CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Committee of the Whole for the Development Committee

Meeting 89/3

3:00 p.m., March 10, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
Dai Q.	
	M. E. Hansen, Temporary
	J. Prader
	L. B. Monyake
	R. J. Lombardo
	G. García, Temporary
	N. Kyriazidis
	S. K. Fayyad, Temporary
M. R. Ghasimi	
	B. Goos
J. E. Ismael	E. Kiriwat
B. Jalan	L. E. N. Fernando
A. Kafka	
	W. N. Engert, Temporary
Mawakani Samba	
Y. A. Nimatallah	
	I. A. Al-Assaf
	M. Fogelholm
	D. Marcel
	G. P. J. Hogeweg
	M. J. Shaffrey, Temporary
	S. Yoshikuni

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

Also Present

Y. L. Fortin, Executive Secretary, Development Committee. IBRD: M. F. Carter, Policy, Planning and Research Staff; V. Corbo, Office of Development Economics; C. Humphreys, Africa Regional Office. African Department: C. Briançon, A. Jbili, A. B. Taylor, R. C. Williams. Exchange and Trade Relations Department: H. B. Junz, Deputy Director; M. G. Gilman, K. M. Meesook, G. Oliveros, C. Puckahtikom, R. L. Sheehy, B. C. Stuart. External Relations Department: E. Ray. Fiscal Affairs Department: A. Tanzi, Director. IMF Institute: O. B. Makalou. Legal Department: R. H. Munzberg, Deputy General Counsel. Research Department: Y. Harada, D. Villanueva. Treasurer's Department: H.-C. Kim. Advisors to Executive Directors: M. Al-Jasser, P. E. Archibong, S. M. Hassan, P. D. Péroz, M. Pétursson, M. A. Tareen, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: B. A. Christiansen, R. Comotto, A. Y. El Mahdi, B. R. Fuleihan, M. Hepp, I. Iljas, P. Kapetanovic, K. Kpetigo, K.-H. Kleine, R. Marino, T. Morita, N. Morshed, A. Rieffel, S. Rouai, G. Serre.

1. PROBLEMS AND ISSUES IN STRUCTURAL ADJUSTMENT; STRUCTURAL REFORM IN FUND-SUPPORTED PROGRAMS; AND PROGRESS OF INITIATIVES BENEFITING SUB-SAHARAN AFRICA

Committee members resumed from the previous meeting (CW/DC/89/2, 3/10/89) their consideration of a staff paper on structural reform in Fund-supported programs (EB/CW/DC/89/3, 2/15/89), and a paper prepared by the World Bank staff on the Bank's experience with structural adjustment lending (EB/CW/DC/89/4, 2/16/89), together with a summary, prepared jointly by the staffs of the Fund and the World Bank, of the problems and issues raised in those two papers, and a joint staff paper on progress with initiatives benefiting sub-Saharan Africa (EB/CW/DC/89/5, 2/16/89).

Mr. Prader made the following statement:

Both of the papers on structural adjustment are concise and thought provoking. They challenge the reader and we may hope will point, between the lines, to such lessons as are to be drawn from past experience on the better design of structural adjustment programs. They might contribute even more to the success of these programs if they were to identify the basic functions of the adjustment models, namely, the long-run balance of payments adjusted (or balance of payments enforced) relative equilibrium prices of the factors of production.

Structural adjustment is being attempted in many developing countries to satisfy a recently emerging need; we can all agree, I think, that the primary objective of the adjustment, a sustainable balance of payments position, is the precondition for the restoration of their access to external financing. At this point, however, viewpoints diverge between prospective lenders and borrowers who have different ways of evaluating the desirability of loans they might enter into. Lenders, especially private lenders, prefer assets with the highest internal rate of return, while borrowers are more concerned with enhancing the present value of their assets. Mathematically it can be shown that assets with higher internal rates of return tend to have lower net present values. Lenders and borrowers thus use significantly different weights in assessing the benefits and costs of possible loans.

In many cases, continuous deterioration in the balance of payments position owing to the country's integration in the world economy has dictated a need for structural adjustment. In these cases, lenders are seeking recovery of their assets in the shortest possible time as the repayment capacity of the borrower improves, while borrowers are seeking current sustainability and long-term durability of their balance of payments improvement.

This brings us again to the question of how to realign the long-term equilibrium relative prices of the factors of production while satisfying the interests of both parties, and what roles the Fund and Bank should play as intermediaries and financiers.

Quick recovery of balance of payments positions involves adjustment of the exchange regime to a realistic and competitive rate. At the same time, the need to service external debt dictates an increase in domestic interest rates to promote domestic savings and encourage the repatriation of private capital. The major short-term effects of these measures will be a shift from the nontradable to the tradable goods sector. Supply shortages in nontradable goods combined with the effects of sharp depreciation and higher interest rates will exert upward pressures on the inflation rate, calling for demand-management policies. In an open exchange and trade system, the major tool of demand management is adjustment to fiscal policy. Since the current status of fiscal policy reflects the current structure of the society, the success of any structural reform aiming at fiscal correction and efficient balance of payments correction depends on the flexibility of the social structure. If the shift from nontradable to tax-free tradable goods requires imposition of indirect taxes (VAT) to offset lost revenues during a period of rising inflation, public acceptance of the shift will depend on the persuasive abilities of the authorities. Announcement of reforms aimed at increasing the efficiency of public expenditures, enhancing the tax base, and improving tax administration, coupled with some fast results, will help to obtain public acquiescence.

In the papers, both Fund and Bank staffs have rightly stressed the importance of the social structure and the institutional setting as factors affecting both the scope of adjustment programs and their success. Both papers make clear that the medium-term success of any structural adjustment program depends on the adaptability of the social structure to new economic realities, and changes in social structures can only be durable when supported by well-designed structural reforms. Sustained improvement in the balance of payments position, and the reforms needed to motivate the required adaptation of social structures, are the defining goals of Fund-Bank collaboration, which must include the joint preparation of sufficiently comprehensive programs.

Lastly, I would like to comment on the paper on the progress of initiatives benefiting sub-Saharan Africa. There can be no doubt that much must be done for the low-income debt-distressed countries of sub-Saharan Africa. We regard the Toronto consensus, the Bank's Special Program of Assistance, and the Fund's structural adjustment and enhanced structural adjustment arrangements as the first steps in the right direction. The World Bank's efforts to deal with the social aspects of adjustment and development in sub-Saharan Africa are most commendable. There remains the need to provide technical assistance to correct the weaknesses in the administrative capacity and strength of these countries' institutions, which are a remaining stumbling block to their efforts to implement adjustment programs. The provision of the needed training and technical assistance should not be considered as the exclusive province of the Bank and Fund, but should also be supported by donors to the greatest possible extent.

Mr. Jalan said that he supported all the initiatives benefiting sub-Saharan African countries. His only point on the staff paper was that in the design of Fund-supported programs, greater attention perhaps had to be paid to the level of development and the institutional structure prevailing in those countries. The kind of policies and programs that were workable in middle-income countries or other developing countries might not be relevant in sub-Saharan Africa. He raised the point because he did not know exactly what would be the right mix of policies of structural reform or stabilization in the kind of situation existing in sub-Saharan Africa, but administrative and managerial infrastructure was clearly an element for consideration. Further work should be done in that area, whether theoretical or empirical.

As for the two papers on structural reform in Fund-supported programs and the World Bank's experience with structural adjustment lending, Mr. Jalan continued, the Board's discussion on conditionality had been scheduled to take place prior to the Committee's consideration of those two papers. As he had already circulated a statement on conditionality, in which he had raised issues with respect to the design as well as the implementation of programs, he would suggest consideration in the papers that had been prepared for the Development Committee, of the points made by him, pending the Board's consideration of conditionality. His suggestions concerned first, the need for more tentative assertions in the Fund paper on the design of structural reform packages, especially with respect to references to specific policy measures in particular areas. Second, while there was clearly no disagreement on the need to differentiate among countries, that point was somewhat lost because of the claims in the staff paper that comprehensive programs were preferable to programs that concentrated on key areas. Inevitably, if the situation in a given country was extremely serious--and unfortunately that was currently often the case--no progress was possible in the absence of a comprehensive approach encompassing the entire economic framework. But the Fund could not take the view that a bold, comprehensive program was essential or workable in all cases. He had been glad to note that the Fund staff paper had made the specific point that the design of financial liberalization programs would have to vary from country to country, depending for instance on the institutional structure.

To illustrate his points, Mr. Jalan noted that among the conclusions drawn at the end of the Fund staff paper, it was clearly implied that the preferable approach was a comprehensive policy package that emphasized an adequate mix of macroeconomic policy instruments and an appropriate balance between demand-management and structural policies. The Bank staff paper came to the different conclusion that adjustment lending was more likely to be successful, when its conditionality concerned primarily those factors that were under the control of the authorities and took the form of action in a few key areas. In sum, it was necessary to recognize that in certain circumstances, the comprehensive, and in other circumstances, the key area approach was called for.

On a related point, he had observed that the Bank's staff was well aware of the possibility of conflicts arising between two desirable policy objectives, Mr. Jalan continued. It was noted on page 4 of the Bank staff paper that "a key problem in designing adjustment programs is that policies to solve a problem in one area may create problems in other areas. For example, a real devaluation needed to protect employment while improving the external account may also increase the budget deficit if the government is a net purchaser of foreign exchange."

In response to a question from the Acting Chairman, Mr. Jalan remarked that the Fund staff paper conveyed the impression that it could always be argued that the exchange rate should be depreciated in line with the inflation rate, whereas the Bank staff paper, while recognizing the validity of that argument, drew attention to the great problems that such a policy would create for the fiscal sector. His point was that the text could be redrafted to read somewhat more tentatively--but without the need for extensive revision at the present late stage--to reflect an awareness that the Fund, in discussing individual policies, would recognize the possibility of conflict between the use of a key policy instrument with respect to different objectives.

The Acting Chairman remarked that it was in fact in such situations that the Fund was often led to prefer a broader, more comprehensive approach.

Mr. Jalan explained that, as he understood it, the Fund, in speaking about a comprehensive approach, meant one that included structural and stabilization policies--in other words, an approach that was not limited to the traditional, financial approach to correcting a balance of payments disequilibrium. He had detected, from the Fund staff paper, a view that a program, to be successful, should pay attention to macroeconomic policies and call for prior action or conditionality that was of broader application than the strictly financial. He recognized that a more comprehensive approach was required in certain cases of severe disequilibrium, but in other cases it was possible to argue that an approach confined to the fiscal deficit or to two or three other key elements in a program would suffice to solve the problem. As for the situation in which a fiscal deficit underlay the balance of payments deficit, but in which the exchange rate had to be adjusted to take into account changes in the rate of inflation, creating problems for fiscal management over a period of time, the point was again more one of the sequencing of action in different areas.

In reaching certain conclusions with respect to structural or long-term policies, greater attention needed to be paid to empirical experience, Mr. Jalan stated. For example, in Annex I to the Fund staff paper, reference was made to the possibility of automatic exchange rate adjustment according to an agreed formula. Yet the actual experience of some countries that had experimented with a preannounced schedule of exchange rate adjustments had led, after about one year, to a financial crisis.

In sum, given the lack of sufficient time to make appropriate changes to the text of the staff paper, Mr. Jalan reiterated that he would be satisfied if the staff could introduce somewhat greater emphasis on the need for differentiation among countries, and on the inevitably tentative policy conclusions, particularly with respect to structural policies, that had to be drawn, experience varying in one way or another from region to region. It was much easier to reach different conclusions in relation to stabilization policies to deal with a balance of payments problem, accompanied by inflation, than in relation to policy instruments relating to the organization of markets or of the economy in general.

Mr. Yoshikuni remarked that since the Board would soon be taking up the review of conditionality and Fund-Bank collaboration, he would not go into specific details on those topics.

The staff papers rightly pointed to the importance of comprehensive programs, Mr. Yoshikuni observed. Macroeconomic policies would play a major role in adjustment efforts, but without structural measures their impact on the economy was limited. That was evident from the several cases in which external adjustment had been successfully achieved through macroeconomic adjustment measures, but in which long-term sustainable growth could not be attained owing to delayed implementation of structural reforms. Conversely, for the steady implementation of structural reforms, a sound macroeconomic situation was essential, and there were many cases of structural policies having failed because of the lack of the necessary macroeconomic policies.

In light of that consideration, Mr. Yoshikuni continued, he believed that timely and active use should be made of stand-by or extended arrangements, even by low-income countries, if the initial macroeconomic distortions were very large, and even though high rates of charge posed a problem.

As for the issue of gaining social support for a program, Mr. Yoshikuni considered that adequate external financing was important. The structural adjustment could, particularly during the early adjustment period, cause a decline in real income and imports without significantly reducing the inflation rate. To ameliorate that situation, the adjustment efforts should be supported by timely and adequate external financial resources. On the other hand, such support should not be allowed to compensate for the failure to implement the structural adjustment measures. That issue might arise when failure to implement the structural measures led to slippages from macroeconomic targets. If the failure was due to factors beyond the authorities' control, active support would be appropriate. In other cases, however, the external support would not be helpful in ensuring incentives for the implementation of adjustment measures. The flexible approach of the creditors in guarding against policy slippages was helpful, but it would be necessary to review closely and judge carefully the cause of slippages on a case-by-case basis. The Fund could play a larger role in that area.

Greater consideration of distributional effects would also help to gain political or social support for a program, Mr. Yoshikuni considered. The recent tendency to take that factor into account was a welcome development. Furthermore, the Fund's staff could strengthen its efforts to collect good data on that aspect for use in drawing up adjustment programs. He understood that poverty reduction objectives were important in that context. Nonetheless, he wished to reiterate clearly the position of his authorities, who were reluctant at the present stage to use such objectives as explicit targets. The reduction of poverty was a socially oriented issue, decisions on which should be left primarily to the authorities. Moreover, the use of such objectives as targets would make it more difficult for the Fund and the authorities to reach agreement on the program, and thus might preclude the timely adoption of adjustment measures and the associated disbursement of Fund resources, which would be counterproductive for the purpose of poverty reduction.

Turning to program design, Mr. Yoshikuni observed that the program should address more selectively the key issues, which were the most serious impediments to long-term sustainable growth, on a country-by-country basis.

He recognized the importance of providing a realistic time frame within which the positive effects of the program's implementation could take place, Mr. Yoshikuni went on, as key structural distortions were often deep rooted and time consuming to remedy. He also noted that the initial adverse impact of the structural adjustment measure sometimes lasted longer and was larger than expected owing to external shocks or other factors. Thus, it would be necessary to think about how to deal with the postprogram period until positive effects emerged. A good solution in that respect might give additional incentives to countries having adjustment programs.

With respect to the monitoring of policy implementation, much scope for improvement still remained, Mr. Yoshikuni commented. He welcomed the good progress achieved in reforms of the exchange rate system and trade policy. On the other hand, the implementation of reforms of the monetary system and the labor market, and in some other areas, had generally been slow. Although that might be attributable to the difficulty of such reforms, it was also due to the fact that the monitoring of policy implementation on the external side was much easier and more refined than monitoring of other structural rigidities. Active use might be made of prior actions in areas where monitoring was difficult.

Finally, a strengthening of the design of structural reforms could be achieved as a result of discussions in the Board, Mr. Yoshikuni stated. In particular, the Board should be careful to learn from the unsuccessful cases of the past. In that vein, the case studies undertaken for the review of conditionality would be most helpful, and should be continued.

Mr. Marcel made the following statement:

> The main idea forming the basis of these reports is that the adjustment process on which countries are embarked will bear fruit only with both the full support of the international financial community and the total commitment by recipient countries to tackle their present economic and financial imbalances. In this regard, we are pleased that many governments have already implemented the necessary adjustment process, but at the same time, we have some concerns on the critical views emerging from various sources on the limits of such adjustment.
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> I fully agree with the paper prepared jointly by the staffs of the Fund and the Bank. It is clear that the credibility of a program and its successful outcome depend on two complementary factors: government involvement and the population's receptivity to the new measures to be implemented. Thus, it is not surprising that with hindsight, measures dealing largely with price distortions or the rationalization of public investment were more effective than measures relating to fiscal policy, financial intermediation, or the structure of the public sector.
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> Another important aspect of the problem is the increasing need to integrate social dimensions in the design of structural adjustment programs. In many respects, this situation more or less indicates a certain failure of the basic assumption of the adjustment concept because its primary target was in fact to alleviate difficulties for the entire population. These developments must lead to the pursuit of a more comprehensive approach in the design of adjustment programs.
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> I would like to stress the advantage of close Fund-Bank collaboration in providing adequate support in implementing structural reform.

Turning to the issues proposed for the Development Committee's discussion, we think that the presentation is candid and reflects very well the concerns of both the Fund and the Bank.

With regard to the scope of structural reforms in Fund-supported programs, it should be noted at the outset that the central objective of structural reforms is not only to improve the efficiency of a given economy but also to heighten both its resilience to external shocks and its responsiveness to policy measures. It follows that the main areas of action for the Fund should be the exchange rate and the trade regime as well as the financial and fiscal system.

I would also like to stress the important impact of the Fund's pedagogic approach in the perception of the adjustment process by recipient countries. It is clear that the role of the Fund has been instrumental in the perception that economic stability cannot be regained in the absence of basic institutional and economic changes.

On the sequencing of reforms, one can recognize that at an early stage, when imbalances appear very wide, progress is easy to measure. But in proportion, as structural reforms are being implemented, and given the need to move ahead, the modalities will become more complex and difficult to operate. Moreover, there is a great temptation to elaborate too tight a schedule of reforms. Thus, we should proceed cautiously in this area; however, this does not necessarily mean that we should adopt too gradual an approach.

The main difficulty in the Fund's monitoring a structural adjustment program stems from the fact that the normal time horizon for such programs is the medium term, whereas financing constraints faced by most countries are of a short-term nature. We think that the best way to overcome the dilemma between short-term and medium-term consideration would be to keep in mind that structural adjustment aimed at strengthening the supply side is a supplement to short-term adjustment in the level of domestic demand, which results from the need to take into account the immediate financing constraints. Therefore, in our view the medium-term conditionality must come along with and not be a substitute for the regular conditionality of a short-term nature.

We believe that adequate technical assistance plays a very important role, in particular to fill the "information gap" which is often a major impediment to structural monitoring. Technical assistance could also prove helpful in laying the groundwork before implementing a program and thereby facilitating a follow-up once the program is completed. In this regard, I agree with Mr. Yoshikuni that it is also important to deal with the postprogram period.

Finally, I would like to emphasize a very interesting point that arises from the Fund staff paper. Indeed, taking into consideration the need to focus political attention on a few key issues, especially in the case of limited administrative capacity, the notion of prioritization of reform in specific structural areas seems to be very helpful.

I take up now the progress of initiatives benefiting sub-Saharan Africa. The special program for Africa was launched only one year ago and it seems too early to assess its impact. The main point is to pursue this initiative in an accurate and timely fashion in order to increase additional financial flows to Africa and to improve coordination among donors. A quick replenishment of IDA and an acceleration of use of structural adjustment and enhanced structural adjustment resources will also improve the concessionality of assistance at a time when the region registered a slight recovery that needs to be sustained, but at the same time when per capita income is still on a long-term downward trend.

This aspect is closely linked to alleviation of the debt burden. The Toronto and Berlin consensus may be considered as a great step in introducing a menu of comparable options. Moreover, the possibility of more favorable decisions on a bilateral and case-by-case basis is not thereby excluded.

Given the assumption that growth is necessary to reduce poverty but may not be sufficient in itself to do so, my authorities share the point of view of the Bank and the Fund on the need to deal with social aspects of adjustment. However, we consider that this aspect must be included in the overall process of adjustment for future programs.

*To conclude, I particularly welcome the World Bank's long-*term perspective study on sub-Saharan Africa which has brought together major actors in Africa's development to reach a common approach. This meets with the idea I elaborated upon at the beginning of my statement that adjustment must be "owned" by recipients through a permanent dialogue with the Bretton Woods institutions.

Mr. Lombardo made the following statement:

During the 1980s, many developing countries showed a deterioration in their economic situation, manifested by lower or negative economic growth and the emergence of external and domestic imbalances. It was evident that in many of these cases, the emergence of imbalances had a clear relation with deep-rooted structural problems in the economy, calling for a combination of macroeconomic policies and structural reforms as the way to restore the necessary conditions of stability, which are the basis for sustained economic growth.

However, experience shows that despite the efforts made, there has been only limited success, and much remains to be done to restore development in the so-called "developing" countries. On this point, let me concentrate my comments on three issues: the importance of coordination between the Bank and the Fund; the time frame considered in the programs agreed with developing member countries; and the different contents of macroeconomic and structural approaches.

On the first issue, we recognize and appreciate the important contribution that the Bank and the Fund have made in support of the adjustment and development efforts of members. This has been of particular importance since the emergence of the debt crisis, which has affected in different degrees most of the countries of the developing world. And experience has shown also the benefits of coordinating and complementing the roles of both institutions. This is particularly clear, given the limited resources available, in terms of economic advice, as well as of financial support, and given the magnitude of the economic and social problems and the poverty of many of the countries involved. We feel that the most efficient way to use these limited resources would avoid the duplication of efforts and enhance the complementarity of the roles of both institutions. In each case, and given the particular circumstances of each country, the emphasis or the degree of participation of each institution should take into account the relative expertise of the World Bank in development aspects, and the relative expertise of the Fund in macroeconomic problems, their efforts being coordinated.

On the second issue, it is clear that economic adjustment policies as well as structural reforms involve economic, social, and political costs. And the benefits, in most cases, appear evident only after some time. Moreover, in the case of structural reforms, the particular experience in the countries of my constituency has shown that a long period of time is required before the positive effects are evident. The implication is that not all the reforms can be implemented at the same time, and in particular, that a realistic time frame is needed when considering a comprehensive policy package. Another implication is that in many cases the assistance and financial support is needed for a longer period of time. In practice, this has implied the need to request a sequence of programs or arrangements, since agreeing on only one program does not provide enough time and resources for a more definite resolution of the problem. In this regard, we feel that a longer-term arrangement, where the benefits can be clearly perceived, has clear advantages for the country compared with a sequence of short- or medium-term arrangements. Furthermore, it would clearly help to better manage the social and political costs and benefits involved in the programs.

On the third issue, the different contents of both macroeconomic and structural approaches imply that macroeconomic policies are emphasized in the short-term programs while the structural approach is emphasized in the long-term ones. But I wonder whether it is clear enough that the number of variables involved in the two analyses is different. In the macroeconomic approach, only a few items are relevant. Therefore, one can infer a few relevant rules. But, is this true in dealing with structural matters? In other words, in dealing with structural matters, can we always apply the same rules to different countries? Sometimes the answer is yes. For instance, public sector problems seem to be similar in Latin American countries. But is this always true with reference to agricultural structure, industrial reform, and trade policy? I think that further comments by the staff on this matter would be very useful.

The increasing evidence of the structural origin of problems related to the emergence of domestic and external imbalances has called for the consideration of structural aspects in many Fund-supported programs in recent years. In this respect, and given the close interrelation between macroeconomic policies and structural reforms in addressing a particular situation, we see that the Fund has a clear role to play. Furthermore, as the staff paper indicates, there is a need to have an adequate balance between macroeconomic management and structural policies in order to achieve the objectives of the program. However, experience has shown that structural reforms need a longer period of time to show positive effects. This would imply the need for programs framed in a medium- or long-term strategy, supported by larger amounts of financing for longer periods of time.

In this regard, the most relevant question is, in our view, how to accommodate the traditional characteristics of short-term Fund- supported programs with the need for the wider time frame that is associated with structural reforms.

The extended Fund facility--although there are only two programs currently in effect under extended arrangements--as well as programs under structural adjustment and enhanced structural adjustment arrangements--have been oriented in the right direction. However, for those countries which are not eligible for the latter two types of arrangements, a sequence of stand-by arrangements has usually been the alternative. We feel that this alternative has some limitations: first, in the sense that the stand-by arrangement is for a relatively limited period of time--usually between 12 and 18 months; second, it is very possible that in this limited time the problem--if it is a deep-rooted structural problem--cannot be resolved; and third, that only the costs, but not the benefits of the measures can be seen during the program period. (Perhaps this outcome has influenced the image of the Fund, increasing the costs of Fund programs). In this case, the long term is not equal to the sum of the short terms.

We see that there are good reasons to improve the Fund's support, when a comprehensive economic package, including strong adjustment measures combined with structural reforms, is in place. Especially for the non-ESAF eligible countries, we feel that a more intensive use of extended arrangements is called for; in the case of Chile, in my constituency, it has proved to be a positive experience.

Mr. Fogelholm said that like Mr. Jalan, he found the timing of the meeting unfortunate in light of the postponement of the discussion on conditionality and the fact that the review of the structural adjustment and enhanced structural adjustment facilities, as well as the meeting on Fund-Bank collaboration, both of which were relevant to the discussion, had yet to take place. Thus, he would confine his remarks to some more general observations; substantive comments would be delivered by his authorities at the Development Committee meeting itself.

When read back to back, the reports of the Bank and the Fund's staffs revealed two striking facts, Mr. Fogelholm observed. The first, in line with Mr. Hogeweg's comments, was that if it had not been known before, it had become crystal clear that the activities of the Fund and the Bank overlapped almost completely. The only significant difference that could be detected was the time frame, the World Bank providing resources with a much longer maturity period. That fact again emphasized the importance of close and amicable cooperation between the two staffs. It also emphasized the need to make every effort to develop a clear division of labor between the two institutions.

On the Fund side, it had been conceded that demand-management policies in many instances needed to be complemented by structural reforms in order to ensure their effectiveness, Mr. Fogelholm said. That being the case, he wished also to emphasize the importance of the Fund limiting its involvement in the structural area, or, to use the words of the Managing Director in his statement in the informal paper on Fund-Bank collaboration, the Fund, in its work, should restrict itself to key structural issues of relevance and that performance criteria should be confined to those issues only.

His second observation concerned the similarities in experience of the Bank and the Fund, Mr. Fogelholm remarked. In effect, it could be asserted that the experience with program design, implementation, and the necessary conditions for success were almost identical. In itself, that should augur well for the future design of programs. As far as the conclusions that had been drawn were concerned, they all seemed relevant and correct to him. Nevertheless, on one point of substance, he wished to note that based on experience to date, it would seem possible to implement structural adjustment with due regard to social and political considerations. In light of recent events, he believed that that specific aspect--the realism of the program--was one to which the Fund would have to pay more attention without compromising the program itself.

Finally, as he believed that it was important and indeed necessary to be able to benefit from experience, Mr. Fogelholm said that the Bank as well as the Fund should continue their assessments of adjustment programs with respect to both their content and to their impact.

Mr. García made the following statement:

> We welcome this opportunity to discuss the policies and results of structural adjustment programs supported by the Fund and the World Bank. The papers presented by the staff of both institutions provide a comprehensive review and we agree with most of the points raised in them. We would like to contribute to the discussion of these issues by making several comments on those aspects we think should be stressed.
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> As mentioned by the staff, success has been achieved in diagnosing and agreeing with the countries on the need for structural adjustment. Problems remain serious in terms of the implementation and sustainability of programs that have been less successful in reducing inflation and unemployment and restoring growth. The main difficulties start with balance of payments deficits that have arisen owing to external shocks from the terms of trade and interest rates, together with domestic policy weaknesses. Imbalances in the world economy affect negatively the external debt service burden as interest rates increase. The fiscal and external imbalances of highly indebted countries worsen even more and inflationary pressures remain high, even though the intention of domestic policy reform is to cope with these problems.

Fiscal deficits are recognized as the major cause of inflationary pressures; however, as the debt burden worsens because of external shocks and higher interest rates, it is not clear cut when fiscal deficits are a consequence, instead of being a cause, even though their reduction is required to diminish inflationary pressure.

To deal with these unfortunate events, most developing countries, particularly in Latin America, have significantly depreciated the real exchange rate with the intention of stimulating exports and reducing foreign expenditure. There has been an enormous reduction in imports and export volume has been increasing. Out of factor income, current account deficits have been reduced or eliminated in countries that have implemented structural reforms. However, the efforts to increase export volume have also been a major reason for the deterioration in the terms of trade, adding more difficulties to the adjustment programs.

As it is well expressed in the staff papers, adequate external financing is a key point for the success of the program, not only in terms of its practical implementation, but also with respect to its sustainability and credibility in the eyes of domestic economic agents. The recognition and willingness to correct domestic distortions and policy weaknesses is an obvious necessary condition but not a sufficient one. For the success of structural adjustment programs, a significant reversal of financial resource transfer is required. Without a practical and viable solution of the external debt problem of most developing countries, it is going to be very difficult to improve the rate of success of policy reforms, even with the willingness of policymakers to undertake them.

We also agree with the staff that the availability of enough financial support at the beginning of the adjustment program is of crucial importance to ease the effects on inflation and unemployment. Strong financial support from abroad, together with the firm intention of the authorities to sustain the program, is a key element in the success of the program.

The urgency of correcting fiscal imbalances has not permitted deeper consideration of the appropriateness and consequences of the measures that are taken. In particular, the effects on unemployment and growth need to be considered more deeply. The only way to ease the urgency of fiscal correction is with the availability of financial support.

Additionally, we also agree with the view of the staff on the effects of the program on the poor. This is also a key point in the success of structural adjustment reforms, for which public support is needed. We welcome the proposal to pay more attention to social considerations in structural reforms.

For the above considerations, we deem it very important to stress that the discussion in the Development Committee of some points, among them, the effects and difficulties caused by the major world economic imbalances for the implementation of structural adjustment in developing countries, and the possibility of increased external resources at the very beginning of a program to reduce the urgency of fiscal measures with an adverse impact on inflation, growth, and employment. Of particular interest in this respect are the type of social programs to alleviate the consequences on the poorer members of society. Also, we cannot avoid discussing the reversal of resource transfer in the context of external debt, which poses serious difficulties for the success of programs, even with the willingness of authorities to assume structural reforms to increase economic efficiency, to regain international competitiveness, and to improve fiscal and financial policies.

Mr. Ghasimi made the following statement:

The staff papers prepared for today's discussion clearly display the shared views and catalogue the common experience of the staff of the two institutions with structural adjustment. Indeed, a typical developing country undertaking a structural adjustment program faces both macroeconomic disequilibrium and microeconomic distortions. Since macroeconomic disequilibrium can also be attributed to the inappropriateness of some economy-wide prices--for example, unsustainable current account deficits can be viewed as a reflection of inappropriate exchange rates, the relative price of nontraded goods, or intertemporal prices--it would not be unfair to maintain that the structural problems are identified with distorted prices and insufficient reliance on markets.

It can hardly be denied that a framework which locates the roots of structural difficulties in distorted prices must naturally identify structural reforms with a reduction in price distortions. In such a framework, it is rather difficult to imagine how the correction and restoration of microeconomic distortions can take precedence over distortions in economy-wide prices. Nevertheless, stabilization policies do not stand in a trade-off relationship with each and every measure of structural reform. This indeed seems to imply that circumstances can be conceived under which stabilization measures and certain structural and institutional reforms can be incorporated in a comprehensive policy reform package.

Reading the staff papers, one may be left with the incorrect impression that both the Fund and the Bank favor contractionary policies over growth-oriented ones, or defensive over positive restructuring. In fact, in the actual design of programs, the staff spares no efforts to ensure that all the feasible positive restructuring measures (e.g., export promotion) precede defensive ones (e.g., greater import competition). Nevertheless, subsequent to the structural reforms, the apparently sick and inefficient enterprises usually fold faster than hoped-for efficient ones emerge and expand. Hence, a long period may indeed elapse before the reform measures manifest net positive effects. During such a period, every feasible effort and initiative should be devoted to protecting the poor against the adverse consequences of structural adjustment. In fact, *the possible adverse impacts on the poor and the social dimen*sions of adjustment need to be addressed properly when adjustment programs are designed, and effective remedial actions must be undertaken before programs are implemented.

We are not quite certain about the conclusion of the staff papers as to the reason for the less than enthusiastic political and social support for adjustment programs. The "rent-seekers" may be vocal, but they are the poor in the adjusting countries, and it is poverty which erupts into social unrest following the announcement of apparently unavoidable, costly, and in many instances, somewhat delayed adjustment measures. It seems to be the certainty, the immediacy, and the diffused costs of the adjustment measures in economies that have long been distorted and ready to disrupt that usually lead to social and political opposition. It does not seem to be the lack of clarity, but the transparency of the general thrust of the adjustment programs which generates opposition to them from the long-time beneficiaries of the distorted systems. Indeed, this is an extremely sensitive issue, but surely more emphasis on effective remedial actions to counteract the potential social cost of adjustment and the introduction of some flexibility, taking each country's specifics into consideration, will be helpful.

We are also not quite in agreement with the staff's views on the root cause of the widespread structural difficulties of the 1980s. True enough, policy-induced price distortions can hinder growth and may in fact have contributed to the severity of the structural difficulties. But, placing absolute faith in the market mechanism under whatever conditions, also does not necessarily lead to assured and sustained growth and did not in fact provide sufficient insurance coverage against the structural difficulties of the 1980s. Some of the developing countries, which turned absolute reliance on the market mechanism into an article of faith in the 1970s, were no more immune to the structural difficulties than others which retained some absolutely essential but temporary market interventions, at least in preparation of the necessary basis for an effective implementation of the market mechanism.

This brings me to the inadequately emphasized root cause of the structural difficulties. Indeed, the phenomenon of "loan-pushing" by some commercial banks and the accompanied inflationary inclinations of the central banks of reserve currency countries in the 1970s and the disinflationary inclinations of the late 1970s and early 1980s created a great deal of difficulty for the developing countries. These alternating inflationary and disinflationary inclinations accentuated the so-called terms of trade and interest rate shocks and were to some extent responsible for the emergence of widespread debt crises and structural difficulties.

The staffs of the two institutions devote considerable ingenuity to devising an appropriate pace of interest rate rationalization to ensure that such rationalization does not lead to undue disruption in the real sector. Similar efforts need to be made on a global scale to ensure that alternating inflationary and disinflationary inclinations of one or two central banks do not lead to future interest rate and terms of trade shocks.

Finally, with regard to the paper on sub-Saharan Africa, we would like to indicate that we continue to support the various and innovative initiatives. While it is clear that these initiatives aim at alleviating debt burdens, unfortunately, the question of availability of new financing in support of adjustment with growth and poverty mitigation has not been adequately addressed.

Mr. Monyake made the following statement:

Let me first associate myself wholeheartedly with Mr. Ghasimi's remarks, which emphasize some of this chair's points. Two issues are clear from the three staff papers reviewing current experience with structural adjustment. First, structural adjustment has been generally accepted by many developing countries as a necessary process in their effort to achieve sustained growth. Second, experience so far with programs of this nature, supported by both the Fund and the World Bank, has shown that their outcome is mixed.

In our view, the basic problems and issues in structural adjustment that must be addressed are largely country specific. In other words, although there may be a broad spectrum of reforms that may be common to a group of developing countries, the Fund and the Bank must bear in mind that these countries do not face identical structural problems, which, therefore, do not require the same set of solutions. For example, the reform of the exchange rate and trade system, public expenditures and taxes, public enterprises, pricing policy, agricultural marketing, industrial and energy policy, and the financial system may be necessary, but the level and pace of such reforms must be tailored to the particular economic circumstances of individual countries. We must also bear in mind that a country's capacity to adjust is related significantly to its level of economic development.

Much also depends on the level of involvement of the authorities in designing a structural adjustment program. If, because of relative technical weakness, or because of the need to hurry through an arrangement to appear to cooperate with the Fund, the Bank, and the creditors, the program design is inconsistent with the existing economic realities, implementation would certainly be difficult as public support would be difficult to sustain. This stresses the need to ensure that structural adjustment programs are really designed and "owned" by the governments. The role of the Fund and the Bank should merely be to assist them in the preparation of these programs. Although both the Fund and the Bank stress that that is their role, we know that this situation is apparent, not real. The staffs often insist, and will not budge, on the level of reforms that must be accomplished: for instance, exchange rate changes could be cited, even though it is a well known fact that it is not possible to determine an equilibrium exchange rate for any country--even for a highly industrialized country. This point underscores the need for flexibility.

In particular, given the need to sustain adjustment in order to realize substantial economic benefits, broad political and social support for the program is crucial. Our experience in this regard indicates that three areas must be given serious attention. First, the public must be made aware of the costs of distortions and the benefits of particular reforms. Second, the vulnerable segments of the society must be adequately protected from the severe hardships that they often bear under the implementation of programs. The Fund and the Bank have recently made some progress in this direction, but much remains to be done.

The third area of concern is the issue of gradualism versus shock treatment in the design and implementation of Fund-supported structural adjustment programs. Once a combination of policy instruments that would reduce macroeconomic imbalances and provide adequate support to economic activity has been determined, how to proceed and at what pace is an issue over which many of our authorities often disagree with the staff. The staffs of the Fund and the Bank apparently prefer shock treatment while many developing countries prefer a gradualist approach. I would like to emphasize that the structural rigidities and bottlenecks that characterize the small, low-income countries in Africa render these economies less responsive to a number of policy measures. This is partly because the substitutability of traded and nontraded goods for both exports and imports is very low. Nonprice factors such as the lack of basic imported inputs and spare parts, as well as nonavailability of critical intermediate and capital goods and power shortages, all combine to constrain expansion of output. In many developing countries with a largely agrarian economic structure, farmers are not integrated into the markets and cannot benefit promptly from price incentives. It is obvious that under such a situation, higher local prices for exports through expenditure-switching measures, such as substantial devaluation, may, in the short run, achieve very little beyond aggravating domestic inflationary pressures. This again tends to support a gradualist approach, under certain economic circum-stances, and should be taken into consideration in program design and implementation.

The general characteristics of low-income economies, some of which I have alluded to, make it difficult for positive effects of structural adjustment programs to be achieved within a relatively short time frame. Taking into consideration the magnitude of the imbalances, the comprehensiveness of the structural adjustment programs, and the potential social and political tension, it is necessary to set a realistic time frame. Indeed, for the low-income countries, programs should be set in a medium- to long-term framework.

An important factor that has hampered implementation of structural adjustment programs is the shortfall in external financing. As the staff has noted, the shortage of external financing has hindered a strong investment response by the private sector. However well designed a program may be, without adequate external financing, and on terms consistent with the country's debt-servicing capacity, not much can be achieved. This issue needs to be stressed and careful attention should be paid to the design of financial packages.

Concerning sub-Saharan Africa, there can be no doubt that many more countries in this region have been implementing structural adjustment programs. They have made major efforts to reform policies. However, in some of these countries, the impact of these programs has been somewhat disappointing; gross domestic product has declined while the unemployment situation and living standards have deteriorated. What this means is that growth should be a central element in the structural adjustment programs for these countries. Attention should be paid to the need to increase savings; the efficiency of public investment and the level of productivity must be enhanced.

Implementation of the World Bank's Special Program of Assistance appears to be broadly on track, but this assistance falls far short of the required external financial resources. The release of cofinancing funds pledged under the Special Program must be expedited. More success at mobilizing external financing for the debt- distressed, low-income countries in sub-Saharan Africa appears to have been achieved more on paper than in practice. The Fund's structural adjustment and the enhanced structural adjustment facilities, established largely for this group of countries, have been very helpful, although the design and implementation of the programs supported by those facilities could be improved. In spite of this commendable effort it is distressing to note that the Fund is withdrawing resources from its African members on a net basis at a time when these countries are facing grave economic and financial problems. While net resource flows to this group of countries increased in nominal terms by 2.5 percent and 5.0 percent in 1986 and 1987, respectively, in real terms they were lower than in 1985, due partly to a net transfer of approximately $1 billion in both 1986 and 1987 to the Fund.

We believe that the Toronto-Berlin consensus on the treatment of the world's poorest debtor nations provides a useful first step in addressing the debt problems of sub-Saharan Africa. But this is by no means adequate. However, to enhance the impact of the Toronto declarations, there is need for the full cooperation of all concerned. Measures must be evolved to ensure that the Toronto-Berlin consensus is effectively implemented. We believe that it is possible to go beyond this consensus. Among other things, Paris Club rescheduling of sub-Saharan Africa's external debt could be on a multiyear basis with much longer maturity and grace periods consistent with the longer-term structural adjustment framework that is suited to this group of countries.

For sub-Saharan Africa, any structural adjustment program which forms part of debt relief--for instance, rescheduling--must be heavily growth oriented. The debt problem here is closely tied to the problem of slow or negative growth and insolvency. What is needed, therefore, is a long-range solution which involves welldesigned productive investment, and programs supported by adequate flows of capital on manageable terms as well as favorable external conditions under which these countries can increase their exports of goods and services to the rest of the world at reasonable prices and also generate sufficient growth.

Finally, we see a very limited role for the market-based approach to the debt issue even in the indebted middle-income countries of this region. Debt/equity swaps might be of assistance in the reduction of the stock of external debt, and encourage foreign investment, but the potential inflationary impact could pose serious macroeconomic management problems. For the region as a whole, adequate external financing and appropriate program design are, perhaps, the two crucial issues that must be addressed if maximum benefit must be derived from structural adjustment programs.

Ms. Hansen made the following statement:

Overall, we found the papers prepared for the Development Committee's discussion of structural adjustment to be frank and informative, and the joint paper summarizing the main issues for discussion, concise and well focused. These papers have already been discussed by the Committee of the Whole at the World Bank, where the U.S. Executive Director made a number of comments which I will not repeat here.

We welcome the Development Committee's discussion of structural adjustment, both at the April meeting and in the fall of 1989. We hope that these discussions will help the Committee arrive at a clear understanding of the benefits of comprehensive adjustment, as well as the high costs of delay, and that this view will be clearly expressed.

The papers before us today demonstrate that prudent macroeconomic policy management and structural reform are complementary. Mr. Ismael's illuminating remarks about Indonesia's experience also illustrate this point. Sound macro policies provide the necessary framework for sustained, noninflationary growth and balance of payments viability, while appropriate structural policies are necessary to ensure an efficient allocation of resources and adequate levels of investment. Experience shows that policy deficiencies in the macro area are often accompanied by policy deficiencies in the structural area and vice versa, as policymakers try to compensate for the weaknesses and distortions in one area by introducing additional distortions in the other. Thus, it is appropriate for members of the Development Committee to consider the progress that the Bank and Fund have made in addressing structural issues; what more can be done to achieve a more sustained adjustment and reform effort; and how the Bank and Fund can improve the design and monitoring of their adjustment program.

Experience shows the importance of persistence in pursuing policy reform, if structural adjustment is to be successful and result in the sustained growth, balance of payments viability, and higher standards of living we are striving for. We hope the discussion in the Development Committee will highlight both the need for country authorities to "own" their adjustment programs, to use the papers' phrase, and to pursue them vigorously and convincingly. Countries can thereby help ensure that the private sector will respond to the new incentives and increase investment; that the international community will offer its financial support to the reform effort; and that the benefits of adjustment will materialize as soon as possible. An essential element in this process is educating the public about both the benefits of undertaking adjustment and reform promptly and the high costs of delay.

We also believe it would be appropriate to draw Ministers' attention to the importance of Fund-Bank collaboration in the design, implementation, and monitoring of structural adjustment programs. While we recognize that the subject of Fund-Bank collaboration is still under discussion by the two Executive Boards, we believe that effective collaboration is sufficiently critical to the overall success of these adjustment programs, and indeed is sufficiently intertwined with the questions which are raised in the issues paper, to merit some explicit reference in the issues for discussion. We would welcome the staff's suggestions as to how this concern might be highlighted for the Development Committee.

Mr. Dai considered that the papers prepared by the Fund and World Bank staff had drawn some valuable conclusions from past experience and could serve as a useful basis for discussion in the Development Committee.

To make just a few general observations, Mr. Dai noted, first, that wide-ranging structural reform usually had a social and political impact on a country. For the design and implementation of structural reform to be successful, greater attention must be paid to the specific institutional, social, and political circumstances of a country. A purely economic view based on simple theoretical inference did not always work and sometimes resulted in mistakes. Adjustment programs must be realistic, a valuable lesson based on experience.

His second general point was that the success of a program depended on whether the government as well as its people "owned" the program, Mr. Dai continued. That important ingredient was also evident from experience. Without the understanding and support of the government and its people, no significant structural reform, no matter how attractive it might sound, would work. There had always been differences between the staff and authorities on the speed of reforms. Some governments had been criticized for "gradualism." Yet governments were generally very sensitive to the possible disruptive consequences of "shock" reform. As a matter of fact, it was a common desire of many developing countries to aim for the rapid development of their economies, to solve their economic problems, and to eliminate bottlenecks as soon as possible. Indeed, on those points, the authorities were usually as anxious as the staff to obtain quick solutions. Nevertheless, the problem lay in how to assess the constraints faced by authorities and the impact on their economies, as well as take into account the interests of the various segments of the population, especially the poorer groups. In that regard, his chair had always maintained that the concerns of and the decisions made by the authorities should be carefully studied and considered, because they were in a more competent position to assess the political and social implications in their own countries. Therefore, their views should be fully respected.

His third and final observation was that with the evolving structural nature of Fund-supported programs resulting from the changes taking place in the world, it was necessary to reconsider and readjust conventional conceptions of a monetary institution or of the short-term revolving character of the Fund's resources, Mr. Dai concluded. New ideas and new practices were needed to adjust to those new circumstances. If the Fund confined itself to the narrow notions of decades ago and blinded itself to the realities of life, it would be left behind in the current world, and as a result, its role would diminish.

Mr. Enoch said that while the papers before the Committee were undoubtedly interesting, it was fair to say that they were not intended to be entirely self-standing. As Mr. Yoshikuni and others had noted, the issues they raised were closely interrelated with those that the Executive Directors were to have covered earlier that week in the discussion on conditionality and that very day on experience with the structural adjustment and enhanced structural adjustment facilities. In addition, as Mr. Hogeweg had already stressed, there was also a close linkage to the discussion the Board would be having the following week on Fund-Bank collaboration. Although the staff papers under discussion and the Committee's consideration of them should provide useful inputs for the Development Committee, he looked forward also to more substantive discussions on those and related issues in the coming weeks.

He could broadly support the thrust of the paper on structural reform in Fund-supported programs, Mr. Enoch continued. He could endorse the Fund's assessment of the role of structural adjustment in the design of those programs, in particular that structural reform was an important complement of macroeconomic policy. The relative importance of macroeconomic measures in a particular program would have to be assessed case by case, and should depend on the extent of structural distortions in an economy. Similarly, optimal sequencing of structural measures would have to be determined case by case. As the Executive Board had observed in a number of recent country discussions, it was often very difficult to quantify the macroeconomic impact of structural reforms, and it might be prudent at the outset not to assume any positive effect in some cases. Nevertheless, the main difficulty with including structural measures in Fund-supported programs had frequently not been uncertainty over their impact but problems of implementation. Those implementation problems could be either technical or reflect ambiguities in the authorities' commitment. To minimize those, structural measures in Fund-supported programs needed to be identified at the outset as specifically as possible, with precise timetables; it might sometimes be appropriate to include achievement of those timetables as program benchmarks. In addition, as several Committee members had noted, there might often be a need for technical assistance.

As the staff papers noted, past experience with structural reform had been mixed, Mr. Enoch continued, reflecting in part the fact that some forms of structural reform were easier to implement than others. Correcting price distortions might be technically easier than reforming the parastatal sectors, and no doubt sometimes much could be achieved simply by removing price distortions. Nevertheless, in the same way that macroeconomic adjustment might fail if the structural rigidities underlying the macroeconomic imbalances were not corrected, so correcting prices might not be fully effective if the environment in which those prices were meant to serve as signals remained constrained, so that agents could not respond to those signals. Shying away from the more difficult structural problems could therefore bring about the failure even of those aspects of structural reform which themselves were technically implemented successfully.

One lesson to be drawn from all that experience was that the Fund had to work closely with the Bank, and that each institution had to recognize the other's expertise in its respective field, Mr. Enoch observed. He did not intend to go into the issue of Fund-Bank collaboration, which the Board would be discussing shortly, but he wished briefly to pick up the reference in the staff papers to the U.K. proposal for a policy framework paper mechanism for middle-income countries. The policy framework paper had been a very useful vehicle for coordination between the Fund and Bank on structural reform in low-income countries, and similar arrangements could be of wider assistance. His authorities were pleased with the indications of support they had received for their proposal, and looked forward to further discussion of it in the future.

He agreed with the argument in the staff paper that the Fund and Bank needed to incorporate social and poverty alleviation objectives in the design of structural reform programs, Mr. Enoch said. Not only were those objectives important in their own right, they were also essential, in order to ensure the sustainability of adjustment. But given the scarcity of available resources, it would be necessary to ensure that means of implementing those objectives were always targeted at the poorest groups. In that connection, the staff papers on poverty which the Fund had discussed in 1988 showed that careful analysis was required in order to properly identify the real impact of Fund programs on the poorest sectors of society.

Finally, Mr. Enoch said that he welcomed the joint Fund/Bank "chapeau" paper for the Development Committee, and the joint paper on initiatives for sub-Saharan Africa, which should provide a useful basis for the Committee's discussion. He would not repeat a number of comments by the U.K. chair at the meeting of the Committee of the Whole of the Bank's Executive Directors.

The Acting Chairman remarked that it might be helpful if Ms. Hansen and Mr. Enoch gave an indication of the comments made by their chairs in the World Bank's Committee of the Whole.

Ms. Hansen responded that the U.S. Executive Director's statement at the World Bank Committee's meeting had included some remarks about the importance of structural reform, the use of Bank resources, and drafting comments with respect to the President's Report to the Development Committee.

Mr. Enoch said that the U.K. chair, in its intervention in the World Bank Committee meeting, had expressed agreement with essentially all that was stated in the joint staff paper on sub-Saharan Africa but had made three points. First, that that report might have made more out of the substantial change in the philosophical outlook of many African governments; second, that the data underlying some of the analysis in the paper should be viewed with some skepticism; and third, that more could have been said about the new policies that were being supported by all the initiatives benefiting sub-Saharan African.

Mr. Goos said that he could shorten his remarks because Mr. Hogeweg had expressed the views that he had had in mind. However, and perhaps to echo somewhat the concerns of Mr. Hogeweg in an even more pointed manner, he remained concerned that the growing integration of structural reform considerations into Fund-supported programs would eventually undermine the effectiveness of the Fund as a monetary institution. The widening coverage of structural issues naturally directed the focus to the medium-term and gradual adjustment, making growth considerations increasingly important. But that shift in focus tended to complicate and prolong the restoration of balance of payments viability, thereby unfortunately making it more costly and painful. Indeed, he wondered whether in a number of cases the Fund, by having accepted the gradual course of adjustment proposed by its members, had not contributed to current adjustment fatigue. Moreover, he feared that the Fund, by being drawn more and more into the role of a de facto medium-term financier, might turn into a development institution, thereby giving up its distinctive features and ultimately undercutting the justification for its unique resource base.

Those deliberately pointed remarks should not be taken to mean that he did not recognize the importance of structural adjustment in many cases, Mr. Goos commented. But he was concerned about the general tendency to attempt to integrate greater elements of structural adjustment into Fund-supported programs. In that respect, he had also been concerned to read in the staff paper on the debt strategy that the move toward greater emphasis on the so-called drops might require the Fund to provide financial support through a sequence of stand-by, extended, or enhanced structural adjustment arrangements. After having read the staff paper on conditionality, and the accompanying study of several cases of decade-long financial adjustment supported by the Fund, he wondered whether the actual intention was to add another layer of Fund arrangements in the next decade, in the expectation that such gradualism might eventually lead to the attainment of balance of payments viability. He had doubts in that respect.

To reiterate a few principles that his chair had stressed in earlier discussions that he felt were critical--or should be critical--to the Fund's involvement in structural reform, Mr. Goos reiterated, first, his firm belief that the financing of medium- to long-term structural reform was among the basic responsibilities of the World Bank and should remain so. Second, the financial support of structural reforms by the Fund appeared to him to be appropriate basically only in cases where structural reform facilitated and expedited the restoration of external viability. If there was a trade-off between external adjustment and structural reform, the Fund must focus in the first instance on the restoration of balance of payments viability. That was the overriding mandate of the Fund, which must not compromise the revolving character of its resources.

His third point of principle was that structural reforms could best be incorporated into structural adjustment and enhanced structural adjustment arrangements, as well as in extended arrangements, Mr. Goos added. In contrast, regular stand-by arrangements did not seem particularly suited to the pursuit of such reforms. By overburdening stand-by arrangements with structural considerations, the Fund risked undermining the flexibility of an instrument that used to be highly effective in attaining shorter-term balance of payments stabilization.

Referring to the text of the Fund staff report on structural reform in Fund-supported programs, and to highlight his concerns, Mr. Goos said that in his view there was too much emphasis on notations like comprehensiveness and medium-term considerations. In that respect, his feelings were similar to those of Mr. Jalan. For instance, the statement on the first page of that paper that "the ingrained nature of internal and external economic imbalances in a large number of developing countries has made it clear that economic stability cannot be regained in the absence of basic institutional and economic changes" did not reflect the reality of Fund-supported programs. He preferred the formulation at the top of page 3, where it was stated that "structural measures may in some cases be necessary to complement demand-management policies to achieve growth-oriented adjustment." That latter concept should be the starting point of the Fund's presentation, not the idea that economic stabilization was not possible without fundamental institutional and economic reform.

Another similarly inaccurate presentation on the first page of the Fund staff paper was to be found in the statement that "the basic concern of the Fund is how structural reforms might help achieve the objectives of external and internal balance over the medium term in the context of an open trade and payment system," Mr. Goos observed. He had thought that the basic concern of the Fund was the restoration of balance of payments stability or viability; whether that had to be attained in the medium term or whether it was possible in the short term had to be left to the specific case. Again, a much more balanced presentation appeared on page 3 of the same paper, where it was stated simply that "the appropriate pace and sequencing of reforms in particular situations is likely to depend on the magnitude of the initial imbalances...." The paper should begin with such more modest statements, leaving until later the reference to the possibility of really difficult cases in which more comprehensive action might be called for.

The very first sentence of the concluding remarks in Section VI of EB/CW/DC/89/3 placed an inappropriate emphasis on comprehensiveness and the medium term, Mr. Goos considered, by stating that "progress toward balance of payments viability with growth may be enhanced by comprehensive policy packages" of a certain type. It would have sufficed to say that such progress "may be enhanced by policy packages that place emphasis on an adequate mix of policy instruments," with a later expression of the thought that "reliance on an unbalanced set of policy instruments is likely to affect adversely the objectives of the program." However, he could conceive of adjustment programs that would be effective if they concentrated on only one structural deficiency and not on a whole set.

Finally, Mr. Goos said that he shared Mr. Jalan's concern about the presentation of the Fund's experience with floating exchange rate systems, which according to Annex I had functioned so satisfactorily in developing countries. He had gained a somewhat different impression from reading the staff paper on conditionality.

Mr. Fayyad made the following statement:

> The papers prepared by the staff thus far on the experience with structural adjustment in developing countries are quite thorough and form a good basis for discussion by the Development Committee. Since we have addressed most of the issues raised in the papers rather extensively on a number of previous occasions, I shall limit myself to a few brief remarks.
>
> The structural policy content of Fund-supported adjustment programs should vary in light of the member country's

circumstances. This is not only because the magnitudes of the distortions involved vary from one case to another, but also because, as noted by the staff, the link between structural reform and external viability is not always clear.

The task of identifying structural problems and the scope of needed reforms should be approached in an objective manner, based on an in-depth knowledge of the economy. Generic reform measures which are based solely on mechanistic or purely theoretical approaches may not be relevant for all countries. The failure of the authorities to implement such measures may give the wrong impression about their commitment to reform.

Optimal sequencing of structural policy measures may not always be feasible, not only because theory provides little guidance in this regard, but also because programs of structural reform are complex and often cover a period extending over several years.

The administrative capacity of a member should be an important factor in determining the scope of structural adjustment that can be incorporated in an adjustment program. Where that capacity is limited, emphasis should be on key structural areas. Of course, the member's sociopolitical capacity is at least as important a consideration in this regard. Furthermore, it should also be emphasized that a decision on the scope and pace of adjustment cannot be divorced from the all important issue of availability of adequate external financing.

It should be recognized that there is need in some instances for gradual implementation of structural reforms in order to mitigate the associated transitional costs in terms of output and employment. The progress which is being made toward mitigating the social costs of adjustment and ensuring that growth strategies reduce poverty as much as possible is welcome. Efforts in this direction are absolutely essential for the sustainability of adjustment.

The choice of monitoring techniques should be guided by the consideration that structural reforms generally require a long period of time to affect target variables and that there is uncertainty with respect to the appropriate timing and magnitude, as well as the ultimate impact, of these reforms. Therefore, monitoring of structural policies should focus on a few key areas with the aim of assessing progress toward achieving program objectives. It would also be advisable to evaluate economic performance in the context of program reviews in a flexible manner so that undue delays do not occur in the completion of these reviews. Prior actions should be envisaged only if they are deemed necessary to enhance the credibility of the program and when the imbalances to be corrected are very large and require a wide range of measures. In some cases, insistence that certain measures be implemented prior to an arrangement with the Fund can lead to undue delays in the whole adjustment effort.

With regard to coordination with the Bank, one would expect the Fund to focus in principle more on the macro aspects of structural policies, and, in particular, on those relating to the external sector. However, given the wide scope of the interlinkages between various policy instruments, reforms, and targets, such a narrow focus may not always be feasible, which would make it necessary for the Fund to draw on the expertise and experience of the Bank in other areas of structural reform. The same may be said about the need for the Bank to draw on the Fund's experience in the areas of adjustment and reform in which the Fund has a comparative advantage. The exact modalities of cooperation between the two institutions may vary from one case to another, but what is important is that every effort should be made to ensure the consistency of the content and timing of recommended policies.

The importance of the availability of adequate and timely external financing on appropriate terms to the success of adjustment in sub-Saharan Africa can hardly be overemphasized. The support provided by the international donor and creditor community to the region in the form of aid allocations, continued rescheduling of debt, as well as through special initiatives such as the Special Program of Assistance, the enhanced structural adjustment facility, and more recently, the Toronto-Berlin consensus, is most welcome. The latter indeed represents a major step by official creditors to help reduce the debt burdens of the poorest countries. However, further consideration needs to be given to measures that would accelerate the process and enhance its impact on these countries.

Finally, the global efforts to help address the problems of some severely indebted middle-income countries should be strengthened and expanded to assist all such countries, including those in sub-Saharan Africa.

Mr. Al-Assaf made the following statement:

The papers before us clearly illustrate the importance of structural reform for external viability and durable growth. Structural reforms provide an environment that is conducive to efficiency and growth, while reducing long-term adjustment costs. Recent experience has shown that in order to realize sustainable noninflationary growth, it is essential to adopt an appropriate medium-term policy assignment, whereby macroeconomic policy aims at price stability while structural reform invigorates growth and employment.

While I warmly welcome today's discussion, I am uncomfortable with addressing structural reform in developing countries independently from such reforms in industrial countries. Indeed, these two issues are interdependent since the removal of structural rigidities in industrial countries is essential for structural adjustment in developing countries. Therefore, I look forward to the discussion of the paper on structural reforms in industrial countries being prepared for the fall meeting of the Development Committee.

I will turn now to the specific points raised in the staff paper. The paper on structural reform in Fund-supported programs stresses the point that, in many cases, macroeconomic adjustment has not been durable owing to the prevalence of structural rigidities. Therefore, the Fund staff argues that macroeconomic adjustment primarily addresses the symptoms of underlying rigidities, which, in turn, need to be corrected through structural adjustment. It is interesting to note that the Bank staff paper emphasizes that structural adjustment can only take place with a stable macroeconomic environment. It is evident that these are interdependent and complementary facets of a well-balanced and clearly articulated policy mix. Thus, staff emphasis on a consistent program is well placed. Nonetheless, it is imperative to stabilize the economy prior to ambitious and politically difficult structural reforms.

The staff correctly points out that any structural adjustment program, to be credible and successful, must be internally consistent and specifically designed for each country. In addition, such a program needs to be realistic and should enjoy the full support of the authorities. Furthermore, a conducive external environment and adequate financing are also needed. The importance of open markets, low interest rates, and noninflationary growth in the industrial countries for the success of structural adjustment programs cannot be overemphasized. That is why I would have preferred to discuss structural adjustment in industrial and developing countries simultaneously.

Although these aforementioned elements are necessary for a successful program, they are not sufficient. Indeed, a pivotal ingredient of any program is the appropriate sequencing of structural reforms. Some of the case studies prepared for the conditionality review have clearly demonstrated the significance of sequencing, which I believe deserves greater in-depth analysis. The staff indicates that, in general, reforms in domestic markets should precede those in the external sector and that current account liberalization should be a prelude to capital account liberalization. In practice, the political and social constraints facing the authorities may lead to an inappropriate sequencing of reforms. Indeed, the staff recognizes this and indicates that it may be beneficial to adopt a second-best approach in some cases. In this regard, one can imagine linking the issue of sequencing to the relative speed of reform in each sector, which in itself would depend on external and domestic developments. Therefore, it is conceptually possible to alter the speed and sequencing of reforms in light of evolving circumstances. If, for example, unfavorable developments occur, a deceleration in reforms and an adjustment of sequencing may be feasible. The opposite could also be true.

While I appreciate the uncertainties involved in this issue, further staff analysis seems appropriate. Moreover, due to the complications involved, I would like to emphasize the importance of collaboration between the Fund and the Bank on structural reforms, as every effort is needed to improve the design and implementation of structural adjustment programs.

Mr. Engert said that in view of the forthcoming discussions on conditionality, the review of the structural adjustment and the enhanced structural adjustment facilities, and the work on Fund-Bank collaboration, he would not touch on any of the substantive issues raised in the papers before the Committee. His authorities also had found the scheduling of the various topics to be awkward. However, the papers prepared by the staff on experience with structural adjustment were a useful overview; his authorities particularly appreciated the joint paper prepared by the staffs of the Fund and the Bank and encouraged building on that effort in the future.

The Deputy Director of the Exchange and Trade Relations Department said that she agreed fully that it would have been easier to tackle the issues under discussion and also to reply to the questions that had been raised if the scheduling of related items on the Board's agenda had been different.

As for the questions raised on the extent to which the Fund and the Bank might be operating in each other's domain, the Deputy Director said that she would prefer, like Mr. Ismael, to stress the symbiotic relationship between the two institutions. To the extent that both the Fund and the Bank were active in the same areas, the Fund was ensuring that the macro imbalances were corrected so that development strategies could be successfully applied. As Mr. Ismael's statement made clear, some macro imbalances could not be removed unless a number of structural and institutional rigidities were tackled. It was in those circumstances that the structural measures must be included in Fund-supported programs, not of course under a series of Fund arrangements, but to permit the initial adjustment to take place and progress to be made. The hope would be that adjustment would continue, whether or not it was supported financially by the Fund.

It was clear from the comments of Committee members that some of the wording of the Fund staff paper needed to be reconsidered, the Deputy Director said. The staff, in fact, agreed with the observations by Mr. Jalan and Mr. Goos with respect to "comprehensive" and "case-by-case" approaches to structural adjustment. By comprehensive the staff meant the need for macro measures to be supported by certain structural measures, the shape of which would depend entirely on the size and degree of the initial distortions and the particular circumstances of the country, including institutional rigidities and social considerations. The first two paragraphs of the concluding remarks in Section VI would be amended to ensure that that point came out more clearly.

On the interlinkage of policies, she had thought that the staff paper had demonstrated full awareness of the fact that correcting one problem could create a need for policy action in another area, with the result that the instruments used must be mutually supportive, the Deputy Director added. Perhaps the natural tendency of the Bank to cite an exchange rate example, and the Fund to refer to import tariff adjustments, had obscured that point. In his statement to the Development Committee on the structural adjustment issue, the Managing Director would no doubt include comments on Fund-Bank collaboration.

It was perhaps also necessary to make it clearer in the staff paper that there was no optimal sequencing and timing of adjustment programs that combined macro and structural reforms, the Deputy Director commented. Again, much depended on the institutional arrangements and on the degree and depth of the distortions.

Whether too much was being expected by way of structural adjustment, too soon, and to what extent adjustment programs were shock treatment was largely a question of expectations, the Deputy Director noted. The success of adjustment programs, particularly on the structural side, depended greatly on changing the expectations of economic agents so that the behavioral changes needed to ensure the effectiveness of the programs came about as fast as possible. If the need for adjustment was great, substantial up-front measures were sometimes necessary. While it was true that, in the exchange rate example cited by Mr. Monyake, the staff would not know what the equilibrium exchange rate was, it was also true that economic agents knew what the wrong exchange rate was. To the extent that those agents expected the status quo to continue, they would not change their behavior patterns as effectively as they might if forceful and credible adjustment was feasible.

The staff had not had in mind preparing a paper on structural reform in industrial countries for the fall meeting of the Development Committee, the Deputy Director of the Exchange and Trade Relations Department explained. Rather, the staff had undertaken to focus, inter alia, on the external environment, which of course included consideration of market rigidities in industrial countries.

The staff representative from the Exchange and Trade Relations Department remarked that the paragraphs in Annex I to EB/CW/DC/89/3 on exchange rate policy should not be taken to mean that the staff was suggesting that a particular exchange rate regime was appropriate for all countries. In referring to floating exchange rate systems, the report had mentioned only that such systems might function satisfactorily; similarly, use of a formula for introducing flexibility into the exchange rate had been mentioned as one among other approaches.

Mr. Goos responded that while that might well be the case, the tendency throughout the paper to be noncommittal made it hard to know what the staff's position was.

The Acting Chairman said that appropriate changes would be made to the text to avoid any possibility of misinterpretation, particularly with respect to the conclusions and the matter of floating exchange rates.

The Executive Secretary remarked that the interest shown by Committee members and their comments would be of use in drafting the communiqué of the Development Committee.

The Committee of the Whole concluded its consideration of the Fund and Bank staff papers on experience and issues in structural adjustment.

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