounts in FY 1982/83, an occurrence that was expected to be repeated in FY 1983/84. He would be interested in hearing an explanation of the factors behind the shortfall and of the traditional practice of underestimating revenues and overestimating expenditures in the formulation of the Singapore budget. On the monetary side, he agreed with the staff that the authorities' policy of focusing on exchange rate management rather than on control of monetary aggregates was appropriate, particularly in view of the high degree of integration of domestic and international capital markets.

The only area of potential weakness seemed to lie in the labor market, Mr. Yamashita said. It was thus important for the authorities to maintain a flexible attitude in implementing public investment programs and in using foreign workers so that labor market constraints did not inhibit export growth. Finally, noting that the complete freedom of capital movements and the resulting development of the Singapore financial market had contributed significantly to the strength of the economy, he would be interested in hearing what effects, if any, similar developments in other parts of the region might be expected to have on the future of Singapore's financial markets.

Mr. Suraisry commented that it was rare that the Executive Board had an opportunity to discuss an economy with strong growth, stable prices, a surplus in both the fiscal and external accounts, a strong currency, comfortable reserves, and negligible debt service. Singapore's recent performance was remarkable by any standard, but particularly as it had been achieved by a small, open economy, with a narrow resource base, during a worldwide recession. Singapore's performance was certainly an excellent example of "the virtues of prudent financial management and free trade" as well as of adaptability and long-range planning.

The success of the authorities in managing the economy could be traced in large part to the consistent pursuit of disciplined financial policies, which had created the appropriate framework for encouraging domestic savings and promoting domestic and foreign investment, Mr. Suraisry continued. On the fiscal side, revenue had kept pace with expenditure, thanks to the buoyancy of tax revenues; government incentives and spending had been efficiently directed into infrastructure and high-technology industries, thus laying the base for sustained growth in the future.

On the monetary side, Mr. Suraisry remarked, the authorities' focus on the exchange rate seemed appropriate, given the integration of domestic and international capital markets. It was, however, interesting to note that the authorities could effectively use the monetary tools at their disposal if circumstances warranted; indeed, they had done so in an effort to discourage "round-tripping" by banks in the Asian dollar market.

With regard to exchange rate management, the marked appreciation of the Singapore dollar since early 1981 had clearly had a discouraging effect on the competitiveness of manufacturing exports, Mr. Suraisry observed. He was happy to see that the authorities were keeping the matter under close review, even though the risk of importing foreign inflation had lessened because inflation in Singapore's industrial trading partners had fallen significantly. Singapore's competitive position had also been affected by the sharp rise in unit labor costs in 1981 and 1982, stemming from the wage correction policy of the past three years. It would be helpful in that regard if the staff or Mr. Jaafar could elaborate on the present and future stance of wage policy. Even if Singapore's competitive position were to improve in 1983, there was nothing the authorities could do about the restrictions placed on their exports by other countries; he shared the hope that others would adopt Singapore's free trade approach.

Taking a medium-term view, Mr. Suraisry commended the authorities for their farsighted restructuring strategy. Their efforts, which were based on the principle of comparative advantage, had already begun to show results. If the emerging recovery in the industrial countries were sustained, and domestic policies remained on their prudent course as at present, the outlook for Singapore should be quite favorable. Finally, he noted from Appendix II of SM/83/217 that "the Singapore authorities did not consent to their proposed quota...under the Eighth Review." He hoped that their decision was not final, because it was in the interest of both Singapore and the Fund that Singapore's quota should be commensurate with its growing economic and financial importance.

Mr. Clark agreed with others that Singapore's economic performance in the recent past had been outstanding, mainly because of a steady pursuit of responsible policies. The openness of the economy posed problems for the conduct of monetary policy, which had led the Singapore authorities to place greater emphasis on the exchange rate; with a suitably restrained fiscal policy, the economy had been able to show great resilience in the face of the external shocks of recent years. For the future, the aim should be to perpetuate what the staff had rightly called the "virtuous circle" of a strong currency, stable prices, and balance of payments surpluses.

The authorities would also need to be aware of the continued risk that increased labor costs--resulting from the wage correction policy--when combined with the strength of the Singapore dollar might inhibit the traditional domestic export sector before the transition to greater reliance on capital-intensive exports had been completed, Mr. Clark continued. In that regard, he would have been interested in a more detailed examination in the staff report of the structural role of the exchange rate.

The remarkable success of Singapore necessarily had some implications for its relations with other economies in the region and for its role in the international financial system, Mr. Clark commented. The combination of a per capita income of about US$6,000 and a sound balance of payments position gave grounds for the hope that Singapore would be able to participate more widely in future in bilateral and multilateral aid programs. Given Singapore's position as an important regional financial center, it was particularly important that full financial statistics--both for Singapore's own external reserves and, more generally, for the Asian currency market--should be available. Noting that the short-term foreign assets of the Investment Corporation were included in official reserves, he wondered whether there might not be some underestimation of overall official external assets because of the exclusion of the long-term investments of the Investment Corporation. He would appreciate hearing from the staff or Mr. Jaafar some indication of the importance of the long-term investments. He had raised those questions only because his authorities felt that Fund surveillance of important regional economies should cover the external effects of the policy stance of those economies; his questions were not in any way intended to detract from his general support of the staff's glowing appraisal of the Singapore economy.

Mr. Morrell stated that, like others, he was in general agreement with the staff appraisal and would therefore limit his remarks to one or two questions. It was clear that Singapore was a major financial center and that the Asian dollar market had recorded unusually strong growth. It was also apparent that the authorities were using a number of fiscal incentives--including tax exemptions--in order to attract business.

Noting that Hong Kong had recently altered its tax structure because it had been losing business to Singapore, he wondered how much fiscal support the market received and whether there were any advantages to Singapore in having an industry that required fiscal support. More particularly, he wondered whether the industry could survive without fiscal support, given the competitive nature of financial centers in the Pacific area.

On another matter, Mr. Morrell observed that the Central Provident Fund collected 46 percent of employees' income--half from the employee and half from the employer--as a vehicle of savings. He also noted that the rate had been increased during 1983, and he wondered on what basis the increase could have been justified, especially as most retirement schemes called for a contribution rate of only 15-20 percent. Perhaps the Central Provident Fund served some purpose other than as a retirement scheme.

Mr. Williams said that he was in broad agreement with the staff appraisal and could associate himself with the comments of others.

The staff representative from the Asian Department remarked that the government budget in Singapore had always overestimated expenditures and underestimated revenues. Strict controls were not exercised in the design of the budget; different departments tended to underestimate revenues to ensure that targets were met and to overestimate expenditures so as to avoid the need for extrabudgetary authorization. As a result, the totals for the budget were often quite inaccurate; indeed, the government budget had recorded overall surpluses since 1968. The Central Provident Fund--which itself registered large surpluses--was not part of the budget in Singapore; if it were included, the surplus of the overall public sector would be significant. The effect of the government and CPF surpluses was to exert a contractionary effect on liquidity, thus ensuring that most of the increase in the volume of money came from abroad.

A large part of the contributions to the CPF was channeled into foreign assets by the Government of Singapore Investment Corporation, the staff representative continued. The authorities felt that such action was appropriate in view of the limited absorptive capacity of the domestic capital market and the need to diversify the CPF's portfolio. The rate of contribution to the CPF was certainly larger than in other countries, but the system seemed to work well.

On another matter, the staff representative observed that Hong Kong's abolition of its withholding tax on interest earned on nonresident foreign currency deposits in early 1982 had not led to any outflow of deposits from Singapore to Hong Kong. However, Hong Kong had managed to attract a larger share of new deposits. As Mr. Morrell had indicated, the market was a competitive one, which meant that Singapore would probably have little flexibility to change its tax incentives if it wished to remain competitive.

Under the wage correction policy, the staff representative continued, wages had been raised to encourage the movement of resources to more capital-intensive sectors. At the same time, the exchange rate had been allowed to appreciate, mainly to offset the effect of foreign inflation and maintain a domestic inflation rate that was somewhat lower. The authorities had been aware that, by following such an approach, they would have been maintaining a cheaper price for capital while lowering export prices in domestic currency. The wage correction policy had ended in mid-1982, and the authorities were studying its impact. It was clear that there had been some shift in resources from labor-intensive to capital-intensive sectors, but weak external demand combined with buoyant domestic demand had reduced the competitiveness of the traded sector relative to the nontraded sector.

Finally, with respect to information on external reserves, the authorities had indicated that the short-term liquid assets of the Government of Singapore Investment Corporation (GSIC) were included in international reserves, the staff representative commented. However, the staff had not been provided with data on GSIC assets, which were considered confidential. Press reports had indicated that the amount might be as high as US$18 billion.

Mr. Jaafar remarked that the contributions by employers and employees to the Central Provident Fund were used not only for employees' retirement benefits but also for housing mortgages, and there were some indications that employees might in future be able to borrow from the CPF for the purpose of investing in public business companies. Finally, while he himself was concerned that Singapore had not consented to a quota increase under the Eighth Review, he noted that the countries that had consented thus far had voting power amounting to less than 35 percent of the total. Since there remained two weeks until the deadline for consents, Directors should not prejudge Singapore's position on the matter.

The Chairman then made the following summing up:

Executive Directors expressed broad support for the thrust of the appraisal in the staff report for the 1983 Article IV consultation with Singapore. They commended the authorities' outstanding success in promoting rapid capital formation, which had underpinned high rates of growth in output and exports. Prudent financial policies had been instrumental in maintaining a strong currency, low inflation, and continued balance of payments surpluses. Despite the adverse impact of weak external demand on export performance, a relatively high growth rate had still been achieved in 1982, on the strength of increased domestic demand.

Directors noted that increased budgetary expenditures, particularly on the housing program, had exerted a countercyclical influence on overall demand in 1982. The continuation of the housing program and the construction of a mass rapid transit system would be major sources of public sector demand in the medium term. The financing of those development expenditures should not pose major difficulties, in view of the expected rapid growth of income and the high buoyancy of tax revenues; however, the expansion of the public sector could increase pressures on an already tight labor market, particularly if the recovery of external demand were sustained. Directors urged that flexibility should be maintained in the implementation of development projects. They noted that the Government's financial operations as a whole continued to exert a contractionary impact on domestic liquidity, thereby inducing inflows of net foreign assets and facilitating the maintenance of a strong currency and low inflation.

Given the close link between domestic and international financial markets, Directors agreed that the authorities' policy focus on maintaining a strong and stable currency rather than on the control of monetary aggregates was appropriate. In the context of exchange rate management, Directors underscored the continued need to strike a balance between moderating external inflation through exchange rate management and protecting external competitiveness. In that regard, and in view of the Fund's surveillance duties, Directors suggested that the provision of more complete statistical information by Singapore would be desirable. They took note of the continuing growth of Singapore as a major financial center and of the Government's exchange and fiscal policies to promote that development.

It was observed that the openness of the global trading and financial system had been of considerable benefit to Singapore's development as a major regional financial center. In that connection, I join others in hoping that Singapore will accept the quota increase proposed under the Eighth Review, which would bring Singapore's quota more in line with its significant position in the world economy.

It is expected that the next Article IV consultation with Singapore will be held by March 1985.

2. UPPER CREDIT TRANCHE ARRANGEMENTS APPROVED IN 1981 - REVIEW

Executive Directors considered a staff paper on a review of upper credit tranche arrangements approved in 1981, together with some issues related to conditionality (EBS/83/215, 10/4/83). They also had before them a background paper on upper credit tranche stand-by and extended arrangements approved in 1981 (EBS/83/216, 10/4/83).

Mr. Schneider observed that the review of upper credit tranche arrangements provided an opportunity for Directors to take a critical look at Fund experience with the application of conditionality, within the framework of Fund-supported adjustment programs. A realistic assessment of that experience could be made only in the wider context of surveillance under Article IV of the Articles of Agreement; conditionality was an integral part of the Fund's surveillance activities and, consequently, it would be wrong to review the application of Fund conditionality outside that context. In addition, the interdependence of the world economy should be taken into account in order to avoid an unfair distribution of the adjustment burden.

Turning to the issues for discussion on page 12 of EBS/83/215, Mr. Schneider said that he shared the staff's view that present guidelines on conditionality, together with the provisions governing the extended Fund facility, represented a reasonable basis for applying the Fund's policy on the use of its resources. The guidelines could be interpreted flexibly because they required the specific circumstances of individual members to be taken into account. Information provided by the staff on the success or failure of Fund-supported programs showed that the majority of the programs had at least facilitated needed adjustment in individual member countries, even if the overall goal of achieving a viable balance of payments position in the medium term had not been achieved in all cases. In that regard, it should be remembered that, in 1981, the global economic environment had made adjustment difficult, as there had been many exogenous factors at work. Nonetheless, a number of countries had succeeded in adjusting, at least in part, because of several elements that were common to each. The first had been a realistic adjustment program that had the full political support of the Government; and thus had been the ability of the authorities to implement agreed policies without adversely affecting the social fabric of the country. A third element had been the timely adaptation of program targets and a flexible formulation of policy in response to changing circumstances.

In a world in which great uncertainties and deep-rooted imbalances existed, it was important further to improve and refine Fund policies on the use of its resources, Mr. Schneider continued. He therefore supported the idea of making greater use of medium-term scenarios to identify a feasible program path toward a viable external payments situation. At the same time, the length of the adjustment period under such circumstances should be clearly determined. In his view, the medium-term scenario should be prepared on the basis of different assumptions in combination with sets of policy recommendations that could be implemented early in the program period if warranted by changing circumstances. He also felt that substantial policy action should be taken prior to, or in the early stages of, whatever type of arrangement was accepted. Despite the staff's apparent preference for one-year arrangements, there were circumstances in which a multiyear arrangement was more appropriate; the choice should depend upon the severity of the maladjustment. If multiyear arrangements were adopted, adjustment should take place from the very beginning; the first year of a multiyear arrangement should not become a holding operation, as it had on occasion in the past. Greater use should be made of reviews, in addition to performance clauses, in order to monitor the progress of adjustment by identifying weaknesses in the implementation of policies at an early stage in the arrangement so that timely action could be taken by the authorities.

On another matter, Mr. Schneider considered that there remained room for a better adaptation of programs and performance criteria to the peculiarities of nonmarket economies. Assuming agreement by such countries, the Fund might consider asking the authorities to introduce some market instruments, on the basis of which the program and the performance criteria could be elaborated.

On the question of undrawn amounts in multiyear arrangements, Mr. Schneider said that he would hesitate to introduce an automatic rephasing of purchases in case of an interruption of the member's right to draw. It was important to look first at the causes of the interruption and to determine whether or not they were largely beyond the control of the authorities; only after such a determination had been made could the Fund properly decide whether a rephasing should result in the reduction of the total use of Fund resources under the arrangement.

For the future, he saw no great merit in reviewing experience with Fund arrangements in a given calendar year, Mr. Schneider commented. Future background papers should be modified to analyze longer periods of program experience. At the same time, it might be useful if the staff could introduce a program evaluation so that Directors could in retrospect assess whether the Fund had prescribed the right "medicine" for countries. As the staff had pointed out in the footnote on page 4 of EBS/83/215, the optimistic forecast in the World Economic Outlook paper that had been prepared in early 1981 might have contributed to an inadequate design of adjustment programs. Finally, he agreed with the staff that prolonged use of Fund resources over extended periods should be examined in the context of the next review, especially since the matter was closely related to the provisions regarding the revolving character of Fund resources.

Mr. Feito noted that the Fund's financial programs and the application of the related conditionality were among the most important elements of the work of the institution, particularly in present circumstances. Indeed, to the outside world, conditionality was the Fund's most important instrument, and different views on the role of the Fund were based largely on different perceptions about the theory and application of conditionality. For example, the level of criticism raised against the Fund was often directly related to the Fund's lending cycle. Phases during which the Fund significantly increased its loans to member countries were often accompanied or immediately followed by an outburst of criticism in which the economic policies recommended to member countries were censored. As the number of countries seeking Fund resources increased, there appeared to be a greater willingness by both existing governments and opposition parties to blame the Fund for responsibilities that would otherwise have to be domestically shouldered; and, as the Fund became more involved in the management of national economies, its activities were more likely to be analyzed by members of the academic community and other institutions that might not fully support the theoretical basis on which conditionality was established or the manner in which it was applied.

Moreover, just because such criticism was rooted in the factors that he had mentioned did not necessarily mean that it was misguided or that it would be limited only to those countries applying Fund programs, Mr. Feito went on. Indeed, criticism against the institution was also growing in large creditor countries, although usually for reasons quite different from those that produced criticism in the debtor countries. In his view, the increase in criticism of Fund activities was not unrelated to the Fund's constrained liquidity position and the uncertainties surrounding it. Because it was mainly the Fund's financial programs that aroused such criticism, Executive Directors should take the opportunity to determine common elements of concern, and to search for possible ways of alleviating them.

There were two main areas in which the staff should work to improve understanding of the Fund's financial programs, and perhaps the quality and consistency of policy packages, in order to render them less open to the simpler forms of criticism, Mr. Feito considered. First, the staff should attempt to clarify the theoretical foundation on which the Fund's policy recommendations were based. One of the common elements of all criticism levied against Fund programs seemed to be a lack of information about the behavioral relationships and theoretical schemes used by the staff to frame policy actions. In the absence of an established body of theoretical schemes to be applied by the staff in the design and implementation of financial programs, it was impossible to confront those who felt that the Fund was, for example, too monetarist, too Keynesian, or too structuralist in its approach.

He understood, of course, that many aspects of Fund advice to member countries were not amenable to being framed in terms of agreed theories or clear models, Mr. Feito remarked. In many cases, the special knowledge of the structure of certain economies that had been gained by staff members in the course of their professional experience, together with an intuitive sense based on that knowledge, was a more powerful instrument of analysis than generally available theoretical models. But, however desirable a pragmatic approach based on such experience might be, there was no denying the value of articulating the main theoretical relationships behind Fund programs, particularly since not all staff members were equally experienced and not all countries--especially those that had not had frequent access to Fund resources--were equally well known. Sooner or later, even the most knowledgeable and intuitive staff members had to come to terms with the need to identify the regulators of the distribution of nominal income as between output, prices, and balance of payments effects, and had to establish reasons for the advocated degree of substitutability or crowding out between the private and public sectors. In order to make such determinations, the staff had to use a set of theoretical relationships, implicitly or explicitly. It was in the interest of the Fund and its members to establish and clarify such a theoretical system for common use by all Fund missions. As he understood it, an effort had been begun by the Research Department in the recent past to carry out precisely such an analytical clarification. He wondered whether that research project was continuing; if so, he would suggest that a deadline be set for its completion and implementation.

A second area in which further work was needed by the staff was related to the empirical evidence available on the quantitative aspects of Fund programs, Mr. Feito said. A frequent criticism of Fund financial arrangements was the weak correlation between the attainment of expected results in the program and the observance of performance criteria. In successive reviews of conditionality, Directors had found it difficult to anticipate the effects of Fund financial programs and to relate them to the observance of the performance criteria with any reasonable degree of accuracy. It was his contention that the difficulty was due mainly to the nature and frequency of reviews of financial arrangements. That was not to say that the period between reviews should be lengthened; rather, a broader retrospective view should be taken with a once-and-for-all statistical analysis encompassing all financial programs implemented throughout the history of the Fund.

Over the past 20 years, more than 200 financial arrangements had been agreed between the Fund and member countries, forming a rich data base that had, on the whole, been statistically unexploited, Mr. Feito remarked. The staff should make an effort to interpret the data in such a way that lessons could be derived with respect to some of the important quantitative aspects of Fund programs. In that regard, he noted in passing that some of the criticism levied at Fund recommendations was often based on casual evidence gathered from, at most, 15-20 cases. If the staff could provide an adequate analysis of the entire existing statistical system with a view to shedding light on the quantitative relationships and possible empirical regularities between, say, observed changes in domestic credit and associated changes in prices, output, and the balance of payments, such criticism would fall away. Nearly all of the financial programs carried out under the auspices of the Fund contained, for example, some element of credit restraint; hence, it would seem possible to infer the statistical relationships between the policy of credit restraint and accompanying changes in output and prices and indicators of balance of payments disequilibrium.

Obviously, there were many qualifications that should be kept in mind in carrying out such a statistical exercise, Mr. Feito commented. Many Fund programs had been interrupted before their conclusion, and some indicators should perhaps be found to account for different economic environments, different exchange rate systems, and significant structural differences in the various economies engaged in Fund programs. As he understood it, no such statistical analysis had been made in the Fund; previous analyses of experience with financial arrangements had been marred by the eagerness of the staff to assess the relative success of the program by resorting to a rather arbitrary choice of data. The analysis that he was proposing would, in principle, not cover the success or failure of particular programs, although it would serve to provide answers to some of the questions that he had mentioned earlier.

Turning to the issues for discussion in EBS/83/215, Mr. Feito agreed in general that more use should be made of medium-term scenarios to identify alternative paths toward the attainment of viable balance of payments structures. Moreover, the points made by the staff regarding program reviews and the policy on waivers and modifications were well taken; in particular, given the strains and uncertainties dominating the period under review--as well as the more recent past--the policy on waivers and modifications of performance criteria should be applied quite flexibly. The erratic nature of capital flows during the current turbulent period certainly called for flexible and enlightened use of waivers and modifications in the face of unexpected developments. In that respect, program reviews also had a useful role to play in ensuring that actual developments did not invalidate major assumptions underlying the performance criteria.

He would have preferred to see some analysis in the staff paper on the potential for wider use of contingency clauses in Fund programs, linking unexpected developments that violated important assumptions to automatic changes in performance criteria, without the necessity for a program review or a waiver request, Mr. Feito went on. Such an approach had been followed in some cases--for example, those of the Central African Republic, Mauritania, and Morocco--where higher than projected external financing had been reflected in a commensurate reduction in the rate of credit expansion. Similarly, in cases like those of Jamaica, Pakistan, Senegal, and Uganda, the adjustment had been designed to be symmetrical, so that domestic credit ceilings could be raised or lowered, depending upon the level of external financing. He wondered why such built-in flexibility could not be extended automatically to synchronize movements between credit ceilings and other types of unanticipated developments that might invalidate the assumptions on which a program was based. Significant divergences in exogenous variables, such as changes in the terms of trade, in international interest rates, or in the rate of growth of external demand for a country's products, could be dealt with by provisions for automatic adjustment of performance criteria, particularly those relating to credit ceilings.

There were many instances in which such built-in flexibility in the application of performance criteria would be a far more efficient way of keeping the program on track than resorting to program reviews or waivers, which were often more time-consuming than necessary, Mr. Feito considered. He would appreciate staff comment on whether it considered such flexibility desirable and, if so, whether it could be confined to specific unexpected changes in exogenous variables--like capital inflows--or whether it could encompass all unexpected changes in all major assumptions and exogenous developments embodied in the program.

A related interesting issue had characterized some recent financial programs in the Western Hemisphere, Mr. Feito observed. With the exception of Fund programs for planned economies, financial programs contemplated the management only of nominal instruments--mainly domestic credit--to attain nominal and real outcomes. Given a set of assumptions and behavioral relationships, the programs linked those nominal changes to a certain rate of price increase and output growth. A problem could arise if the rate of inflation over the span of the program turned out to be much higher than expected as a result of either miscalculations or unexpected developments. If, for example, a greater than expected devaluation, a greater than expected growth in nominal wages, a bad harvest, or an increase in inflationary expectations should occur, prices might rise faster than expected. Then, with fixed nominal credit ceilings and broadly fixed nominal income, real income had to fall in order to offset the rise in the inflation rate. The country might find it extremely burdensome to carry out the greater than expected real adjustment effort, and, eventually, the performance criteria might not be met. Then a waiver or a new program would have to be prepared accommodating more modest progress in the control of the short-run inflation rate. Such a development could be highly damaging to the country if there were capital inflows linked to the smooth implementation of the program, because an interruption of the program could also interrupt capital inflows.

In such cases, Mr. Feito concluded, it might be better if performance criteria were designed to accommodate certain types of transitory increases in the expected inflation rate. He recognized that it was not easy to distinguish between transitory inflationary forces and permanent ones; however, some lessons could be learned from a review of recent experience with highly inflationary economies. Finally, he could support the proposed decision, although he wondered whether, given the importance for the stability of the international economy of the results of some financial programs and related conditionality issues, the next review should not be held somewhat earlier than December 31, 1984.

Mr. Finaish observed that, given that the objective of adjustment policies was to attain balance of payments viability over the medium term, the staff suggestion to make more use of medium-term scenarios to identify a feasible path toward balance of payments viability for purposes of program formulation seemed to be quite logical and could contribute to improvements in program design. A more forward-looking approach, in the context of the Fund's regular surveillance exercise, could also be helpful in the earlier detection of serious external financial problems of the sort that had surfaced in recent years. However, it also had to be recognized that the use of longer-term projections for program formulation had some limitations. Balance of payments forecasts were subject to many uncertainties; those uncertainties had increased in recent years and might be particularly great in some individual cases and over periods long enough to include the time of repurchases. Hence, care should be exercised in deriving policy conclusions from the medium-term scenarios.

The concept of balance of payments viability as the objective of Fund programs deserved some comment, Mr. Finaish considered. The staff had defined it as "the attainment of a current account deficit that can be financed by normal capital flows, given the foreign reserve target." While such a definition would serve as an appropriate measure of payments balance in most situations, the objective of Fund programs could not be only a speedy achievement of balance in the external accounts without regard for what the achievement entailed in terms of other objectives of macroeconomic policy, such as growth. Even if the attainment of balance of payments viability were the only objective of Fund programs, a payments position might not be considered fully viable--and the adjustment leading to it fully durable--unless it were accompanied by a reasonably satisfactory domestic economic performance. If that was true, then the goal of the exercise for the identification and attainment of balance of payments viability over the medium term should not be to focus only on measures that would secure a payments turnaround; rather, the goal should be to identify a feasible course for macroeconomic policy that could combine payments adjustment with internal balance.

With regard to the issue of prior or early actions and the speed of adjustment, Mr. Finaish noted from the staff report that the requirement of prior or early policy action had been increasing over the past two years. While in some cases the speedup of the pace of adjustment might be related to a marked reduction in external financing and the need for an early restoration of confidence in the economy, in other cases it had the appearance of being an element in the general tightening of conditionality over the period. The phasing of adjustment, like its content, should be determined in relation to the nature of the case in question. Any general tilt toward front-loading adjustment would be unwarranted. While the need for adjustment might be particularly urgent in some cases, he could think of several considerations that could in other circumstances point to a more gradual pace of adjustment. Those included the nature of the initial conditions, the pace at which the imbalances needing correction had developed, the extent to which the adjustment envisaged included structural measures, the constraints on administrative capacity, and the limits of social and political tolerance to the adjustments that might be necessary. The requirements of prior or early action, when imposed, should reflect such considerations rather than giving the impression that they were called for because of skepticism about the seriousness of the authorities' policy commitments. Devices such as performance criteria and reviews--the use of which had also been increasing in the recent past--provided adequate means for a continuous monitoring of the implementation of those commitments. He was also interested in the relationship between the phasing of adjustment and the phasing of financing, and he wondered whether the staff felt that a significant change in the one would, in most situations, require a corresponding adjustment in the other.

Commenting on the policy on extended arrangements, Mr. Finaish observed that the establishment of the extended Fund facility had been based on an appropriate and welcome recognition that a durable balance of payments adjustment in many cases required important structural changes that could best be implemented over a period of time longer than was generally associated with stand-by arrangements. However, the reduction in the number of extended arrangements granted since 1981 seemed to indicate some retreat from the extended Fund facility, which gave him cause for concern. It was, moreover, ironic that such a retreat should have occurred at a time when the Fund had been increasing its emphasis on structural adjustment in Fund programs.

The movement away from extended arrangements appeared to have stemmed mainly from two notions: first, that the record of performance under extended arrangements had been less satisfactory than that under stand-by arrangements, and, second, that there had been a tendency toward weaker conditionality and shortfalls in program implementation under extended arrangements, arising from the lack of detailed specification of policy measures and performance criteria at the outset of an arrangement for its entire duration, Mr. Finaish continued. Neither of those ideas, however, appeared to be adequately substantiated by evidence. In comparing the results under extended arrangements and stand-by arrangements, Directors should keep certain considerations in mind. First, the adjustment involved was of a different nature for each, and there were differences in the apportionment of the adjustment effort among the various macroeconomic objectives as well as differences in the time lags involved. It should also be noted that inadequacies in program design had tended to occur more frequently in structurally oriented programs, an outcome that was no doubt a reflection partly of the greater complexity and difficulty of adjustment of a structural character.

The fact that policy measures could not be laid down precisely at the outset for the entire duration of an extended arrangement should not necessarily be considered a weakness, Mr. Finaish remarked. Such a characteristic was, after all, also shared by multiyear stand-by arrangements. Besides, the basic thrust and content of the adjustment strategy for the entire duration of an extended arrangement was agreed at the outset; it was only the specification of quantitative performance criteria and related policy details that were left to be determined at a later stage in light of subsequent developments. Moreover, periodic program reviews could ensure that policy commitments expressed initially in rather broad terms were translated into adequate policy actions at the appropriate time. Hence, where a country was able to present a coherent medium-term adjustment program, the appropriate vehicle for Fund assistance continued to be the extended arrangement. It should be stressed that reliance on shorter-term arrangements in circumstances requiring medium-term solutions would carry the risk of constricting the scope of adjustment and, furthermore, that the advantages of an extended arrangement in such circumstances could not be fully obtained under successive one-year stand-by arrangements. To the extent that problems had been encountered under extended arrangements, an effort should be made to learn from experience and to make improvements, rather than simply reverting to short-term arrangements.

On a related matter, Mr. Finaish took note of the indication by the staff that, since the carrying out of extended arrangements was likely to make great demands on political support, "it must be ascertained that this support exists." It was not clear how the staff proposed to go about ascertaining the existence of such support; in his own view, the authorities' willingness to undertake the necessary measures should serve as an adequate indication of the existence of support, especially since, as far as he knew, the staff did not possess any special expertise for reaching an independent or more reliable assessment of the matter.

In EBS/83/215 the staff had suggested the insertion of a clause in all multiyear arrangements that would allow for rephasing of undrawn balances that might accumulate as a result of prolonged interruption of purchases, including the possibility of a reduction in total access, Mr. Finaish noted. It was not clear whether such a change was really necessary, however. Under present practice, interrupted programs were later allowed to resume through approval of waivers or modifications of performance criteria in cases where the basic thrust of the program remained unchanged and the deviations from the initial targets had not been very large. If such a policy was applied fully, many of the interruptions might not become protracted, and the question of rephasing might not arise. Even in cases where the interruption was for some reason relatively long, but the implementation of the program remained basically on track, there might still be no need for rephasing or limitation of access. In cases in which the interruption had been protracted and the basic thrust of the program had not remained intact, it might be better to formulate a new program.

Another suggestion by the staff was for greater flexibility in the use of waivers and modifications, even in cases of relatively large deviations from performance criteria, where such deviations stemmed from uncertainties relating to capital inflows in connection with debt reorganization and where program implementation basically remained on track, Mr. Finaish recalled. That suggestion had merit, but it was unclear why the same flexibility could not be exercised in similar situations arising from other types of unforeseen developments or forecasting difficulties. He would welcome staff comment on that matter as well as an indication of whether the reported fewer number of waivers and modifications in the 1981 programs as compared with programs covered under the previous review reflected some tightening of the policy on waivers and modifications. In addition to considering a more flexible approach toward waivers and modifications, the staff should look toward greater use of contingent performance criteria in the presence of significant uncertainties as a way of reducing the frequency with which performance criteria were breached and programs were interrupted.

With regard to suggestions for further work by the staff, Mr. Finaish considered that a longer period for the analysis of program experience might be helpful. On the proposal that the staff should give special attention in the next review to the issue of prolonged use of Fund resources, he had two observations. First, the existence of a significant amount of additional needed adjustment at the end of an arrangement--and hence the possible need for successive arrangements--might not imply a deficient policy implementation or weak conditionality; such a situation could also arise from the large size of the initial imbalance, the mainly structural nature of the adjustments involved, adverse exogenous developments, and inadequate program design. Second, whether or not successive arrangements in a given case implied a prolonged use of Fund resources that was incompatible with their revolving character would depend on the particular attributes of the case. It would also follow that no general cut-off point was feasible. Finally, given the proposal to focus in the next review on the question of prolonged use of Fund resources, he wondered whether a separate paper on that matter--as proposed in the current work program--would still be necessary.

Mr. Lovato expressed appreciation for the two novel features that had been incorporated into the current review with respect to the methodology employed in surveying countries' performance and economic outcomes under Fund-supported programs. The first new feature was the adoption of a more disaggregated approach in describing country-specific situations and the departure from the more conventional use of general averages in analyzing the record of countries in program implementation. The second new feature was the unified treatment of one-year and multiyear arrangements through eliminating the often arbitrary distinction between programs in two rigid categories that no longer seemed operationally relevant, especially since even short-run stabilization policies were, in an increasing number of cases, couched in a medium-term framework and often encompassed at least some supply-oriented measures.

Turning to the issues for discussion in the staff paper, Mr. Lovato observed that it was widely recognized that programs designed to promote external adjustment should be framed in the medium term and that the policies that were presumed to lead to a viable external payments position had to be outlined with care according to a specific time profile that might go well beyond the period in which the Fund could offer financial assistance. In the circumstances, it was of paramount importance to analyze and assess in detail the balance of payments position that was expected at the expiration of the program.

Alternative scenarios could be useful, Mr. Lovato considered, particularly if some specified probabilities were attached to each in order to take account of the uncertainties involved in projecting the future path of the various unknown variables. Based on the alternative scenarios, different programs could be devised in case developments did not progress as expected. The indentification of a viable external position over the medium term and the delineation of policies required to attain it had to be essential features of adjustment programs with the Fund; accordingly, the degree of success or failure of such programs should be judged against the progress in advancing the country's economy toward that viable external position. That was a somewhat different yardstick than the one traditionally used in the Fund's periodic reviews of its upper credit tranche programs, where successful adjustment was measured by the degree to which the immediate objectives--namely, those for the balance of payments, inflation, growth, and so on--were achieved during the program period. An appraisal of the performance of the economy with respect to those short-term objectives was certainly helpful, but it might not offer much relevant information about the likely final outcome of the adjustment being undertaken.

The lack of a clear relationship between the meeting of short-term objectives and the final outcome of adjustment added a further element of uncertainty to those already recognized as existing between performance criteria (or immediate targets) and final targets and between policy instruments and targets, Mr. Lovato remarked. He could therefore support the staff's proposal to de-emphasize short-term targets and performance criteria in assessing achievements under Fund programs while placing a greater emphasis on the adjustment already undertaken during the program period and the amount of adjustment remaining to be accomplished at the end of the period in order to attain an external position that could be sustained in the medium term.

He shared the staff's view that the question of cumulative and prolonged use of Fund credit by some members should warrant special attention by the Executive Board, Mr. Lovato continued. A similar suggestion had been put forward some time ago by Mr. Wicks, who had remarked on the need to discuss in greater depth the situation of "chronic users of Fund resources." In recent years, an increasing number of countries had been coming to the Fund in an apparently endless sequence of cumulative arrangements, and recent Board discussions of some of those countries had highlighted the peculiar situation. Occasionally, continued recourse to Fund resources had been assumed at the end of an existing program almost as a given, and balance of payments projections had been developed actually embodying that assumption.

On another matter, Mr. Lovato observed that early or prior policy actions were instrumental in enhancing the prospects for a more rapid adjustment. In most cases, there were long delays before the effects of policies became evident, so that the earlier that policies could be adopted the better. At the same time, the announcement of early and strong policy decisions in Fund programs were received positively by both the Fund and by commercial lenders. The staff had argued that the costs to a deficit country of delayed adjustment were high because of the disruption of normal trade credits and flows of goods and because of the damage to the confidence of potential creditors. In a world in which commercial lending to developing countries was severely rationed, the supply of external finance was directly related to the degree and speed of adjustment undertaken in each country. In such circumstances, a rapid and socially painful adjustment might well have become an obliged choice for many countries.

With regard to extended arrangements, Mr. Lovato considered that the existing provisions of the extended Fund facility were appropriate to deal with payments problems of a more structural origin. Despite various difficulties that had hindered implementation in a few instances, extended arrangements did have an important role to play in fostering policies designed to overcome structural imbalances in developing economies. He agreed that the Executive Board should ensure in each case that the requirements for an extended Fund facility purchase should be strictly met, although he was disturbed by the recent tendency to downplay the value of extended arrangements.

On the techniques for monitoring programs involving Fund support, Mr. Lovato said that he had been pleased to note that prior actions and review clauses had assumed a greater importance in recent years relative to performance criteria, which in many instances had been inadequate. Reviews were to be preferred both because they involved direct contact and cooperation between the Fund and the authorities and because they were useful in situations in which the response of real variables to changes in financial policies was more difficult to project. Finally, with respect to external debt rescheduling, a great deal of work remained to be done in analysis and presentation in Fund reports. Debt renegotiations had been treated in different ways in the 12 programs shown in Appendix D, and, despite some progress made more recently, it seemed that the problem of uniform treatment had not yet been overcome. Uniform treatment was necessary in his view; for example, in a report on any country in which debt service obligations were deferred as a consequence of rescheduling, the debt relief entailed by that rescheduling should be shown explicitly as an item in the current account of the balance of payments.

Mr. Blandin said that he was in agreement with the two main conclusions at the end of the staff paper, namely, that the current guidelines on conditionality remained valid in present circumstances and that "the provisions of the extended Fund facility remained suitable for dealing with particular payments problems of a more structural nature." Still, for a large proportion of stand-by and extended arrangements, success had been elusive; indeed, in a number of cases, attempts at redressing the external situation had failed to a great extent. For that reason, the effort to improve the contribution that Fund programs could make to the adjustment process was certainly desirable, and he welcomed the section of EBS/83/215 dealing with the ways in which adjustment prospects could be enhanced. He had only two qualifications to his general support for the proposals outlined in that section. The first was related to the speed of adjustment and the second to the treatment of undrawn amounts in multiyear arrangements.

He could agree fully with the view that there could not be a uniform speed of adjustment valid for all countries in all circumstances, Mr. Blandin continued. The relative scarcity of financial resources at present--including resources from the Fund--and the still gloomy world economic outlook might well justify the broad conclusion that a more speedy adjustment in general was called for. The use of medium-term scenarios should therefore be helpful, but only to the extent that they provided a better assessment of what could reasonably be expected from a given country over a specific period of time. The medium-term scenario should not be used in too dogmatic a way, and he had some reservations about the suggestion that "faster adjustment means that some of the necessary measures would have to be taken at the outset of the program." Too systematic a front-loading of adjustment under Fund programs could lead to a change in the nature of Fund assistance from an approach that emphasized orderly and durable adjustment to a "quick-fix" approach that might yield spectacular results initially but would not necessarily contribute to the longer-term economic balance of the country.

With regard to the treatment of undrawn amounts in multiyear arrangements, Mr. Blandin observed from the staff report that the prolonged interruption of a member's drawing rights under a multiyear arrangement might entitle that member to an unusually large drawing when its rights were eventually restored. The staff had suggested that, in such cases, the Fund should have the authority to reduce the original amount of the arrangement. He was not certain that he could fully endorse such a suggestion, and he was not convinced that experience thus far showed that it was necessary. Moreover, he failed to understand the rationale behind the proposal; the restoration of the drawing rights of a member was in any event conditional upon the re-establishment of the adjustment process, and reducing the amount available would in a sense penalize the member even if the original objectives of the program were eventually reached. In addition, there might be a hidden cost to such an approach. Especially in the case of multiyear arrangements, the size of the initial amount was an essential element in the eyes of the authorities, but more so in the eyes of participants in the financial market and other creditors. One important facet of the catalytic role of the Fund was the understanding that, provided the adjustment process remained on track, the Fund's resources would remain firmly committed and the rights of members to draw on those resources would not be challenged. The approach suggested by the staff would clearly cast serious doubts on the reliability of Fund agreements with members and could therefore be counterproductive.

In his view, experience with extended arrangements in the Fund had, on the whole, been largely positive, and such arrangements should be accepted whenever the conditions set out in the relevant decision were met, Mr. Blandin commented. In that regard, it was worth noting from page 39 of EBS/83/216 that the only countries that had reached or outperformed their growth objectives under Fund programs were those that had concluded multiyear arrangements with the Fund. That favorable outcome seemed to argue strongly against a more restrictive attitude toward concluding extended arrangements in future or modifiying the rules currently in force. Such a decision would lead to an undesirable emphasis on shorter arrangements in circumstances that required medium-term solutions, and there would be a risk that the scope of adjustment would as a result become too narrow. There were, of course, a number of extended arrangements that had run into difficulty. The proper response in those cases was to look more closely at the technical aspects of the individual programs; in that regard, closer cooperation with the World Bank might be desirable.

He had mixed feelings about the emphasis on maintaining the revolving character of the Fund's resources and on the desirability of focusing on that matter in the next review, Mr. Blandin said. He was uncertain whether the idea behind such a preoccupation was to limit the number of arrangements that any given member was entitled to enter into over a given period, or whether it was to make certain that the countries drawing on the Fund would be in a position to repay the Fund in due course. It would be helpful if the staff could elaborate on the reasons why it had proposed focusing on that issue in the next review.

Mr. Ismael observed that the period covered by the review was quite short. Many policy actions produced results only after a considerable lag, and it might not always be appropriate to judge the success or failure of a program entirely on the basis of the meeting of performance criteria over a given period. Besides, countries continually changed their policies, and the external environment within which programs were devised also changed, sometimes rather too rapidly. In the circumstances, he agreed with the staff that it was somewhat meaningless to label programs as success stories or as failures. In the final paragraph on page 39 of EBS/83/216, the staff had concluded that programs with the countries under review had been basically successful in achieving the external current account and inflation objectives; unfortunately, the targets had often been met at the cost of a lower growth rate. While he agreed that a sound external position was a prerequisite for the attainment of other objectives, his preference was to take account of all the objectives of a given government and not to emphasize only the attainment of a viable balance of payments position.

Another general issue was the need to reconcile the views of those who favored extended arrangements in order to resolve structural problems with the views of those who preferred shorter-term programs on the grounds that smaller amounts were involved and that the programs could be more easily formulated, monitored, and implemented, Mr. Ismael continued. It was clear that fewer extended arrangements were being brought to the Board at present than a few years previously, despite a strong argument by the staff in favor of medium-term programs. The conflicting views of Directors should be resolved in order to give clear guidance to the staff. In particular, small countries facing structural problems should be given greater encouragement to approach the Fund at an early stage of their difficulties so that they could avoid having to adopt harsh measures after the situation had gotten out of hand.

Turning to the issues for discussion in EBS/83/215, Mr. Ismael said that he could support greater use of medium-term scenarios as a basis for adopting medium-term programs, which he hoped would entail meaningful amounts of financial assistance. He also agreed with the staff that it was important for member countries facing financial and economic difficulties to adopt suitable corrective policies at an early stage. However, he would caution against excessive front-loading of adjustment in Fund programs; while recognizing that structural problems took time to resolve because of supply bottlenecks, he had also observed that too rapid an adjustment could result in social and political instability. In the circumstances, there was need for caution in determining the appropriate pace at which adjustment policies should be implemented. In that respect, extended arrangements seemed to constitute an appropriate and useful form of Fund assistance, and such arrangements should focus on a medium-term adjustment strategy in order to set the direction and basic stance of policy for the full period of the program.

Another issue for discussion in the staff paper concerned chronic users of Fund resources and the way in which the revolving character of those resources could be ensured, Mr. Ismael observed. While he agreed with the general principle of the revolving character of Fund resources, he was reluctant to see an increase in the pace at which they revolved. Implicit in the staff's suggestion was a tightening of conditionality, an approach that he could not accept.

With regard to the potential for flexibility in Fund programs, Mr. Ismael said that he would prefer to see flexibility in both directions. There were times when additional measures were required and other times when policies already in place should be eased. The staff already recognized the importance of modifications and waivers in the implementation of Fund programs, and he would be happy to see a broader flexibility exercised more frequently as a way of avoiding a collapse of those programs.

Turning to the proposed decision, Mr. Ismael noted an implicit contradiction between paragraphs 1 and 2. The first paragraph stated that the provisions of the extended Fund facility remained appropriate in present circumstances, which implied that the Fund was encouraging member countries to adopt medium-term programs in order to deal with their structural problems. The second paragraph, however, placed emphasis on the revolving character of the Fund's resources, which implied fairly rapid adjustment and perhaps shorter-term arrangements. If it was agreed that the extended Fund facility was an appropriate mechanism for dealing with structural problems that required time to resolve, it seemed inappropriate to suggest that the time taken by countries to adjust should be shorter. In his view, any effort to shorten the adjustment period allowed for resolving structural problems could reduce the effectiveness and success rate of Fund programs.

Mr. Tvedt stated that he was in agreement with most of the views expressed in the staff papers and could support the decisions set out in EBS/83/215. Greater emphasis should in general be attached to analyzing member countries' economic situations in a medium-term perspective. In connection with Article IV consultations, a medium-term analysis could contribute to the identification of emerging problems and imbalances at an early stage. Similarly, an integrated medium-term analysis in connection with Fund-supported programs would probably improve the potential for formulating policies that were better adapted to the underlying balance of payments problems of members. That approach was, of course, based on the assumption that the borrowing country could be flexible and was prepared to reassess its economic policy measures in light of developments; in those cases, a medium-term forecast might well serve as a reference point for necessary policy changes if, during the program period, developments should deviate from the assumptions.

The medium-term strategy appeared to be of particular importance in connection with multiyear arrangements, Mr. Tvedt continued. Despite the numerous problems involved in quantifying future developments, the effort to identify the impact of exogenous shocks could prove to be an important step in clarifying at an early stage economic and other important constraints that might hamper a successful implementation of Fund programs.

The Fund should continue to attach importance to ensuring that some measures were implemented at the outset of a program period in the form of early policy action, Mr. Tvedt considered. Early policy action could help to restore confidence in the economy by the private financial markets. Also, since many policy measures had an effect on the economy only after a considerable lag, there was some advantage to adopting policies early in the program period. It was true that greater emphasis on front-loading of policy measures would lead to a greater burden of adjustment in the short term for the borrowing countries; in that respect, countries that implemented stronger adjustment measures should perhaps be considered for maximum borrowing under the enlarged access policy in accordance with the guidelines drawn up by the Interim Committee in September 1983. Many multiyear programs were interrupted because the prescribed policy program was not implemented or became less relevant in the light of actual developments. In that regard, the Fund should examine the potential for some type of early warning system that would allow for reviews earlier than originally agreed so that the economic policy program could be adjusted; it was important to determine whether the deviations in the program were due to purely temporary or to more permanent factors.

It was imperative for the Fund to make an effort as soon as possible to assess the experience with members that had de facto made continuous use of the Fund's resources over a number of years, Mr. Tvedt commented. The extent of such use and the means by which the revolving character of the Fund's resources could be ensured should be surveyed.

Finally, with regard to the problem of growing undrawn balances in connection with postponed or interrupted multiyear arrangements, the staff's proposal to allow for rephasing during the remaining program period merited further attention, Mr. Tvedt said. However, in the absence of any additional data, consideration of the matter would likely hinge only on the full assessment of the multiyear arrangements approved in 1981 or more recently. It would be preferable if the staff could undertake a medium-term retrospective analysis of the impact of the multiyear arrangements approved in earlier years as well.

The Executive Directors agreed to continue their discussion at 3:00 p.m.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/154 (11/14/83) and EBM/83/155 (11/16/83).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/276 (11/10/83) and EBAP/83/277 (11/14/83), by an Advisor to an Executive Director as set forth in EBAP/83/276 (11/10/83), and by an Assistant to an Executive Director as set forth in EBAP/83/276 (11/10/83) is approved.

APPROVED: March 26, 1984

LEO VAN HOUTVEN
Secretary