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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/156

3:00 p.m., November 16, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	P. D. Péroz, Temporary
	M. Teijeiro
R. D. Erb	
M. Finaish	T. Alhaimus
	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	
G. Laske	
G. Lovato	C. P. Caranicas
	C. J. Batliwalla, Temporary
Y. A. Nimatallah	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
J. A. Kay, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; F. d'A. Collings, M. Sidibé, A. C. Woodward. Asian Department: U. Baumgartner. European Department: 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, M. R. Kelly, D. A. Lipton, C. M. Loser, J. R. Marquez-Ruarte, R. L. Sheehy, P. M. Thomsen. External Relations Department: A. F. Mohammed, Director. Legal Department, G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; W. E. Holder, Ph. Lachman, S. A. Silard. Middle Eastern Department: Z. Iqbal. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; O. E. G. Johnson, A. Lanyi. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, J. R. N. Almeida, S. El-Khouri, K. A. Hansen, H.-S. Lee, Y. Okubo, M. Z. M. Qureshi. Assistants to Executive Directors: M. Camara, M. B. Chatah, L. E. J. Coene, M. Eran, G. Ercel, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, H. Kobayashi, P. Leeahtam, J. K. Orleans-Lindsay, E. Portas, M. Rasyid, J. Reddy, C. A. Salinas, A. A. Scholten, D. I. S. Shaw, S. Sornyanyontr, Wang C. Y., J. C. Williams, A. Yasseri.

1. UPPER CREDIT TRANCHE ARRANGEMENTS APPROVED IN 1981 - REVIEW

The Executive Directors resumed from their previous meeting (EBM/83/155, 11/16/83) their review of upper credit tranche arrangements approved in 1981 and of some issues relating to conditionality (EBS/83/215, 10/4/83). They also had before them a paper containing background material (EBS/83/216, 10/4/83).

Mr. Polak said that he found the two staff papers extremely interesting. It was important for the Fund, in analyzing its experience with stand-by and extended arrangements, to try to see what lessons could be drawn. Such an attempt required a systematic presentation, something that had been carried out in a satisfactory manner in EBS/83/216.

While most Executive Directors had addressed themselves almost exclusively to the lessons to be drawn, Mr. Polak continued, he felt it important to pay some attention to the analysis itself. Although Executive Directors were considering the 27 cases for the year 1981, the purpose was more to add them to the body of prior experience than to undertake a single year's analysis. In more general terms, the aim ought to be to see whether the experience of each succeeding year confirmed the findings of earlier years. Looking forward, he would like to see a discussion of the situation that would prevail when a country was due to repurchase, as well as some debate on the action that ought to be taken when a country had made use of a series of arrangements with the Fund or prolonged its use of Fund resources over a long period. He greatly welcomed the staff paper on experience in Africa produced earlier in the year (DM/83/54, 7/13/83). Even though the experience reported by the staff might not in itself be satisfactory, the staff had given a good analysis of the reasons for the outcome. The body of information was important to the Fund, and would no doubt in due course be published.

On a technical point, Mr. Polak observed, he wished to support strongly the presentation of figures on individual countries on the basis of unweighted averages, as had been done in Tables 5, 6, and 7 of EBS/83/216. He would recommend to the staff that it should reconsider whether it had acted correctly in using weighted averages in Tables 2, 3, and 4 of the same paper. The case that it had made for doing so did not seem fully justified. Similarly, he had been interested to see that the staff divided all the available cases into three roughly equal groups: *supply-determined programs*, *mostly demand-determined programs*, and mixed-strategy programs. He did however wonder whether such small groups, of between eight and ten countries each, would give significant averages. He missed in particular the unweighted average for the 27 countries as a group. One reason why he doubted whether the differences shown between the various groups were significant, was that he would have expected that the figures for the mixed-strategy programs would fall somewhere between those for demand restraint programs and those for supply-oriented programs. However, they did not do so, being more extreme in every single case.

While it was inevitable that Executive Directors should discuss the experience of 1981 two years after the event, Mr. Polak considered, it would have been desirable to include in the staff paper any information that had become available on 1982 and 1983. The only fact given for those years was that there had been no more than six extended arrangements in the two years together. More data could certainly have been provided, even if for information only. Similarly, it would have been useful to include a table listing the arrangements concluded in 1982 and 1983, together with the waivers that had been granted in those years.

Regarding the attainment of objectives, Mr. Polak found that the main conclusions of the 1982 review (EBM/82/93, 7/7/82) had been validated: in general, the implementation of adjustment measures and the observance of performance criteria coincided with movements toward balance of payments viability; and that there was a high correlation between the observance of performance criteria and other evidences of success. Another conclusion that seemed to have been valid was that exogenous shocks had not by themselves determined whether a program succeeded or not; a much more important factor had been what the staff had called a firm and persistent political commitment to carrying out the program.

The staff had perhaps been too gloomy in appraising the lack of results with respect to real growth and the improvement of the balance of payments, Mr. Polak observed. It was true that real growth had fallen short by about 2 percentage points from the targets for 1981 programs, but the outcome had been better than for the world as a whole. For all non-oil developing countries, the shortfall had been about 3 percentage points in 1981, and it seemed likely, according to figures from the May 1982 World Economic Outlook, that the shortfall would be roughly similar in 1982. Consequently, on the whole, countries with Fund programs had fared slightly better than the non-oil developing countries as a group. Similarly, the countries with programs had managed to cut down their current account deficit as a proportion of their exports of goods and services by some 10 percentage points from 1980 to 1982, while net oil importing less developed countries as a whole had been unable to reduce their deficits during the period. It was perhaps a pity that such a basis of comparison had not been used by the staff. Similarly, he had been struck that, with all the emphasis on the failures of domestic policy, the countries with Fund programs had suffered much more severely in their terms of trade during 1979-80 than the non-oil less developed countries as a group; the terms of trade for the countries with programs had declined by 16 percent before the year in which they had entered into relations with the Fund, while those for the larger group had declined by only 6 percent. Furthermore, while something had been said about import and export growth, no comparable statistics had been given. It would have been interesting to see whether the argument that the Fund tried to find solutions by cutting imports was valid or not.

Taking up the debate on the benefits of one-year programs as opposed to multiyear programs, Mr. Polak remarked that careful analysis did seem to show that the one-year programs had been notably more successful than the multiyear programs, for instance, in terms of programs that had had to be terminated early and in some other terms as well. It would, however, be wrong to conclude that the Fund ought to move in general from multiyear to one-year programs. The Fund granted three-year programs to countries that were in severe difficulties, and it would not make life easier for those countries if the Fund were to grant them only one-year programs. Regardless of whether the outcome was a one-year or a three-year program, it was important that the Fund should agree on a long-term adjustment program with countries in difficult structural situations. While in the past there might have been some tendency to easing the conditions of the first year of a three-year program, he did not believe that that weakness persisted.

On page 9 of EBS/83/215, Mr. Polak recalled, the staff had taken up the difficult situation that arose when there were long interruptions in three-year programs. He had been interested in the comments by Mr. Schneider and Mr. Blandin at EBM/83/155. He did not consider that it would be proper to adopt a rule of general rephasing in those circumstances. The matter would have to be considered on a case-by-case basis, and sometimes rephasing might be appropriate. On other occasions it would only be reasonable for the Fund to make the resources available to the country at a later stage.

Regarding the content of the programs, Mr. Polak remarked that the evidence that exchange rate changes were good for periods of more than one year provided that the changes were repeated every month did not strike him as convincing. It was interesting to note that an exchange rate change was the policy measure with the highest rate of application in Fund arrangements. While there were many cases in which an exchange rate change had no doubt been necessary, the staff might perhaps have been rather too ready to recommend such changes, even when a rate had been fixed in terms of a major currency as an established element of policy of the country concerned and when the rate was not yet clearly out of line. As to the reduction of public sector deficits, he had been struck by the interesting finding that expenditure control had on the whole been more successful than increases in revenue. He would like the staff to keep track of the cases in order to see whether additional evidence would prove the finding to be a general rule. The staff had also shown the need for early action both in one-year stand-by arrangements and in extended arrangements, including the emphasis on prior action in many cases. A case also seemed to have been made for avoiding making the performance criteria so complicated that it was difficult to know whether a country had adhered to them or not. There had been a discussion on that point in connection with one of the countries in his constituency.

Reviews had proved useful, Mr. Polak considered, and greater reliance on them had clearly proved a sensible decision. They had also enabled the Executive Board to remain in close contact with the progress of a program. Nevertheless, there was a limit to the number of reviews that could sensibly be conducted, and some measures, like exchange rate changes, did not in fact produce results in one quarter that could be observed in a review. He wished to guard against the possibility that a three-year arrangement with quarterly reviews became in fact no more than 12 quarterly arrangements.

The staff had mentioned that total drawings under one-year stand-by arrangements had amounted to 94 percent of the approved amount, Mr. Polak noted. He understood that the staff considered that 94 percent was a satisfactory figure, but that 100 percent would have been better. That interpretation was of course entirely different from the one adopted when stand-by arrangements had first been introduced. At that time, a stand-by arrangement had been considered a safeguard for countries not in immediate difficulties that wished to enhance their status in the financial markets while obtaining contingent protection. Stand-by arrangements on which no drawings were made had been common in the Fund perhaps ten years previously; currently, however, there seemed to be no such arrangements. There might be a new field for stand-by arrangements, especially on the part of countries that had had a three-year arrangement and drawn 450 percent of their quota, so that there was little more that they could obtain from the Fund. For such countries, a true stand-by arrangement would be quite applicable. It would be made available on the understanding that it would be accompanied by a policy package to be brought into operation when the country was unable to obtain other financial resources or in certain circumstances beyond the control of the country; it would however not be drawn upon to meet payments difficulties that were basically due to failures of policy within the country.

Mr. Laske stated that he would confine his observations to the issues for discussion set out in Section VI of EBS/83/215. While he could support the draft decision exactly as written, he would like to place particular emphasis on the second half of the last sentence of that decision, namely, "with particular reference to the importance of ensuring the revolving character of the Fund's resources." The staff had shown, particularly in EBS/83/216, that the extended use of the Fund's resources by a number of countries might put into question the revolving character of its resources. Of the 27 arrangements approved in 1981, no fewer than nine had been with countries that had made uninterrupted use of the Fund's resources for more than 12 years, with two of the nine countries having made use of the Fund's resources for more than 15 years. That development raised the question whether the adjustment strategy pursued by the nine countries had been correct, and whether the adjustment measures that had been implemented had been carried far enough. If the answer to those two questions was positive, why had the countries needed Fund support even after a long succession of adjustment programs? Because of the importance of the question, he warmly

supported the suggestion that the cases of the continued use of Fund resources should receive special attention in the next review of upper credit tranche arrangements. Indeed, he was by no means sure that it was desirable to postpone such an important discussion for a whole year. He would welcome it if the staff could immediately undertake a thorough analysis of those cases, and if Executive Directors could have the results as soon as possible.

The Fund's experience with extended arrangements was complex, Mr. Laske considered. While he certainly agreed with the statement that the extended arrangement was the appropriate form of Fund support when balance of payments problems were caused by structural maladjustments and weaknesses, he was worried that extended arrangements appeared to have the largest share of program failures or early terminations of programs. No fewer than half the extended arrangements approved in 1981 had been canceled, all the cancellations taking place within the first year. Half the arrangements approved before 1981 had also been canceled before their expiration. The record was therefore not impressive. Although five of the extended arrangements granted in 1981 had not yet been completed, and final conclusions could thus not yet be drawn, the fact that half the arrangements had broken down rather early in their life made it necessary to reach certain conclusions on what ought to be done to make extended arrangements more successful.

Where there might be some doubt about the capability of the authorities who had requested assistance from the Fund in connection with structural problems, Mr. Laske went on, it might be desirable first to concentrate on shorter-term arrangements so as to prepare the ground for a longer-term arrangement in which the structural problems could be adequately addressed. In constructing an extended arrangement, the staff was faced with the difficult task of reconciling the revolving nature of the Fund's resources with the need to correct maladjustments that were mainly deep seated and protracted. Basically, such an adjustment required the use of longer-term funds, simply because its success could not reasonably be predicted. To secure success as soon as possible, the program should be well defined and should be carried out promptly. In that connection, he had been impressed by the staff analysis showing the relative impact of external and internal factors on adjustment programs under extended arrangements. The staff had shown that the authorities' determination to implement the adjustment policies was of overriding importance in achieving an improvement of the balance of payments position. At the same time, no systematic relationship had been detected between adverse exogenous developments and progress toward balance of payments viability. In other words, countries that pursued sound policies had been better able to absorb external shocks than those that were slow in taking policy action. The conclusions to be drawn seemed clear: programs for extended arrangements should ensure progress in establishing a viable balance of payments position over the medium term, a period that he would define normally to be within the lifetime of an extended arrangement. The program should also be specific for each of its three years, spell out which areas of policy should be addressed, and indicate what the objectives of policy actions should be.

In the early stages of extended arrangements, Mr. Laske went on, substantial progress should be made in reducing price distortions, including of course establishing an appropriate exchange rate relationship. Front-loading both of the amount and of the intensity of the measures to be taken would demonstrate the determination of the authorities and ensure that the adjustment process got off to a quick start. There were a number of examples where gradualism in the design of an extended arrangement had been one of the causes of its demise.

A particularly vexing problem for extended arrangements was that posed by adjustment programs incorporating large and comprehensive investment plans, which were often intended to be the centerpiece of structural improvement, Mr. Laske observed. He had long maintained that adjustment strategies based heavily or primarily on investment might be better suited to the World Bank than to the Fund; in the real world, however, adjustment measures with and adjustment measures without prominent investment components tended to overlap. Nevertheless, where investment played a major part, the program should be left to the World Bank, and Fund programs involving investment plans should be worked out and monitored in close cooperation with the Bank.

The staff had defined a viable balance of payments position as one in which the current account deficit could be financed by normal capital flows without further recourse to financial assistance by the Fund, Mr. Laske noted. He warmly endorsed that definition; it fitted the objectives of Fund policy neatly. In view of the reduced availability of commercial financing and of the obvious limitations on official development aid, adjustment should take place rapidly to bring about a viable balance of payments position.

The staff had suggested that it should develop alternative medium-term scenarios showing the way to viable payments positions, Mr. Laske observed. The idea was an attractive one, especially if it were to include additional measures to be taken if progress under the program threatened to fall behind schedule. The whole purpose of such a course would be to enhance the prospects of successfully completing the program and to reveal any shortcomings as early as possible. He had indeed no objection to calling such a proposal an early warning system, and he would like to see such a thing brought into operation. He would however ask the staff to be seriously on its guard against the potential danger that the writing of alternative scenarios might unintentionally lead to an extension of the time for adjustment.

Taking up the problem of how to treat undrawn balances that had been accumulated when disbursements had been interrupted, Mr. Laske remarked that the staff proposal, which would be to provide for rephasing after such interruptions, did merit careful consideration and implementation. The rephasing should bring about an even distribution of the resources available for an arrangement, and should avoid an undue bunching after a program had been set back on track. Naturally, he would not exclude the possibility of front-loading at the

restart of an arrangement, but only if particularly strong action were taken fully to catch up the ground lost during the interruption. It would of course also be possible to reduce the aggregate amount made available under an arrangement, as part of the restart conditions. Such a reduction should be considered whenever the interruption of disbursements had been the consequence of the adoption of weak policies by the authorities. Finally, the idea of providing for a review of credit tranche arrangements covering a longer time than one year would be valuable. He would go further and suggest that the staff should look closely at extended arrangements whenever they were completed, in order to obtain more insight into how such arrangements worked and a better analysis of the programs connected with them.

Mr. Joyce stated that he could agree with earlier speakers that no amendment to the guidelines on conditionality was necessary at present. He also agreed that the provisions of the decision establishing the extended Fund facility remained appropriate; he could therefore support the proposed decision. Nevertheless, the review provided an opportunity for seeing whether changes in emphasis might be needed.

In EBS/83/215, the staff had provided a useful indication on how the broad design of adjustment programs and key indicators could help to define a path leading to a viable long-term balance of payments position, Mr. Joyce noted. Nevertheless, he did have some concerns. First, like Mr. Laske, he was concerned about the apparent high rate of failure, or at least the rate of interruption, of so many longer-term arrangements. Five of the ten extended arrangements approved in 1981 had been canceled in 1982, and two of the four multiyear stand-by arrangements had been interrupted. He did of course realize that, as the staff itself had mentioned, even when a program had been interrupted, substantial progress might have been achieved beforehand. In some cases, progress toward a viable balance of payments position had been resumed, or progress had been strengthened, under a subsequent Fund program. It was interesting that the experience of one-year stand-by arrangements approved in 1981 was considerably better than it had been in earlier reviews, with 94 percent of the approved drawings being purchased.

The outcome could of course be taken as an indication that multiyear arrangements were more likely to run into trouble than one-year arrangements, Mr. Joyce remarked, but he did not wish to draw such a rigid conclusion from the available data, and certainly not to say whether more emphasis should be placed on one-year as opposed to multiyear programs. He did however accept the underlying premise put forward by the staff that the goal of extended arrangements should be the restoration of a member's balance of payments position for medium-term viability as quickly as possible. Such an objective was essential if countries were to achieve a sustainable balance of payments position and to ensure the revolving character of the Fund's resources, so that the resources would be available when other members were in difficulty. His other concern was that, as had been made clear by the staff, even in some cases where

the performance criteria themselves had been met, it was impossible to say whether progress had been made toward balance of payments viability by the end of the program. That was a matter that ought to be looked into in a future review.

As to specific policy questions, he agreed in general with the staff suggestions in EBS/83/215, Mr. Joyce said. More emphasis certainly needed to be given to the development of medium-term scenarios leading to the identification of feasible paths to the achievement of a viable external payments position. Such a goal might not always be attainable within the time limits of a program, but Executive Directors needed some assurance that the balance of payments position could become viable in the medium term. It was also essential to formulate medium-term adjustment strategies for such programs. Appropriate demand management measures ought to be formulated early in the life of a program in order to ensure sufficient financial stability for supply-side measures to take hold. He could also agree that the strategy itself should set out the basic stance of policy for the whole three-year period.

He noted the staff point that the early adoption of policy measures did seem to increase the likelihood that the adjustment program would bring about an improvement in the balance of payments within the time-frame of the program, Mr. Joyce noted. Indeed, delays in introducing policies had often been associated with departures from program objectives. The authorities should therefore be urged to implement policy changes relatively early in the adjustment period. Indeed, the willingness of the authorities to take prompt action was often an indication of their dedication to the success of the program itself. However, he wished to make a distinction between the desirability of taking prompt action and a demand for prior action as such. There were cases in which prior action was called for. As the staff had observed, prior action was particularly necessary if a need for a basic change in the direction of economic policy had been identified. Prior action might also be desirable in instances where there had been major problems with earlier programs because of the authorities' failure, for whatever reason, to implement certain kinds of measures, or in instances where certain policy actions were critical to the success of the program as currently defined.

He was however still convinced that Fund management and staff should be careful in specifying the need for prior action, Mr. Joyce went on. There were clearly trade-offs between different types of policy options, and ultimately it was for the Executive Board to consider whether an appropriate overall balance had been struck. Meanwhile, he supported the continuation of the present practice of dealing with requests for prior action on a case-by-case basis.

As to the speed of adjustment, Mr. Joyce said that he shared the staff view that, with the reduction in commercial flows to developing countries, and uncertainties as to the amount of future financial flows that might be available, adjustment should be taken promptly to reduce a country's financing requirements. The relatively limited amount of the

Fund's own resources that might be available to finance adjustment also pointed to the need for relatively swift adjustment by countries. If financing was limited, failure to adjust quickly might well lead to the emergence of arrears or the introduction of import or exchange controls that were contrary to the fundamental aims of the Fund--controls that in themselves were likely to affect seriously a country's ability to obtain outside financing, thus forcing the country to undergo an even more rapid adjustment. On the other hand, he recognized that if adjustment was pushed too fast, the acceptability of the program to the authorities themselves and perhaps, even more important, to various key sectors of the economy might be undermined, thus leading to delays or even to a breakdown in the arrangement. The right speed for adjustment was clearly a matter for decision in each case. Where it was the shortage of financing that dictated the pace of adjustment, the most desirable solution was to see whether steps could be taken that would provide the additional funds needed to meet the financing gap.

It would be useful if the next review were to focus on the experience of members that had been steady or frequent users of Fund resources because they had endured long-standing payments difficulties, Mr. Joyce observed. He would support Mr. Wicks's earlier request for a paper on the subject. Finally, he was as disturbed as the staff about the size of large potential drawings that could be made by countries when their right to draw was restored after prolonged failure to meet performance criteria. Any program review that re-established a country's right to draw following four or five months of inability to do so should automatically contain a review of the phasing of the program to ensure that the timing and size of the drawings were appropriate. In some cases, it might also be necessary to look at the total amount of drawings available over the remainder of the program to see whether the amount was appropriate or whether a new program ought not to be sought as a means of adhering more clearly to the path to balance of payments viability in the time remaining. Such reviews would of course have to be conducted on a case-by-case basis. Consideration might be given to the desirability of introducing a clause into Fund programs providing for the automatic cancellation of a program if a country had not been able to draw for, say, 12 months. It could be argued that after such a period it was unlikely that a country would be able to return to the original program path.

The period covered by the review paper was short, Mr. Joyce mentioned; Executive Directors should therefore be prudent about trying to draw conclusions from the data provided. Second, the failure of programs often seemed to flow from the failure of the authorities to implement a program, not necessarily because of political will but frequently because of administrative weakness. Such a conclusion did seem to support a need for more technical assistance by the Fund in both fiscal and monetary fields. Third, there seemed to be a need for more contingency planning on the part both of the staff and of the authorities that entered into programs with the Fund. It was important that understandings should be reached at the time the programs were being constructed as to what ought

to be done if corrective action was needed, either because of the failure of the measures adopted to provide the desired results or because of slippages in implementation, or because of changing conditions. When such action was needed it was usually needed quickly; it would therefore be an error to wait until the need appeared to begin thinking about appropriate action. He therefore supported Mr. Tvedt's view of the importance of having an early warning system, so that such actions could be triggered sooner rather than later.

Mr. Kabbaj remarked that it was reasonable to begin a discussion of issues relating to conditionality with an assessment of the programs already completed or currently in operation, even though objective assessment might prove difficult. EBS/83/216 contained an attempted assessment of adjustment programs from the standpoint of whether they had attained the immediate objective and whether they had helped to bring about progress toward the medium-term objective of a viable balance of payments situation.

From the standpoint of reaching immediate objectives, Mr. Kabbaj went on, it was evident that export performance had generally fallen short of the intended targets. Perhaps not surprisingly, the shortfall was more pronounced in countries following demand restraint programs than in those pursuing structural or supply-side policies. Although it was difficult to separate the effects of one type of program from the other in view of the inevitable overlapping, Table 7 on page 36 of EBS/83/216 clearly demonstrated that purely demand restraint programs had on average not been as successful as other programs in attaining the projected objectives. Such policies seemed to undermine countries' growth prospects. The result seemed to show that greater emphasis ought to be placed on supply considerations and on measures aimed at strengthening the real sectors of countries with programs.

Another noteworthy point, Mr. Kabbaj considered, was the increase in the debt service burden being experienced by the majority of countries with programs. The deterioration reflected the slow growth of exports and the unfavorable international environment. The unsatisfactory shift underlined the importance of securing greater commercial bank cooperation with the Fund in finding ways to reschedule the debt commitments of developing countries on more favorable terms.

As to the medium-term evaluation, as the staff had observed, the uncertain economic outlook, elements of subjective judgment, problems of comparison, and difficulties of precise quantification of distant variables, made it almost impossible to arrive at clear conclusions, Mr. Kabbaj observed. It was therefore necessary to treat any results with caution and to prepare alternative sets of assumptions to avoid miscalculations. Nevertheless, in view of the size of the initial imbalances, one possible conclusion was that the adjustment process should be phased over longer periods, and that multiyear arrangements should be adopted. It was true that the staff had concluded that, on average, multiyear arrangements had been less successful in enabling

countries to meet their performance criteria, or to implement policy measures, than one-year programs. It would however be preferable to find ways of overcoming that defect than to opt for one-year arrangements. For instance, early policy action would in general raise the effectiveness of multiyear arrangements. It was therefore disappointing to learn that in 1982, and so far in 1983, only six extended arrangements had been approved. It was certainly desirable to consider the adoption of more multiyear programs with a view to alleviating the countries' problems and to making the programs better suited to the needs of borrowing countries.

Only 8 out of 27 countries had in fact observed the performance criteria at all strictly, Mr. Kabbaj noted. The staff had referred to the incomplete implementation of policies as a cause of departure from the performance criteria. However, a lack of response to unanticipated exogenous factors had also been important. Of the performance criteria, credit policies and limits on external payments arrears were the most frequently breached. The frequency of nonobservance of those criteria, and the ensuing interruption of the drawings by the borrowing members, demonstrated the need to review the way in which the criteria were formulated, for the purpose of easing some of the difficulties experienced by borrowers. In particular, waivers and modifications of the criteria in the light of changed circumstances, or emerging exogenous developments, should be granted more frequently. Waivers and modifications were particularly important for performance clauses on external payments arrears in view of the difficulties experienced by many borrowing countries facing higher interest rates. They were also handicapped by a reluctance on the part of some commercial banks to reschedule their debts on more favorable terms or to grant new lines of credit, and on the part of some donor countries to grant additional financial resources.

As to the more general question of conditionality, Mr. Kabbaj noted that the principles of uniformity and flexibility of treatment applied to the wide spectrum of Fund programs; and the conditionality made provision for the institutional characteristics and particular circumstances of different countries. It was therefore important to strike a delicate balance between the need to adjust the economy toward a viable balance of payments equilibrium and the degree of responsiveness of the economic and social forces operating in a particular country to the provisions of the program.

Commenting on the proposals for the more frequent use of medium-term scenarios as a means of identifying a feasible growth path, Mr. Kabbaj conceded that the design of the program should reflect the changing pattern of the imbalances, by which he meant the tendency in recent years for deep-rooted structural problems to emerge. The solution to such problems would require a longer-term appproach; in consequence, medium-term scenarios would prove useful in projecting a more fundamental image of the economy in future years. At the same time, in recent years, world economic problems had become more intense and the outcome more unpredictable.

Indeed, the complexity of economic, social, and political forces at work had become so apparent that the staff had said that planned or implemented policy changes might at times have been inappropriate to cope with the emerging structural problems, Mr. Kabbaj noted. Such events would require either frequent revisions of medium-term scenarios, or the use of more than one scenario to allow for any possible divergence of economic variables from their predicted path. Such flexibility would acknowledge the unenviable position in which many national authorities found themselves of having to cope with unexpected deterioration in their economic performance brought on by exogenous factors, and thus having to face the nonobservance of performance criteria for reasons largely beyond their control. Furthermore, the formulation of alternative scenarios would have the advantage of reducing the uncertain elements contained in any prediction that looked far ahead. Naturally, any alternative criteria should be adjusted toward more stringency or greater ease of conditionality, depending on circumstances.

With regard to the preference for early policy actions, Mr. Kabbaj remarked that in principle it would be sound to have early resort to corrective measures; the point had frequently been made in Fund documents. The important task was to strike a balance between the need for early adjustment and the social and political acceptability of such a program, taking due account of the existence of administrative machinery in each country with which to carry out the programs effectively. In brief, there was certainly a case for pragmatism and the recognition of the individual political and social climate in member countries using Fund resources. The divergences in political, educational, and social characteristics made it imperative to stress the cooperative nature of any adjustment program. The task of adjustment and the adoption of politically unpopular balance of payments corrective measures was not the responsibility of debtor countries alone. It was a global problem and, as such, involved both developing and industrial countries, as well as commercial banks and international financial institutions.

In considering the experience of those countries that had used Fund resources continuously, and the effect of such behavior on the revolving character of the Fund's resources, Mr. Kabbaj observed, the question arose whether it had become necessary to reconcile the objection to the continued use of Fund resources with the now standard provision in rescheduling agreements stipulating that during the rescheduling period, or any further extension thereof, a country should have in operation a Fund-directed adjustment program.

Finally, Mr. Kabbaj remarked, conditionality did not universally mean the introduction of corrective policies to steer an economy toward a viable balance of payments position. In many cases, the country was already following appropriate adjustment policies; what was needed was time and more financial resources to enable it to persist with those policies. In conclusion, he could accept the proposed decision.

Mr. Wicks considered that the two papers were rather somber. Although the period covered was quite a short one, he had noted the staff observation that, whatever the reason, the absence of clear progress toward balance of payments viability in the many countries having arrangements with the Fund implied that their capacity to effect timely repurchases of drawings from the Fund was not significantly enhanced during the period of the arrangement. The full significance of that sentence had yet to be perceived. While there had been some successes, for others the picture had been mixed and unsatisfactory. He did not conclude that the Executive Board should seek a fundamentally new approach. Rather, he would prefer to let the approach change in the light of current circumstances, while keeping a close watch on the medium-term perspective.

As to the substance of EBS/83/215, Mr. Wicks said that he could agree with the two paragraphs of the decision. The guidelines for conditionality were still appropriate and should be followed; he strongly endorsed the suggestion that medium-term scenarios should be produced. The attainment of a viable balance of payments position was, after all, the objective of the Fund's business, and it was important to know how it could be achieved in particular cases. Such scenarios should be just as much a feature of one-year programs as of three-year programs. They should clearly not be mechanical, but they must be drafted sensitively to local political conditions. Any such scenarios should be both indicative and illustrative.

He welcomed the growing practice of holding reviews midway through a program period, Mr. Wicks observed. While the practice would create additional work, it was better to set out broad policy objectives for a country, then review progress in a Board discussion, and finally settle the detailed program criteria during each review. It could certainly be argued that reviews and performance criteria could be set for a 12-month period. But in the present uncertain climate and in view of the fact that a number of members continued to meet all the performance criteria under a program while failing to make the desired adjustments, a better approach in difficult cases would be first to set firm performance criteria for, say, six months, and to provide only indicative performance criteria for the second six months. The indicative criteria could be approved during a review that would simultaneously suggest indicative criteria for a later stage of the program. Naturally, if circumstances were to change, the earlier performance criteria would also have to be changed.

In difficult circumstances, Mr. Wicks considered, it could be desirable for the Executive Board to have an opportunity to express a view about the design of programs well in advance. Such a procedure had been effective in connection with Portugal earlier in 1983; it might avoid problems with other countries by giving the staff an opportunity at an early stage to know Executive Directors' views on the fundamentals of a program that it would be designing.

Regarding waivers and modification of performance criteria, Mr. Wicks stated, they should continue to be used only when performance criteria had been technically breached, rather than on the occasion of more fundamental lapses. An example of a technical breach would be an unforeseen delay in capital flows resulting from rescheduling, although in that event he would wish to be clear that the finance would be forthcoming, and that deviations from the program would be reversible inside the program period.

He also believed that early policy action was correct, Mr. Wicks mentioned. Indeed, if prior action could not be taken, there should be a close synchronization of policy actions with program drawings. In other cases, initial drawings might be postponed until some specified performance criterion had been met. In all cases, the staff would have to justify any front-end loading of drawings that it intended to suggest to the Executive Board.

As to the choice between a stand-by arrangement or an extended arrangement, Mr. Wicks remarked that, in general terms, extended arrangements were appropriate only when certain conditions were met. The first would be that a member could provide a comprehensive and realistic program for a full three-year period. Second, the program should be so strong that unforeseen developments were unlikely to cause its breakdown. Third, the administrative system, particularly in the financial field, should be sufficiently developed and flexible enough to give confidence that the adjustment program could be effectively carried out. Those were quite difficult commitments, and in most cases it would be better to take advantage of the greater flexibility offered by a series of stand-by arrangments. Stand-by arrangements could give proper emphasis to essential short-term measures, while incorporating supply-side actions that would not yield fruits until the medium term. If the Fund undertook a series of stand-by arrangements with a member, the arrangements ought to be framed in a medium-term adjustment context.

There were two criteria in the decision on extended arrangements under which members might draw from the Fund, Mr. Wicks noted. One was that there should be serious payments imbalances relating to structural maladjustments, the other that slow growth and an inherently weak balance of payments position should be preventing pursuit of an active development policy. The staff ought to examine each application carefully and explicitly against those criteria. Moreover, if the Fund made a commitment to provide credit to a member for a three-year period, to be repaid over a period of between three and ten years, the adjustment path for the whole three-year period should be clearly delineated from the outset of the arrangement. Structural adjustment measures should be initiated in the early stages of extended arrangements. The decision indeed stated that the entire program had to be adequate for the solution of the member's problems. His conclusion was that an extended arrangement should not be predicated on the assumption that there would be a follow-on program to correct any remaining imbalance in the balance of

payments position. If the situation was such as to appear to require, in advance, a further program with the Fund, a series of stand-by arrangements should be used.

Regarding the respective roles of the World Bank and the Fund in balance of payments adjustments over the medium term, Mr. Wicks remarked that the Fund's role was clearly centered on macroeconomic changes. However, macroeconomic adjustments would often not be fully effective, or would take longer to materialize, unless they were accompanied by a program of microeconomic reforms in such matters as state enterprises, energy policies, agricultural marketing, and the like. Those areas were within the World Bank's field of competence and eligible for structural adjustment loans. He hoped that consideration would be given to an approach whereby extended arrangements were normally accompanied by a structural adjustment loan or some other World Bank device that would help to tackle the necessary microeconomic reforms, as had been done, for instance, in Yugoslavia and Turkey. He understood that it would not always be possible for the World Bank to present a structural adjustment loan. For instance, the World Bank did not have sufficient resources to finance a structural adjustment loan for a country such as Brazil. On the other hand, it would be wrong to argue that a country such as Brazil should not have the benefit of the policy advice that went with a structural adjustment loan.

He concluded from his analysis that there was a gap in the combined approach of the Fund and the World Bank, Mr. Wicks went on. If there was a small country for which a structural adjustment loan was appropriate, the two Bretton Woods institutions together could marshal the financial and technical resources to deal with the country's problems. However, for a large country it was harder for the Fund and the World Bank to act as they would like, because they had insufficient resources. Executive Directors had heard earlier in the day how the Managing Director had given advice on the financial control of parastatal enterprises in Brazil. While he was glad that the Managing Director had been able to do so, that was the type of matter with which the World Bank was competent to deal. The point he had been making was that macroeconomic reforms and microeconomic reforms should go hand in hand; if the Fund and the World Bank together did not have sufficient financial resources, they could at least provide appropriate advice.

Taking up the problem of countries that had become regular users of Fund resources, Mr. Wicks noted that the staff had suggested that, on the occasion of the next review of the Fund's conditionality, the Board ought to examine the topic more closely. His authorities, however, felt that the matter needed earlier attention. In view of the Fund's limited resources, of the difficulties encountered by the countries concerned and of the need to preserve the revolving nature of the Fund's assets, he agreed with Mr. Laske and Mr. Joyce that Executive Directors should discuss a paper on the topic well before the next review of conditionality. Indeed, he hoped that the discussion could take place soon after the discussion on access to the Fund's resources, meaning early in the new year.

Mr. Tshishimbi commented that the review of the experience with the Fund's upper credit tranche arrangements was being undertaken at a moment of great uncertainty in the world economy. At such a time, there was a natural tendency to be more cautious. Executive Directors were rightly concerned by the liquidity prospects for the world as a whole and for the Fund in particular. It would however be unwise to allow the Fund to become the victim of the liquidity syndrome, to the point of reversing the progress already achieved in improving adjustment programs supported by the use of Fund resources, or by imposing excessive conditionality on the Fund's members. While he agreed in general with the thrust of EBS/83/215 and EBS/83/216, he had comments on certain aspects.

The two papers, Mr. Tshishimbi went on, clearly showed that not all programs approved in 1981 had been failures; several had had a happy ending or were about to do so. The staff had indicated that countries having successfully implemented planned adjustment measures had done so by acting early and through flexible policies. At the same time, the staff had thrown some doubt on the adequacy of the design of certain Fund programs. It was being claimed, for instance, that overoptimistic projections for export growth during the program period had led to the adoption of a more gradual adjustment path than one that would have been appropriate in the circumstances. The widespread lack of data and the fragility of the administrative apparatus, as well as the limitations of some of the instruments employed, were cited as major constraints on the attainment of adjustment objectives. He agreed with the general thrust of that assessment. The commodity price forecast, for instance, seemed very uncertain, and no one had so far developed a satisfactory model. He also recognized that in some countries with Fund programs the administrations were not very efficient; but that situation only pointed to the continued need for technical assistance, a matter on which the Fund had indeed been helpful. As to commodity price forecasts, he could only express the hope that the staff would take note of the uncertainty surrounding such forecasts and perhaps look at ways of improving them.

He had been rather perplexed on reading the staff's statement on page 4 of EBS/83/215 that the policy changes being planned and implemented were sometimes inappropriate or not sufficiently strong to redress the problems to which they were directed. The staff seemed to be advocating a shift from extended arrangements to one-year stand-by arrangements. One of the reasons why extended arrangements had not been as successful as one-year arrangements was that the complementary actions, including investment programs supported by the World Bank, had not materialized or had been unduly delayed. In addition, the monitoring of extended arrangements had so far been subject to the same kind of performance criteria as stand-by arrangements. In his view, the criteria for extended arrangements should take account of the special nature and the objectives of those programs. Particular emphasis on a criterion applicable to structural inadequacies would certainly contribute to improving the monitoring of such inadequacies. Perhaps the staff could look further into that point.

Extended arrangements should remain part of the Fund's armament, Mr. Tshishimbi urged. In view of the staff's own emphasis on the need to develop medium-term scenarios as a way of identifying the feasible path to a viable external payments position, he would support a greater use of extended arrangements for countries that needed structural adjustment, and he would endorse everything that Mr. Wicks had said about collaboration between the World Bank and the Fund in support of medium-term programs.

The analysis provided by the staff showed that the amount of adjustment that remained to be accomplished when programs had been unsuccessful was substantial, Mr. Tshishimbi noted. It was indeed so substantial as to constitute a matter of concern, and the staff had presented a number of suggestions to deal with the problem. Regarding the identification of a viable external payments position, he agreed with the staff that adjustments should be designed to achieve a viable balance of payments position in the medium term, while keeping inflation under control and establishing conditions for sustained economic growth. In view of the uncertainties that usually surrounded the projection of important variables in the medium term, he was not convinced that it would be at all helpful to lay down at the outset of the program all the specific measures to be taken during the course of an arrangement extending over a period lower than a year. Such a procedure seemed likely to make it difficult to implement the program as a whole. It would be more practicable to continue to explore the feasibility of adopting additional measures at the time of program reviews. He had been attracted by the idea of establishing firm criteria for the first half of the program and, on the occasion of the mid-term review, agreeing upon firm criteria based on the tentative criteria that had been set up at the beginning of the period. His chair would support the continued use of appropriate review clauses in extended arrangements.

As to the speed of adjustment, Mr. Tshishimbi said that he agreed in principle with the statement on page 6 of EBS/83/215 that adjustment could be orderly only if it was programmed to take place sufficiently fast to keep the demand for exceptional finance throughout the program period within the limits of prospective supply. However, he did not accept the implication that more of the required measures should be taken in the early stages of the program. As the staff had correctly mentioned, some measures could only be spread out over the entire program period. Pushing measures through in the early stages of a program might sometimes overburden a country and result in the accumulation of payments arrears, which the program had been intended to reduce in the first place. The pace of adjustment should remain adapted to the economic circumstances of the country concerned.

Commenting on the way in which adjustment programs should be monitored, Mr. Tshishimbi noted that the staff had mentioned continued use by the Fund of prior actions, performance criteria, consultations, and reviews. More recently, the use of prior actions and reviews had been intensified, although waivers and modifications of performance

criteria had also been approved when necessary. The staff had raised the question whether there should be any change in the rate of adjustment in the remaining period of a program that had been interrupted. Alterations of that kind could easily lead to a softening of the overall adjustment, something that should not be precluded beforehand. Clearly, any review of the adjustment should be carried out on a case-by-case basis.

The staff had seemed to suggest that after a prolonged interruption of a member's right to request purchases under an arrangement, purchases should be rephased for the remaining period, Mr. Tshishimbi stated. For his part, as long as a country had a balance of payments need, even after an interruption of a program, he did not clearly see the reason for reducing the amount of resources that should be available to the country when it regained its right to draw, the more so as the country in question might well have accumulated considerable financing requirements at that time. In conclusion, he had no difficulty in supporting the proposed decision.

Mr. Yamashita stated that he could broadly associate himself with the views presented by the staff in EBS/83/215 and could support the proposed decision. The adjustment programs under review had been adopted in difficult economic circumstances. In view of the continuing changes in the economic environment and the reappraisal of economic policies in many countries, it was difficult to make a complete review of the programs or to classify them into two simple categories, successes and failures. Nevertheless, as the staff had suggested, the degree of success of the program in promoting progress toward balance of payments viability depended upon the way in which the originally planned adjustment policies had been followed. The sustained implementation of policies, the early adoption of policy actions, and the degree of flexibility of policy formulation, especially in response to emerging difficult circumstances, had been among the main factors leading to success. Another important factor had been the appropriateness of the original program design. Naturally, program design had been influenced by conditions within the country, the lack of data being a particular hazard not only in designing programs but also in implementing and monitoring them. Where there was room for improvement in that field, the Fund should be prepared to assist members with the collection of data needed for designing programs.

The staff had put forward the view that more use should be made of medium-term scenarios in identifying a feasible path to a viable external payments position, Mr. Yamashita noted. He could agree that the use of medium-term scenarios could be helpful. Indeed, the staff had made important progress in recent months in presenting medium-term analyses of the prospective debt service burden in most programs. Nevertheless, it was important to remember that medium-term analyses were subject to various uncertainties. The staff would do well to present more explicitly whenever possible the assumptions underlying the analyses based on scenarios.

As to the need for early policy action, Mr. Yamashita considered that early action was essential for promoting rapid adjustment. It could also contribute to normalizing the financial relations of the country concerned. As to whether extended arrangements were useful, he certainly believed that they could be useful in certain cases. Such assistance should in no way be regarded as development finance. In view of the need to preserve the temporary and revolving character of Fund financing, it was essential that agreed criteria should be met when assistance was provided under extended arrangements. In particular, countries should contemplate making significant progress toward balance of payments viability within the period of the arrangement. Some degree of front-loading of measures in a program would be desirable in order to provide a buffer against legislative delays or other forms of slippage. He had noted Mr. Blandin's observation at EBM/83/155 to the effect that the front-loading of policy measures might run the risk of leading to a "quick fix." Nevertheless, he favored some degree of front-loading of measures in view of recent experience with a number of programs. In brief, he fully associated himself with the views put forward by Mr. Wicks regarding the use of extended arrangements. An appropriate relationship between extended arrangements in the Fund and structural adjustment loans in the World Bank should also be further explored.

On a more technical point, the staff had referred to a problem arising when purchases were postponed or interrupted under multiyear arrangements, and when large undrawn balances accumulated. A member with inappropriately large amounts available when drawing rights were restored after prolonged failure to meet performance criteria should in certain cases have to accept rephasing of purchases as part of a necessary review of its right to continue requesting purchases. He hoped that the staff would explore the matter further. At the same time, in some other cases, a Fund member might need to draw the full amount available at the time of the restoration of its right to draw, to meet large immediate financing needs. Finally, he could fully support the proposal that the next review of upper credit tranche arrangements should focus on the experience of members that had used Fund resources continuously for several years.

Miss Batliwalla noted that the review focused on the evaluation of some 27 upper credit tranche arrangements, both stand-by arrangements and extended arrangements, entered into in 1981; and that it came to the same disheartening conclusion as previous recent reviews, namely, that a number of countries had achieved little or no progress toward balance of payments viability during the period covered by an arrangement with the Fund. Moreover, in some cases where progress had been achieved, the quantum of adjustment remaining to be accomplished was still substantial, so that several countries had had to make continuous use of the Fund's resources over an extended period. Such discouraging performance had led the staff to put forward a number of suggestions for ways in which future arrangements could be strengthened, primarily with a view to ensuring the revolving character of the Fund's resources. She had serious reservations regarding the conclusions that the staff had drawn from the review.

She did however agree with the observation set out on page 2 of EBS/83/216 to the effect that the assessment should be regarded as preliminary and tentative because the time frame was so short, Miss Batliwalla continued. Further in-depth study was called for. There was no way of knowing from the review whether the policy recommendations put forward by the Fund had been adequate in relation to the conditions prevailing in individual countries, and the measures suggested for strengthening future arrangements did not logically flow from the staff's analysis. For instance, to equate strong or early action with success and weak or delayed action with failure was not very helpful. It was more important to know whether the structure and content of the programs had been suitable for achieving the kind of adjustment that was envisaged. For instance, it would be interesting to discuss the extent to which flaws in the design of the program or exogenous developments had contributed to the lack of balance of payments adjustment. In more general terms, there was little information on whether the policy mix of the programs was of the right sort. A more detailed cross-country analysis should be carried out, with emphasis on the reasons for the failure of programs in certain countries that had met the criteria suggested by the Fund, and for the success of countries that had not fulfilled the performance criteria. Only after such a study would it be possible to take informed decisions on conditionality for the future.

While she shared the staff view set out on page 2 of EBS/83/215 that the implementation of adjustment programs should be assessed in relation to medium-term balance of payments viability, Miss Batliwalla asserted, she felt that the staff should take into account the impact of exogenous factors, both internal and external, whether positive or negative, beyond the control of the authorities. Such a step was particularly important during a period in which program expectations regarding the external environment had proved significantly wide of the mark. Progress might not seem to be unduly delayed if appropriate allowance were made for such deviations.

The staff had concluded that countries that had succeeded in implementing adjustment measures were generally more successful in moving toward a better balance of payments position than those that did not, Miss Batliwalla observed, although the extent of the improvement sometimes fell considerably short of what had been intended at the outset. The staff's conclusion was not borne out by analysis. That success had not been universal suggested that the nature of the programs and the policy prescriptions needed to be continuously examined; it could imply that the original targets were either too high or inappropriate. The staff had gone on to observe that, while exogenous developments could be adverse to a country that had entered into a program with the Fund, they did not have a systematic effect on the progress of the arrangement. Such an observation needed to be tested further. It was at least necessary to examine the underlying factors that had made a program

successful, even in cases where additional adjustment was necessary owing to a deterioration in the external situation, in comparison with those cases where the authorities had been unable to cope with the external deterioration.

It seemed rather mechanistic to conclude, as the staff had done at the bottom of page 3, that a relatively favorable view of export prospects at the beginning of a program might have contributed to the adoption of policies aimed at a more gradual adjustment path than had proved to be appropriate, Miss Batliwalla stated. The adjustment path had to be related to what was feasible and accessible for a member in a given situation. It would be naive to insist that the desired progress should take place regardless of the circumstances. The interdependence of nations and the policies followed by the rest of the world needed to be taken into account; in appropriate cases, the adjustment period should be extended and the objectives modified.

Commenting on the issues set out for discussion, Miss Batliwalla noted that the staff had suggested the need for medium-term scenarios to identify feasible paths to a viable external position. The staff was after all already identifying such scenarios to a varying degree. While she believed that a medium-term scenario would be useful for identifying an adjustment path, her authorities were of the view that, in the light of the uncertainties of both internal and external situations, judgments regarding viable balance of payments positions needed to be modified from time to time. In present circumstances, it was difficult to undertake realistic medium-term scenarios. There would be a number of plausible alternative projections of key variables over the medium term. Thus, in charting a tentative adjustment path, the Fund should be particularly careful not to become the prisoner of its projections; it should instead build into the scenarios an element of flexibility. It would be desirable if more work could be done to improve forecasting techniques and thereafter to prepare a central scenario with alternative variations, which would help in devising an appropriate adjustment strategy.

The staff had also suggested the need for early policy action as a means of strengthening adjustment strategy and enhancing the likelihood of attaining program objectives, Miss Batliwalla observed. The staff had however not clearly shown whether the adoption of early policy action was either necessary or sufficient for the success of Fund programs. There was in her view a misplaced emphasis on preconditions for securing program implementation. Overinsistence on preconditions could dissuade politically weak governments from approaching the Fund and could thus be counterproductive. The staff seemed to envisage that the scope of prior action could be very wide, ranging from the adjustment of the exchange rate, changing the interest rate, and altering the cost of energy to the removal of restrictions and the introduction of new taxes. The use of preconditions on an extensive scale as a means of securing rapid adjustment might be politically unacceptable. The nature of policy commitments in broad terms was included in the letter of intent. She did not really understand what the staff had meant by suggesting an

advance statement of specific additional measures to be taken during the course of an arrangement. Her authorities felt that it would be a retrograde step to stipulate more specific requirements in that connection; such requirements would in most cases compromise the authority of legislatures while seriously constraining the new mobility of the authorities to achieve the objective through alternative strategies. Insisting that policies be implemented at an early stage in the program might also make governments more reluctant to undertake the necessary adjustment later, and might create a situation of unnecessary confrontation between governments and the Fund. Such front-loading of conditionality could result in countries shying away from the needed adjustment. Extreme caution and detailed analysis were called for in introducing any such prescriptions.

The limitations of financing had recently led to excessive emphasis on the speed of adjustment without regard to the world economic situation, Miss Batliwalla considered. It ought to be recognized that chronic disequilibria built up over a long period were not amenable to any rapid elimination. To try to act overhastily could entail higher costs in terms both of growth and of unemployment, in turn jeopardizing the smooth growth of the international economy. There was greater merit in adopting a gradual approach than in opting for draconian measures that sought adjustment in quantum jumps. In that respect, it might be useful if the proposed study also examined the experience of previous programs with varying speeds of adjustment.

In view of the uncertainties relating to economic development even in a single year, rigid and mechanistic emphasis on adherence to performance criteria was likely to lead to avoidable disruptions in the smooth management of the economy, Miss Batliwalla considered. As long as a program was moving smoothly along the broad lines intended, a flexible approach to waivers and modifications would be helpful. A degree of flexibility could be provided in respect of performance criteria through an understanding that temporary breaches thereof within certain limits would be disregarded more or less automatically if the overall implementation of the program was on track. Such flexibility would improve the prospects for the success of the program.

She had detected in the staff recommendations an intention to overcome the resource constraint by seeking to reduce the undrawn amounts under multiyear arrangements on the ground that the program had been interrupted, Miss Batliwalla said. As the drawing rights were restored only after consultations between the Fund and the authorities, so long as a program was in force and there was a balance of payments need, she was not convinced about the desirability of reducing the overall purchases agreed upon. The member had already suffered because of the interruption of purchases; to inflict further hardship for a reduction of the agreed total purchases would not be an imaginative way of tackling a situation in which the Fund would undoubtedly be required to play a wider role, particularly if the balance of payments need had not diminished. Authorities in her constituency felt that countries should not be denied such accumulated resources. Like Mr. Blandin, they felt that the introduction of any rephasing would be counterproductive.

The relative absence of waivers and the small number of interruptions of Fund programs was a reflection of the severity of the conditionality being applied at a time when aid flows had fallen and the recycling mechanism had come under strain, Miss Batliwalla commented. The extent to which Fund programs had been effective in relation to their stated objectives of bringing about balance of payments adjustment was a moot question, even in cases where performance criteria had been met. The review indicated that balance of payments adjustment had been minimal: in an overwhelming number of cases, exports had not increased, and so-called adjustment had come about, if at all, through the excessive compression of imports, with its concomitant impact on growth. The present adjustment strategy seemed to sacrifice growth for adjustment. If structural adjustment was to be successful, it would have to be accompanied by the provision of resources over a long period, so that countries could work their way onto a sustained growth path; such a strategy was unlikely to be detrimental to the revolving character of the Fund's resources. The term "revolving" was not synonymous with "short term"; it only emphasized the requirement on the part of a member to repay in full and on time. After all, there was no evidence that the Fund's resources had ever been in jeopardy. According to EBS/83/216, the net use of Fund credit had been outstanding for more than 15 years in only two of the 27 countries under review, and for more than ten years in seven cases. While she had no objection to the staff's examining the question of the context of the next review, she did not believe that the matter posed a serious problem for the Fund. In fact, such a low figure at the height of the current world recession spoke well of countries seeking adjustment with Fund assistance.

The present review had brought to light the poor record of extended arrangements that had foundered on the rock of conditionality, Miss Batliwalla observed. Like Mr. Lovato, she felt that the present review had overplayed the success of one-year arrangements. The interruption of several extended arrangements had apparently influenced the staff toward giving preference to one-year arrangements over multi-year arrangements. It was however unwise to de-emphasize a policy that offered long-lasting adjustment. Shorter programs provided too little scope for change, and successive one-year stand-by arrangements were not a suitable alternative to the formulation of an integrated long-term strategy, for there was always the uncertainty of whether annual stand-by arrangements could be repeated. When structural adjustment was called for, her chair continued to hold the view that one extended arrangement could do more than three successive stand-by arrangements. It therefore viewed with some concern the front-loading of conditionality in extended arrangements.

In brief, Miss Batliwalla resumed, the staff's logic seemed to be that the greater the dislocation in the external accounts, even when due to exogenous factors, the speedier and more stringent should the adjustment effort be. The study did however not seem to provide sufficient grounds for such a conclusion. It had to be recognized that the optimal pace of adjustment for many developing countries under differing external

conditions would have to be longer than that for industrial countries, and the global recession, the decline in trade and capital flows, and high interest rates, had necessarily elongated the adjustment process. She would therefore specifically urge that in the application of the existing guidelines on conditionality, the Fund staff, the management, and the Executive Board should take a realistic view of the economic situation of a member and the world at large before deciding what was economically feasible in view of the political, social, and institutional circumstances.

Taking up the proposed decision, Miss Batliwalla noted that the paper was intended to be a review of upper credit tranche arrangements. In order to come to any judgment whether the provisions of the extended facility remained appropriate or not, a far more comprehensive review would be required. Her chair felt that there was a case for adopting a less rigorous conditionality than at present. Regarding the second part of the decision, which proposed an examination of the appropriateness of the provisions of the extended Fund facility and the guidelines on conditionality, with particular reference to the importance of ensuring the revolving character of the Fund's resources, a comprehensive study of all aspects of conditionality would be required. She presumed that the review relating to the revolving character of the Fund's resources mentioned in paragraph 2 of the decision referred in particular to continued use of stand-by and extended arrangements. She would prefer to await the results of the study requested by Mr. Wicks on that point, instead of making the review part of the proposed decision.

Mr. Nimatallah remarked that the recent reviews had been helpful in pointing to necessary improvements in the design and implementation of Fund-supported adjustment programs. The changes had included the greater use of one-year arrangements, prior actions, review clauses, and performance criteria applying to specific policy changes. The present review showed that those modifications had already started to yield positive results. There was of course scope for further improvement in performance in certain areas. The immediate balance of payments objectives under Fund-supported programs had been broadly met in most cases. Yet those objectives had been attained in many instances at a substantial cost, and even then objectives had been reached more as the result of exogenous factors than of program design. For example, in the programs covered by the present review, exports had grown on average by 11 percentage points less than expected, while imports had risen on average by about 9 percentage points less than expected. The immediate current account targets had therefore been met but at a lower level of economic activity than had been programmed. Growth under the recent programs had been very low, only about 1 percent on average, clearly a cause for concern.

Equally important, the present review, like its predecessors, had shown that substantial adjustment still had to be undertaken in many cases at the end of the program period if balance of payments viability was to be achieved, Mr. Nimatallah noted. The central question was how the Fund could assist members to adjust in a dynamic growth-oriented

context. One of the suggestions made by the staff--that it should identify a sustainable balance of payments position and select an adjustment path toward it--was most helpful. Following such an approach, the external payments position of a country would be projected over the medium term using various assumptions with exogenous variables and domestic policies. Subsequently, the policy variables could be modified to achieve a sustainable balance of payments position, depending on the behavior of the exogenous variables. Such an approach was both flexible and dynamic. It was also more conducive to achieving adjustment with growth than a shorter-term approach. The economic environment had changed. Because of the continuing recovery in the world economic situation and the persistence of debt problems, it might be necessary for the sake of flexibility for Fund programs to take into account the close links between adjustment and growth. There could be several balance of payments equilibria at each level of economic activity and income. As to the speed of adjustment, the correct rate seemed to depend on the extent of the imbalances in the economy of the country concerned. The topic was one that ought to be examined on a case-by-case basis. If the imbalances were extensive, more rapid adjustment would be needed to achieve balance of payments viability over the medium term. In such cases, prior actions would probably be needed to ensure the success of the adjustment effort. Experience had shown that early adjustment gave a country more flexibility and greater control over its future adjustment efforts. The longer adjustment was delayed, the more difficult the country found it to adjust later.

Regarding the topic of the existence of large undrawn amounts in multiyear arrangements, Mr. Nimatallah remarked that purchases were usually phased in line with the expected pace of adjustment. That pace could of course be interrupted to the point of disrupting the purchase sizes. There might therefore be reason in rare instances to rephase purchases under arrangements when the pattern of adjustment itself had been interrupted. However, in so doing, a number of considerations should be taken into account, including the reasons for the interruption of purchases, the length of the interruption period, the extent of the deviation from the expected performance, and the ability of the member to obtain financing from other sources. Furthermore, particular care should be exercised to ensure that the rephasing of purchases would not dissuade the member from putting the program back on track or disturb the expectations of other participants in the financing. The alternative of course would be to initiate a new program, which might not be any more agreeable to the recipient than rephasing.

Taking up the special criteria applicable to arrangements under the extended arrangement, Mr. Nimatallah remarked that it was true that experience under the extended arrangements approved in 1981 had not been encouraging. Five of the ten arrangements had been canceled, and problems had been encountered in most of the remainder. It was however also true that the world economy had gone through a difficult period since 1981. The international recession had been deeper and longer than many had expected at that time. Hence the climate for sustained adjustment had

been difficult. It would be wrong to draw conclusions based on the experience of 1981 alone, and to try to scale down the use of the extended arrangements accordingly. Extended arrangements had served member countries well in the past, and there had been some important and successful arrangements under the facility. Perhaps extended arrangements, ceteris paribus, were more successful at a time of economic growth and a more favorable international environment. Now that economic recovery was under way, the extended arrangements should be continued in suitable cases and in the right circumstances. If they were to have an improved chance of success, extended arrangements should be coordinated with the World Bank. Because of its emphasis on structural adjustment, an extended arrangement should be considered the ideal framework for cooperation between the Fund and the World Bank. He hoped that in the future there would be an input from the World Bank into the design and monitoring of structural adjustments at the microeconomic level in all extended arrangements.

The staff appeared to be suggesting a tightening of the criteria to be applied to extended arrangements, Mr. Nimatallah noted. While generally agreeing with the staff about the conditions that should be applicable to extended arrangements, he was troubled by the vagueness of some of the suggestions. The staff had mentioned, for instance, that the administrative structure should be in place before a country could qualify for an extended arrangement. If that meant that committees and similar devices were to be established within a country to monitor the implementation of an extended arrangement, the suggestion was reasonable. If, however, it meant that a sophisticated bureaucratic structure, something that required many years to establish, should be in place before an agreement could be reached on an extended arrangement, the staff would be asking too much. He therefore hoped that the staff would be pragmatic and exercise flexibility in applying any such criterion.

Finally, Mr. Nimatallah observed that he supported the suggestion that the staff should modify the format of future background papers so as to capture longer periods for the analysis of program experience. He also supported the proposed study on countries that had made continuous use of Fund resources over a prolonged period. He expected the study to examine why those countries had had to use Fund resources continuously for so long, including the design of their programs. He could support the proposed decision.

Mr. Erb remarked that, as many Executive Directors had said, the primary objective of any Fund adjustment program was the achievement of a viable balance of payments position. In addition, Directors had noted that Fund programs usually aimed at reducing inflation and establishing improved conditions for economic growth. The staff was also correct in underscoring the importance in Fund programs of establishing improved conditions for economic growth within the scope of external resources that were available. He would put the matter more strongly than the staff by emphasizing the importance of price stability. However, he would have liked to see explicit reference to, and analysis of, the

objective of avoiding measures such as exchange or trade restrictions that might have destructive effects on other countries. As he had said before, his chair did not view the Fund's financial resources either as an inducement or as a reward for adopting policies designed to achieve a sustainable balance of payments position and sustainable growth. The policies devoted to achieving those ends should be perceived as being in the interests of the countries themselves. Individual countries ought to assume responsibility for the policies that they pursued. The Fund could not impose policies on a country, but it could decide whether it wished to lend and, contrary to popular conception, when the Fund lent money, the adjustment effort in the recipient country tended to ease. As the Fund's approval of a country's policies usually acted as a catalyst for other sources of finance, the country's overall adjustment was eased still further.

He agreed with the staff, Mr. Erb remarked, when it pointed out that successful--and enduring--adjustment efforts required a political commitment and follow-through on the part of governments. Thus, the Fund should do more to encourage governments to inform and educate their public on the need to adjust, and on the consequences of not adjusting. The Fund should not willingly accept the role of scapegoat, nor should it allow itself to be blamed for the adjustment that a country had to make to live within its available external financial resources and improve overall economic performance.

Taking up the various issues raised in the staff paper, Mr. Erb remarked that the staff had defined external payments stability as the attainment of a current account deficit that could be financed by normal capital flows in light of the foreign reserve target. Although they were probably implicit in the staff's definition, two additional elements ought to be explicitly incorporated in the concept of a viable payments position. First, a country's external financial position, including its official asset/liability position, should be sufficiently strong to enable the country to weather likely fluctuations in current and capital account flows. Second, the country should be able to refinance the debt that would fall due in future years. The staff should explicitly cover all three elements when assessing whether and when a country would achieve a sustainable balance of payments position.

As his chair had advocated, Mr. Erb continued, the analysis of both one-year and multiyear programs should be placed in a medium-term context. On the question of medium-term analyses, like other Directors, he believed, first, that the staff should be explicit about the key assumptions that it had been using when simulating a country's medium-term prospects. Second, in view of the difficulty of forecasting hypothetical situations, it might be useful in some cases if the staff would present alternative scenarios, perhaps with a base case showing the balance of payments prospects in the absence of appropriate policy adjustments. Third, the staff should be quite explicit about which policy adjustments were most necessary for promoting balance of payments adjustment and restoring the domestic conditions for economic growth. What he would

like to see contained in staff papers would be the priorities that ought to be followed to bring about the adjustment of the balance of payments approach. In brief, he wished both the staff and the Board to avoid a mechanical or "checklist" approach to conditionality.

Fourth, it would be useful in analyzing the policy context of programs for the staff to provide more technical background on its policy recommendations, including any behavioral relations and models used by the staff when assessing the impact of policies on balance of payments adjustment and economic growth. Finally, medium-term analyses should not be used as an excuse to delay adjustment.

He agreed with the staff that the analysis of the expected strength of the balance of payments at the time when repurchases fell due had sometimes not received sufficient attention, even in three-year extended arrangements, Mr. Erb stated. It would be desirable to have a more explicit discussion of how the country intended to repay the Fund.

Dealing with the topic of the speed of adjustment, Mr. Erb remarked that experience suggested that the Fund did not need to encourage countries to proceed cautiously when implementing their adjustment, nor was it necessary to encourage a country to be too optimistic about the future. If anything, the Fund should err on the side of encouraging strong adjustment at the outset of a program, usually the time when a government was politically in the strongest position to act. In addition to the degree of adjustment at the start of a program, the success would often depend on the ability and willingness of the government to adapt policies to changing circumstances. At the start of a program, it might be useful for the Fund staff to point out possible contingency actions, should developments turn out worse than expected. On the other hand, if circumstances turned out to be better than expected, the objective ought to be to strengthen the external asset liability position. As to monitoring adjustment programs, frequent communication between the Fund staff and governments was desirable. Whether in the guise of formal reviews or not, there should be a continuous process of consultation, with the staff keeping abreast of developments within the country. While regular reviews were appropriate, they should be timed in a way that fitted with the government's major economic decisions regarding future policy choices. There could certainly be too many reviews.

Regarding the undrawn amounts in multiyear arrangements, Mr. Erb stated that he agreed with the staff proposal to the effect that an explicit provision should be included in all multiyear arrangements that would allow for the possibility of rephasing purchases as part of the review after a prolonged interruption.

As to the extended Fund facility, Mr. Erb agreed with the staff that the facility should be used only in appropriate limited circumstances, and that the experience at least of the program in 1981 had not been very satisfactory. Like Mr. Wicks, he felt that the matter should be discussed in the near future if only because it was partly related to the

question of cooperation between the Fund and the World Bank, with particular reference to structural adjustment. It would be useful to discuss the kind of structural adjustment that would be appropriately financed within an extended arrangement by the Fund, and to identify other types of structural adjustment that would be more appropriately handled by a development institution.

On the suggestions for further work, Mr. Erb stated, the staff should examine more extensively the experience of those countries that had used Fund resources continuously for several years. He could also support the suggestion that future background papers should analyze longer periods than the period of the program and shortly thereafter. In that analysis he would include a description of the policies and events leading up to the program period as well as ensuing developments. The establishment of a medium-term framework of analysis as part of Fund programs and Fund surveillance activities should provide some useful inputs and background for the studies. In addition, it might be possible for surveillance reports to include a more systematic review of the consequences of having followed past Fund advice, and of not having done so. Bringing all the available advice together should make it possible to establish a better framework for individual countries in analyzing what policy adjustments had the most significant effect on the balance of payments and on establishing better conditions for economic growth. While the staff had done a good job in EBS/83/215 and EBS/83/216, there were surely other techniques for providing a more useful analysis.

Mr. Kafka welcomed the idea that Executive Directors should be supplied with medium-term scenarios showing feasible alternative paths to a viable external payments position in connection with each Fund program. While the staff had already begun to do something of the sort, he wondered whether scenarios would not be less useful than a sensitivity analysis of possible outcomes related to the various assumptions underlying the formula. In every case, it would be helpful if the staff made the assumptions as explicit as possible.

The timing of policy action and the speed of adjustment were functions of the amount of external finance available, Mr. Kafka considered. Care would have to be taken however that speed was not sought by unnecessarily harsh instruments, which might be counterproductive. In that connection, he agreed with the observations of Mr. Blandin and Mr. Joyce. Adjustment was a multifaceted matter that went beyond the balance of payments, a point that national authorities should take into account in constructing programs; and the international community as a whole needed to consider continuously the resources that it ought to contribute to promote adjustment. He agreed strongly on the need for extended arrangements in the circumstances mentioned in the decision. He supported the observations made by Mr. Blandin and Mr. Schneider on the delicate problems raised by the proposals to consider reviewing the size of access to interrupted programs. He would certainly not wish to see any automatic cut-off clauses. It was essential to study the

problem of the continuous use of Fund resources, and he therefore supported Mr. Wicks's call for an early paper on the matter. Once Executive Directors had discussed the paper, the staff could formulate proposals for later consideration.

The proposed decision was appropriate, and, like others, especially Mr. Finaish, he believed that the Fund's policies should continue to be applied flexibly in all respects, including those on the nature of conditionality, modifications, reviews, and the question of satisfactory administrative structures and political commitment, Mr. Kafka stated. Other points to be taken into account in assessing the particular circumstances of each member were the world situation as a whole, and the functional relationship that might exist between that situation and the situation of each individual member country. A new look not only at contingency clauses but also at the possibility of a wider and more independent use of review clauses would be appropriate. On a question of policy content, the Fund should be careful not lightly to disturb long-established exchange rate relationships, unless the case was demonstrated beyond any reasonable doubt.

Mr. Zhang remarked that, in reviewing the upper credit tranche arrangements approved in 1981, the staff had come to the conclusion that while many of the arrangements achieved substantial progress toward balance of payments viability, in others the picture was mixed or unsatisfactory. He was in general agreement with that evaluation, and would concentrate on six specific points.

Commenting on the design of a program, Mr. Zhang remarked that to identify a feasible path to a viable external payments position, the staff had rightly stressed the need to make more use of medium-term scenarios. However, in view of the uncertainties confronting the world economy, he wondered what assumptions should be used for projecting a medium-term scenario that might be considered realistic and reasonable. If the scenario was used to set targets for a program, it would have to take into account a broader spectrum of objectives that would include not only balance of payments equilibrium or the control of inflation but also the growth and pattern of output and particularly the distribution of income. In fact, in the 1981 arrangements under review, no explicit target on distribution of income was included, because the staff held the view that the Fund should take a neutral position toward distribution problems in countries. Those programs had however in practice entailed disproportionate changes in the income shares of different groups, with the shares of wage and other lower income earners as a rule suffering most. Experience had shown that in developing countries, because of the high import content of the consumption of high-income groups, a shift of income toward those groups would necessarily offset the intended restrictive impact of demand management on the balance of payments. Furthermore, it would be interesting to know the extent to which, in designing a program, the Fund had normally accepted the government's judgment as to the priority to be given to various objectives, targets, and strategies. How would differences be resolved?

Among the instruments of adjustment, devaluation had often been given pride of place, Mr. Zhang noted. However, in recommending devaluation, its effects on domestic prices, and hence inflation, were generally underplayed in order to highlight its impact on restoring the competitiveness of the country's exports and on restraining its demand for imports. He wondered whether all the relevant elasticities had been estimated before the final decision on devaluation was taken. Furthermore, the present devaluation policy advocated in Fund programs, if applied too generally and too readily, would eventually lead to competitive devaluations by individual countries.

The raising of interest rates had been increasingly relied upon as a principal adjustment instrument, Mr. Zhang said. As shown in earlier Board discussions on the topic, the effects of interest rates on saving in the developing countries tended to be weak and uncertain.

For supply-side adjustments, the measure generally employed in Fund programs had been price incentives that implicitly assumed that supply could and would respond promptly to changes in prices, Mr. Zhang remarked. However, in practice, because of the rigidity of the economic structures and supply bottlenecks in most developing countries, production was slow to respond to any stimulus, including changes in price structures. That was one of the reasons for the disappointing results in many adjustment programs.

As to the speed of adjustment, Mr. Zhang observed that the staff had concluded that the speedier the process of adjustment, the better for the country. In other words, a country should be subject to a form of shock treatment. However, experience had shown that such treatment could be costly to the country concerned and that the desired results might not always be realized as programmed. Excessively speedy adjustment could not be expected to work effectively in most developing countries, where the structures of domestic demand and supply were rigid, and world demand for their exports was generally weak and stagnant. On the contrary, for those countries a multiyear program of structural adjustment or an extended arrangement would clearly be more relevant. In that connection, he did not agree with the staff's assertion that such programs should not be prescribed for a country unless, in its judgment, there was political support, and the requisite administrative structure existed.

Taking up the question of monitoring adjustment programs, Mr. Zhang observed that prior actions had assumed increasing importance in setting up a program. He wondered whether the change represented a trend toward tightening conditionality by the Fund. The staff had gone on to say that prior actions did not necessarily guarantee that an adjustment program would be implemented as planned. He wondered why not. One logical explanation was that the more fundamental structural problems of the developing countries could not be solved by quick-fix methods. In addition, ineffective prior actions could be quite costly to a country.

As to the setting of the performance criteria, he would like the staff to explain in general terms which factors governed the final choice between alternative quantitative specifications.

What factors were used to measure the degree of tightness of conditionality in a program, Mr. Zhang inquired and to provide the basis for intercountry comparisons? Judging from the changes in the level of lending, in the program duration, and in the policy content of the arrangements approved since 1981, it was evident that there had been a gradual tightening of conditionality in Fund programs over the years. If his assessment was correct, the facts would contradict the spirit of the proposed decision, which seemed to imply that no change in the degree of conditionality had taken place since 1981. In that case, he wondered whether the tightening of conditionality that had in fact occurred had been the automatic consequences of a continued application of the underlying principles adopted by the Fund.

The country data in Appendix A and in the accompanying charts at the end of EBS/83/216 deserved further analysis, Mr. Zhang considered. The meaning and significance of the deviations of countries from the 45 degree line in the charts should be systematically explained, and perhaps cross sectoral correlation analysis attempted. He hoped that the staff would look into those matters in future reports.

Mr. Teijeiro said first that he would support the proposal for a more intensive use of medium-term scenarios. It would be useful if such projections were accompanied by a detailed discussion of the assumptions that the staff had adopted and of the sensitivity of the projections to alternative assumptions with respect to key variables. Second, the case for early policy action could not be challenged. There had always been a case for such early action. Recent developments in the world economy might have affected the extent to which early action should be pursued, but each would have to be dealt with on a case-by-case basis. Third, he did not see convincing arguments in favor of including provisions in multiyear arrangements to enable the Fund to reconsider the use of undrawn balances. Fourth, he would join Mr. Feito and other speakers in their arguments for greater flexibility in facing a highly uncertain world. The case was particularly important for countries facing simultaneous negotiations with commercial banks. Not only should there be a more flexible use of waivers, but the adoption of other instruments might avoid undesirable repercussions that might arise from the grant of waivers. For instance, the usual arrears test put significant pressure on member countries to finalize loan agreements at a certain date, which might weaken countries' negotiating capacity. One form of alternative to a performance criterion, even with a waiver, might be to place an upper limit on gross reserves or hold a special review to deal with that factor during a program period. He had noted from EBS/83/216 that the most frequently waived ceiling in 1981 had been the external payments arrears test. Like Mr. Wicks, he had noted with satisfaction that in the Brazilian case, the nominal targets were set for periods of three months. That was another efficient way of approaching current uncertainties in a flexible manner. He supported the proposed decision.

Mr. Morrell said that he agreed with the proposed decision. He also agreed with Mr. Polak regarding the desirability of looking at the Fund's experience over a longer period of time. At present, Executive Directors had some difficulty with what was virtually a snapshot approach, looking at programs for a period of one year. While he would not wish the staff's review paper to be any longer, a greater use of tables might help to assess the outcome of the various programs.

As to the points for discussion, Mr. Morrell said that he would agree with most other speakers that greater use should be made of medium-term scenarios. It was important for Executive Directors to be able to see that a country would be on a viable path at the time the Board approved a program. However, as a number of Executive Directors had noted, there were certainly limitations involved in that process. Even the most sophisticated modeling was dependent on the quality of the exogenous forecasts, and he agreed with Mr. Erb that it was important to specify the key assumptions that the staff was making.

As to the extended arrangements, like others he had noted that less use was apparently being made of the facility, probably reflecting the difficulties of having to specify a policy path over a full three-year period, Mr. Morrell stated. Yet, at the same time as Executive Directors were seeing the difficulties of being able to specify a three-year scenario and appropriate policy measures, Executive Directors were asking the staff to make greater use of scenarios under one-year programs. Put differently, in making medium-term scenarios for one-year programs, the Fund was at least implicitly making assumptions about policy actions; yet when the question of extended arrangements arose, the institution was unable to make such explicit assumptions.

He agreed that it was desirable for countries to take both early policy actions and prior actions, Mr. Morrell observed. He did not believe that prior actions could be used to introduce a "quick fix." Such a thing was not really possible in the sense that, while measures might appear dramatic or severe, there was bound to be a considerable lag in their impact. Moreover, it was expecting a great deal of a one-year stand-by arrangement to achieve very much. Many measures could be introduced, but for them to have any actual impact was quite a different matter. Consequently, countries should take actions at an early stage, even before approval of the program by the Executive Board. Moreover, such a requirement should not be taken to imply a lack of confidence in the authorities. In that connection, he wondered how much work had been done on the lags that were inevitable between the time when measures were introduced and the time when they actually achieved results. An examination of the whole body of data that must have been built up on the Fund's stand-by arrangements and extended arrangements over the years should provide a basis on which to work in examining the time that was actually required to meet the criteria set out in the Fund's program. He also agreed that Directors should look at the experience of countries that had used Fund resources for several years uninterruptedly. However, he would not wish to see that work incorporated in a review of experience

of stand-by and extended arrangements for any given year. Nevertheless, he would join Mr. Laske and Mr. Wicks in asking that a paper on the topic should be undertaken in less than one year.

Regarding amounts undrawn in the event of a suspension of an extended arrangement or stand-by arrangement, and the rephasing of amounts set aside for multiyear arrangements, he had considerable difficulty, Mr. Morrell stated. He could see that a number of considerations told in favor of making it possible for undrawn amounts to be rephased. At a time when the Fund's resources were under considerable pressure, it seemed desirable to free for use resources that had been committed but were in fact unlikely to be used. At a time when the Fund was seeking resources from various sources, it should make every effort to ensure that the figures of amounts committed were not misleading.

Similarly, from the standpoint of liquidity management it was undesirable to have large amounts of resources committed, without knowing whether they would be ultimately required, Mr. Morrell observed. On the other hand, he could see that in cases like that of Brazil, where the Fund was involved in negotiations on the financing of a package, it was important to ensure that the resources would not automatically expire. If the Fund was expecting other institutions to finance a program over a period of a year, it was simply inconceivable that the Fund's share should be withdrawn because of failure of the country to meet all the performance criteria. Consequently, in some circumstances, it would be reasonable to introduce rephasing after a certain period, when there was no danger of disrupting an overall financing package in which the Fund had played a part. Similarly, he wondered whether it would be possible to have an expiry provision after a certain quite lengthy period, or whether in certain circumstances it would be appropriate to cancel programs and negotiate anew.

Mr. Ajayi remarked that the review of upper credit tranche arrangements was an important occasion, particularly for countries that had embarked upon Fund-supported programs. It had become even more important as many member countries continued to face severe external payments imbalances and were turning to the Fund for assistance. The objective of such reviews ought to be to take a critical look at the record, and, where deficiencies were apparent, to take practical steps to improve the situation. The basic question was therefore how to characterize the general performance of the programs under review. Once that question had been answered, the next step would be to compare the conclusion with the lessons learned from previous reviews. The staff had stated that, in view of the changing economic environment and the continuing reappraisal of economic policies in member countries, it would be inappropriate to make a clear-cut statement as to whether the programs had failed or succeeded. The justification for failing to make an assessment was not very convincing. It should be possible to decide whether or not Fund programs were successful, even in a changing international economic environment.

Having examined the performance record, it was his judgment that progress under the programs in general had been less than satisfactory, Mr. Ajayi stated. While considerable success had been achieved in reducing inflation, growth rates had generally been below program targets, and the apparent improvement in the external current account of countries pursuing adjustment programs had largely been a reflection of the compression of imports, which had had adverse consequences for investment and economic growth. The move toward a viable balance of payments position--the most important objective of Fund programs--was also under question, even in some cases where members succeeded in meeting most or all performance criteria, or had been the beneficiary of consecutive Fund-supported programs.

It was particularly interesting, Mr. Ajayi considered, that, despite the breach of certain performance criteria--sometimes by wide margins--a number of countries had been able to make some progress toward balance of payments viability, an indication that performance criteria should not be treated as sacrosanct, but viewed with flexibility as success or failure hinged crucially on program design. Consequently, the Fund should not hesitate to grant waivers or modifications of performance criteria when unforeseen factors that were known to be beyond the control of the authorities made it impossible to meet program targets.

It was a matter of concern, Mr. Ajayi considered, that 50 percent of the arrangements under the extended Fund facility approved in 1980 and 1981 had been canceled, especially as one of the major reasons for the Fund's having established the extended Fund facility had been to assist member countries in overcoming structural imbalances in their economies. While he agreed with the approach of incorporating policy measures aimed at increasing production, mobilizing resources, and improving their utilization in an extended arrangement, there was still the question concerning the extent to which the Fund's policy advice was consistent with the medium-term objective of structural change. When there were difficulties in meeting performance criteria, the blame should not necessarily fall solely on the member. It would be only proper to ask whether the targets were realistic, and whether the Fund should devise other approaches. While he could agree with the staff suggestion on page 12 of EBS/83/215, he would stress that the points listed for consideration by the staff were only a few of many that needed to be considered. Only six extended arrangements had been approved during 1982 and 1983, compared with ten arrangements in 1981. What appeared to be happening was a shift toward one-year arrangements. However, simply ignoring the need for structural adjustment did not mean that the problem would disappear; he himself did not believe that stand-by arrangements were the appropriate means of tackling structural adjustment.

As for the timing of adjustment measures, Mr. Ajayi said that he agreed that as a general rule it was in the best interest of member countries to take early corrective action whenever economic imbalances emerged. However, he had some misgivings about the conclusion that timely action called for most of the envisaged policy measures to be

implemented prior to the beginning of the program or in its first year. Indeed, the front-loading of adjustment policies might be counterproductive. Quite apart from the fact that some policies could be implemented only over an extended period, particularly when the problems addressed were structural, excessive rapidity might result in political resistance that could delay the adjustment process. Attempts to achieve rapid adjustment might also lead to mistakes in cases where the program design proved to be inappropriate. The issue did not boil down merely to prompt adjustment or delayed adjustment; some attention had to be paid to those factors that bore on whether or not a given adjustment path was practical in light of the peculiar characteristics of the country concerned.

It would be helpful if the staff could develop medium-term scenarios as a means of identifying the feasible path to a viable external payments position, Mr. Ajayi considered. However, he was not sure that it would be practicable to insist that the authorities should state in advance specific additional policy measures that they would take should it prove necessary to do so during the period of an arrangement. In many cases it had been difficult for the Fund to reach agreement on program measures; the difficulty would be compounded if governments were required to spell out additional measures in detail.

On the issue of undrawn balances under multiyear arrangements, Mr. Ajayi stated that he failed to see the logic behind the staff's suggestion that purchases of undrawn amounts accumulated as a result of a temporary interruption in the member's right to purchase under a multiyear arrangement should be rephased. Both the question of need and the Fund's commitments should take precedence over what might be construed as an attempt to limit access. If the review showed a balance of payments need, and the Fund was satisfied with the country's intentions, it should have access to the undrawn balance in full. While he understood the need for the Fund to conserve resources, that should not lead the institution to deprive deserving programs of already agreed financing.

The issue of the revolving character of the Fund's resources was an important one, and it should be correctly and liberally interpreted, Mr. Ajayi commented. It would be a mistake to consider a country's continuous use of Fund resources for several years as being contrary to the revolving character of the Fund's resources. However, while it would be instructive to discuss the topic in the next review of upper tranche arrangements, the purpose should not be to tighten conditionality further and deprive the members of the use of Fund resources. Rather, as Mr. Nimatallah had suggested, the review should explain why those countries had continued to rely on Fund financing, and what could be done to assist them to overcome the problems that might be identified as being responsible for the persistence of the situation. He could support the proposed decision.

The Director of the Exchange and Trade Relations Department remarked that the Executive Directors' statements had covered a broad range of issues. Many questions had been raised that it would be

convenient for the staff to answer by direct contact after the meeting. As to what the review should cover, and where future studies should lead, he agreed with those Directors who had suggested that the staff make use of the information that had been built up over a number of years. The time had clearly come for the staff to move away from a review of a single year's experience with stand-by and extended arrangements and to cover longer periods. However, it was important that in doing so the staff should not abandon its commitment to reviewing every arrangement as it came to an end, in order to see what lessons could be learned from it. He agreed with Mr. Feito that anything the staff could do to explain why it was recommending a given course of action would be both useful and necessary. Although much had been done in that field, much still remained to be done.

As to the work that the Research Department was undertaking, the Director mentioned that the Research Department had in progress one paper on the theory and design of financial programs and another on the quantitative aspects of stabilization policies. Both those papers were expected to be ready for the summer of 1984, and the staff expected to supplement the main papers with other studies that might arise from an examination of the material.

The staff certainly accepted the need to study the implications of prolonged or continued use of Fund resources, the Director stated. A paper on the topic would be made available in the spring of 1984. In its list of proposed topics for study, the staff had been focusing on a number of other issues. It had seemed clear to the staff in writing EBS/83/215 that it was important to explain that, when the Fund insisted on specific policy conditions, it did so in order to maintain the revolving character of the Fund's resources. Prolonged use of the Fund's resources called for appropriate conditionality. It certainly seemed worthwhile to study cases where there had been a continuous use of the Fund's resources. The staff would examine the available data, and put forward any recommendations that seemed desirable.

Commenting on the reaction of Executive Directors to the existing performance clauses, the Director remarked that Mr. Feito and some others suggested that the staff ought to rely more on automatic adjustment performance clauses. On the other hand, some Directors had said that what the Fund needed was simple performance clauses and that many of the present ones were too complicated. While it might be worth studying the possibility of automatic adjustment rather more closely, in current conditions the staff had been particularly impressed by the narrow margin of reserves available to many countries that had been using Fund resources. One reason for not suggesting the greater use of automatic adjustment clauses was that it was important to look at countries' policies. Even if the causes of their difficulties were exogenous, the countries had to react by changing policies. Otherwise, there could be a flight of capital. The purpose of the review should therefore be to provide an opportunity to the Executive Board for reassuring itself that the situation was moving satisfactorily. If the Fund was to play its catalytic

role, it was important for observers to know that the Executive Board had looked at the situation and decided that the countries involved had acted appropriately. The most important thing was that the review should be a cooperative effort to handle problems as they arose.

Some speakers had suggested that if there was to be a front-loading of policy measures, the Fund should also offer some front-loading of resources, the Director recalled. The topic could be discussed in greater detail in connection with the papers on access to the Fund's resources to be taken up in the coming months.

Taking up the topic of the medium-term scenarios, the Director remarked that the staff welcomed the endorsement given to the proposal. There was a great deal of work to be carried out in that field. The intention was to establish a working party with the area departments to review some of the problems that had arisen. In a one-year stand-by arrangement, it was fairly difficult to decide how firmly the policies agreed upon would be adopted, and consequently how much faith could be placed in medium-term projections without the policies already being in place. Nevertheless, in making policy decisions, the staff ought to have a view of the future. It would try to obtain one by drawing on its experience with member countries.

A number of questions seemed to indicate that Executive Directors wondered whether the staff was fully committed to multiyear arrangements, the Director commented. The staff recommended the continuation of the extended Fund facility. The problems that had arisen by no means weakened the staff's desire to offer extended arrangements on suitable occasions. The one aspect that had given rise to some feelings of doubt was the emergence of fairly large undrawn balances. What the staff had had in mind in describing that situation was simply to say that there was some inconsistency between the rules as they applied to one-year arrangements and those that applied to multiyear arrangements. The intention had been to point out the existence of the inconsistency and to return to the problem after the discussions on access to the Fund's resources. It was important to ensure that the resources available should be used consistently for all members on the basis of whatever policy on access was finally adopted. The access policy had of course to be applied uniformly, irrespective of whether a member had a one-year arrangement or a multiyear arrangement with the Fund.

Speaking on individual points, the Director of the Exchange and Trade Relations Department agreed with Mr. Erb that the staff had said less about trade restrictions and exchange restrictions than might have been desirable. In current circumstances, the staff was often so concerned to ensure that countries achieved a viable balance of payments position, in the sense of merely avoiding arrears, that it had not sufficiently stressed the importance of ensuring that countries avoided restrictions that might be related to balance of payments considerations. Certainly, a balance of payments position could not be considered viable unless restrictions related to balance of payments purposes had been

eliminated. As to whether the staff had been "trigger happy" on exchange rates--as suggested by Mr. Polak--the record did not support his comment. In examining the data, the staff had felt in some cases that the delay in obtaining improvements perhaps suggested that the staff had understated the need for improved incentives. Nor could he agree with Miss Batliwalla that the staff had been excessively aggressive on the exchange rate problems that had come before it in 1980 and 1981.

The staff representative from the Exchange and Trade Relations Department remarked that the staff had been able to deal with a number of technical questions outside the Board meeting. It had listened with great attention to the remarks by Executive Directors and would certainly structure the next review paper with those remarks in mind.

Taking up more specific points, the staff representative, replying to Mr. Feito's suggestion regarding the adoption of contingency provisions or automatic adjustment, noted that in very few cases where the staff had in fact introduced such clauses had they actually become operational. Thus one might wonder whether it was worthwhile to add an additional factor to an already complicated process. The staff would however continue to explore ways of using such devices whenever appropriate.

Some sentences in the papers had apparently been misunderstood, the staff representative from the Exchange and Trade Relations Department noted. Certainly, in noting the high "utilization" rate of stand-by arrangements during 1981, the staff had not meant to imply that the rate was in itself a criterion of success or failure of arrangements. Similarly, in juxtaposing performance with regard to target growth rates vis-à-vis the attainment of balance of payments targets, the staff had not meant to suggest--as some Executive Directors seemed to have inferred--that balance of payments adjustment had been sought at the cost of growth. Indeed, the frequently observed discrepancy between the targeted growth rate and the actual rate could well be said to suggest that the programmers had been making too much rather than too little allowance for growth. In any case, the actual growth performance of the countries with programs indicated that countries that had been successful in making more rather than less balance of payments adjustment had also been the ones where the growth performance had improved the most over the period immediately preceding the arrangement with the Fund.

The Chairman made the following concluding remarks:

> First, I think that everybody agrees that the guidelines on conditionality remain viable; they do not need to be amended at this point.
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> Second, more use of medium-term scenarios is obviously welcome as a means of assessing the viability of the external position of member countries and the proper path for reaching a viable position. I think it is fair to say that the Board feels that medium-term scenarios are a useful instrument for

determining the nature and the speed of the adjustment measures as well as for monitoring the execution of the programs against the medium-term path. But the Board also clearly stated that we ought not to be dogmatic or mechanistic, but on the contrary indicative and sensitive, in establishing these scenarios--scenarios that, of course, have to be tailored to the situation of individual countries--and that we have to be both pragmatic in using this instrument and careful in laying out the assumptions on which they are based. The staff should in any event be more explicit than it is at the moment in indicating the major assumptions on which these exercises are based.

My third point is that many Directors agreed that it is important to adopt suitable policies at an early stage. Personally, I very much share that view. The cost of delays in action, the natural lags between the adoption of policy and results, the scarcity of foreign resources, the need to restore or preserve external credibility, all militate in favor of early policy actions, which does not necessarily mean prior actions. It is however clear that, in proposing this concentration of action at an early stage of the program, the Fund must keep in mind what is feasible in the light of the specific circumstances of the country.

My fourth point concerns extended arrangements. There is clearly a difference of view among two groups of Executive Directors, who however do not make up the whole Board.

One group feels that there has been an undue reduction in the use of the extended Fund facility and a shift toward a more intensive use of a succession of stand-by arrangements. These Directors feel that the move is unfortunate in view of the structural problems facing many countries and the need to put more emphasis on medium-term adjustment.

The other group however feels that for the past two or three years the outcome of extended arrangements has not been favorable, and that this calls for great caution in the application of the policy.

I want to assure the Executive Board that management and staff will continue to apply the extended Fund facility decision in an unbiased fashion; but I do not believe that it is in the interest of member countries or of the Fund to engage in extended arrangements that are not related to well-designed programs covering the whole three-year period, programs that must be implementable in the ways described in the staff paper. The present circumstances make these conditions more difficult to fulfill than in the past, but we shall continue to apply the extended Fund facility policy with every hope of making it a success.

My fifth remark is on the uninterrupted use of Fund resources. I think it is clear today that Directors have agreed that this matter deserves special attention. A paper will be prepared; the Director of the Exchange and Trade Relations Department has indicated that we should be able to complete it be next spring, and I hope that we can get it out before the next meeting of the Interim Committee.

My sixth and last point is on the treatment of undrawn balances after prolonged interruptions of multiyear arrangements. I have heard your views on this and noted them with great care. We shall come back to this matter, which is complex, and we will then address the matter in greater detail.

I have also noted the many suggestions made today. Among them was one that we should analyze the Fund's experience with conditionality over a longer period, focusing not only on the specific year examined but also on what happened before and since. I also noted Mr. Polak's more specific suggestions on the use of unweighted averages in all cases. I can agree with him on that point and also on the usefulness of making comparisons between the economic performances of countries with and without Fund programs. Like Mr. Feito, I think that it would be valuable to make more explicit the theoretical framework underpinning the Fund's programs; to do so may help to understand the fundamental purpose of these actions and give the people with whom we negotiate a clearer understanding of the relationships involved. I also agree with the idea of sensitivity alternatives for medium-term scenarios. It will be useful to have a set of alternative assumptions regarding some sensitive key parameters. Among other things, it could help us detect early slippages, and facilitate contingency action to cope with situations that turn out to be quite different from what we had expected.

The Executive Directors took the following decision:

1. Pursuant to Decision No. 7157-(82/93), adopted July 7, 1982, the Fund has reviewed the provisions of the extended Fund facility further, together with a review of the Fund's stand-by arrangements, and decides that the provisions of the extended Fund facility remain appropriate in present circumstances.

2. The Fund will again review programs supported by stand-by and extended arrangements, not later than December 31, 1984. This review will examine the appropriateness of the provisions of the extended Fund facility and the guidelines on conditionality, with particular reference to the importance of ensuring the revolving character of the Fund's resources.

Decision No. 7558-(83/156), adopted
November 16, 1983

APPROVED: March 26, 1984

LEO VAN HOUTVEN
Secretary