IMMEDIATE ATTENTION

CONFIDENTIAL

February 20, 1986

To: Members of the Committee of the Whole for the Development Committee

From: The Acting Secretary

Subject: Draft Minutes of Meeting 85/2

Attached are the draft minutes of the meeting of the Committee of the Whole for the Development Committee held on April 5, 1985. If no further revisions are proposed by the close of business on Thursday, February 27, 1986, the draft minutes will be deemed approved on that date.

Att: (1)

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CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Committee of the Whole for the Development Committee

Meeting 85/2

11:00 a.m., April 5, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. K. Bush
	S. Kolb, Temporary
	G. E. L. Nguyen, Temporary
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
	Jaafar A.
R. K. Joyce	
A. Kafka	H. A. Arias
H. Lundstrom	H. Fugmann
E. I. M. Mtei	A. Abdallah
	B. Jensen
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	R. Msadek, Temporary
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

F. Fischer, Executive Secretary, Development Committee; A. Shakow, International Relations Department, IBRD. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; M. Allen, S. J. Anjaria, K. B. Dillon, N. Kirmani, C. M. Watson. External Relations Department: H. O. Hartmann. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director. Secretary's Department: J. W. Lang, Jr., Deputy Director, A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer. Western Hemisphere Department: E. Hernandez-Cata. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, J. Hospedales, J.-C. Obame, G. W. K. Pickering, T. Sirivedhin, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, W.-R. Bengs, J. Bulloch, M. B. Chatah, J. de la Herrán, V. Govindarajan, A. K. Juusela, H. Kobayashi, K. Murakami, A. Mustafa, E. Olsen, J. Reddy, A. A. Scholten, L. Tornetta, A. J. Tregilgas, E. L. Walker, A. Yasseri.

1. FUND-RELATED ISSUES - BACKGROUND PAPER

The Committee members considered a background paper on Fund-related issues prepared for the meeting of the Development Committee to be held in April (EB/CW/DC/85/2, 3/29/85). Mr. F. Fischer, Executive Secretary, Development Committee, was also present.

The Chairman noted that the background paper had been prepared in response to the request of the Development Committee at its previous meeting, as mentioned in paragraph 7 of the press communiqué issued September 1984. In drafting the paper, the staff had had the benefit of the views expressed by Executive Directors during their recent discussions on trade, debt, and surveillance; if necessary, a revised version would be issued following the present discussion, and in the light of the Executive Board's recently completed discussion on the World Economic Outlook.

Mr. Sengupta considered that the background paper was generally quite satisfactory, although he hoped that the points of emphasis he was to make would be taken into account in any revision.

The treatment of adjustment in industrial countries in Section IV was particularly satisfactory, Mr. Sengupta commented. Two important points had been brought out in the well written paragraphs on protectionism, namely, that nontariff barriers were leading to the failure of market signals in the international economy, and the redistribution of resources, to the disadvantage of potential exporters and to the advantage of existing producers with sheltered markets. In line with those views, it would seem appropriate to add to the coverage in Section IV of the need for more flexible markets to accommodate rapid technological change by mentioning also changes in comparative advantage with respect to the world division of labor. The comparative advantage acquired by developing countries in certain fields of activity might result not so much from technological change as from the evolution of the international economic system that called for active measures of structural adjustment in developed countries, which should abandon such activities, thereby dealing with their own unemployment problems.

The overall tenor of the background paper, beginning with the opening paragraph of Section II on the current situation and outlook, was optimistic, Mr. Sengupta noted, although according to some, the world economy was still in a deep crisis. Indeed, it was plausible to argue that a major share of the economic growth recorded in 1984 reflected the low base of the preceding years. In the Western Hemisphere, GDP growth had been negative in 1982 and 1983, significantly so in the latter year; the positive growth registered in 1984 could not therefore be considered a great improvement. Similarly, inflation was still rising in the developing countries as a whole--from 24.7 percent in 1982 to 33 percent in 1983 and 37.7 percent in 1984--with the Western Hemisphere having experienced a sharp increase in those same years from 65.5 percent to 105 percent to

119.8 percent. As foreseen in the World Bank scenario, there was also likely to be a continuation in future of the long-term transfer of resources from developing to developed countries; according to the World Bank debt tables, the reverse flow of resources from all developing countries in 1984 had reached $7 billion; for major borrowers the figure was $15 billion.

On a more technical point, the statement that correcting structural disproportions involved a relative redistribution of income as an economy was returned to its "longer-run equilibrium path" assumed that there was such a path, Mr. Sengupta noted. The subsequent reference to the sustainable growth path of an economy seemed more appropriate; he doubted whether long-run equilibrium paths could be established even in a purely empirical model. He would dispute the observation in Section IV on adjustment in industrial countries that another aspect of the attempt to deal with structural problems had been the reduction in administrative regulation of markets and in the scope of the public sector. Presumably, the intention was to refer to reducing unproductive activities of the public sector; surely, the U.S. Government was not totally opposed to all market regulations.

In Section V on adjustment in developing countries, it was difficult to support the point made on pages 11-12 that the absence of a real increase in ODA was attributable first, to "a shortage of development projects to finance at the present time," and second, to "donors' unwillingness to expand commitments," Mr. Sengupta stated. First, there was no lack of good projects; rather, the transfer of real savings from the industrial countries to the developing countries had been minimal for some time, as the statistics showed. He recalled having referred in that connection, during the Executive Board discussion on external indebtedness, to a specific paragraph in the paper prepared for the World Economic Outlook on trends in capital flows to developing countries (SM/85/79, 3/11/85). For the low-income, least developed countries, the issue was much more one of willingness on the part of developed countries to share their savings with the developing countries because the rate of return was a long-term structural one. While he did not mind the emphasis placed in the background paper on the need to review projects carefully in case they were no longer in line with available resources, the main emphasis should be on the willingness to invest.

As for the statement that the generation of private savings was a sort of function of price stability, rising real interest rates, and profitable and efficient investment opportunities, Mr. Sengupta considered that the issue was more complicated. Private savings depended greatly on the growth of real income, at least in the early stages of development. Most empirical studies did not show a high elasticity of savings to interest rates, although that elasticity improved over time as development took place. Investment opportunities might exist, but the market rate of return was not always attractive if prices did not reflect real scarcities;

that was why state planning had assumed such importance. In describing the savings effort in developing countries, greater emphasis should be placed on the need to increase real income.

Most developing countries were not basically opposed to another round of multilateral trade negotiations, Mr. Sengupta observed, but they would like all the obligations undertaken in the previous round to be fulfilled. The rollback of existing protection for future trade liberalization should not be seen as depending on there being a new round of multilateral trade negotiations.

In conclusion, Mr. Sengupta considered that Section V on adjustment in developing countries had brought out all the issues succinctly and should lead to a useful discussion in the Development Committee.

Mr. Lundstrom said that he agreed with Mr. Sengupta that the background paper was excellent but that it needed some revision in light of the recent discussions in the Executive Board. The balanced summing up of the discussion of the World Economic Outlook should be reflected in the background paper. The revisions were, however, more a matter of nuance than of substance, although the paper was perhaps more optimistic than the general outcome of the Board's discussion warranted and should perhaps have an element of uncertainty injected in it.

In Section II on the current situation and outlook, the major problem areas were indicated as being fiscal and payments imbalances, high real interest rates, rigidities in labor markets, and a drift toward protectionism, Mr. Lundstrom noted. His personal view was that high unemployment in many countries, and not only in Europe, constituted a problem in itself and was not always a consequence of rigidities in labor markets. In the same vein, no more than passing reference had been made in Section IV in connection with the problem of protectionist pressures, to high levels of unemployment in Europe, which were described as being engendered by structural problems. Yet it was equally true, as a large number of Executive Directors had observed, that relatively low rates of growth were a reason for high unemployment.

Like Mr. Sengupta, he had certain difficulties with the paragraph on overseas development assistance in Section V, Mr. Lundstrom remarked. First, it was misleading to preface the sentence on page 11 on the debt ratios of countries relying on ODA with the word "although." More important, the explanation of the failure of ODA to increase was also misleading, especially in relation to the subsequent reference to the real reason: that ODA had not only failed to increase but had declined, and not only since the so-called shortage of projects in 1984 but since 1982. That decline in ODA was more than a reflection of unwillingness to expand commitments; it reflected the desire to reduce those commitments. The quantitative aspect of assistance to developing countries could have been brought out much better. Not until the last paragraph of the background paper was it stated that "...the multilateral forums have a responsibility not only to encourage the pursuit of needed adjustment strategies"--an appropriate emphasis--"but also to ensure that adequate financing is available."

Mr. Nimatallah remarked that international trade was an important aspect of countries' interdependence. As someone had once written, World War III would be waged for markets. Apparently, the war had started, with both sides having their reasons. Developing countries, to find the investment opportunities they needed, had to seek markets abroad because their domestic markets were too thin. Unfortunately, those external markets were afflicted with rigidities arising either from the inability to adopt new technologies as fast as possible or because of the failure to deal with unemployment, which of course was itself a product of rigidities. One of the many aspects of such rigidities was the high cost of delaying technological change, which made it difficult for governments to handle the political realities of unemployment, at least in the short run. It was of the utmost importance for industrial countries and developing countries to face up squarely to the fact that they needed each other's markets. Industrial countries would have to rely on the increase in the purchasing power of developing countries, who must be given an opportunity to develop their industrial and other potential, thereby strengthening their markets. But unless developing countries' real incomes grew, which presupposed development opportunities, domestic markets would not grow. As Mr. Sengupta had observed, as important as such factors as price stability and real interest rates were for enhancing savings and sustaining growth, the main source of savings was income; and while savings could be ploughed back into investment, investment depended on growing markets. The background paper could make a contribution to the forthcoming discussions if it highlighted the need for both industrial and developing countries to reach an understanding on early and systematic action to release the forces to promote international trade.

On the matter of capital flows, Mr. Nimatallah noted the lack of attention to the disappearance of surpluses, no doubt for cyclical reasons, that had enabled certain countries to export capital to countries in need of capital imports. Even in the industrial countries, there was less of an unwillingness to export capital than a lack of capital to export. Until the present phase of the cycle had ended, probably in two years or so, when the industrial countries should once again be able to resume capital exports, it would be important for the developing countries to make a point of increasing domestic savings to the maximum extent possible; that should also attract as much capital as possible on a basis that might have little to do with investment opportunities, and not necessarily in the form of overseas development assistance. Before he was accused of sounding like a representative from an industrial country, he hastened to add that flows of ODA should be increased by all countries to satisfy the need of developing countries for a steady flow of capital until they were able to sustain an increased rate of domestic savings. At the same time, developing countries must recognize that less capital might be available from traditional sources.

Mr. Kafka remarked that his reaction to the background paper was similar to that of those Directors who had preceded him. The paper could not be criticized for not mentioning all the issues, but its general tone was one of complacency, especially against the background of the Chairman's realistic summary of the Executive Board's discussion of the World Economic Outlook, which should find its way into the background paper.

Without wishing himself to give the impression that he was complacent about inflation in developing countries, Mr. Kafka continued, it should be noted that the data mentioned in the background paper referred to average rates of inflation, which were about ten times higher than median rates of inflation, or in the range of 100 percent compared to 10 percent.

The two sections on industrial countries and developing countries seemed to him to convey two different views about ODA, Mr. Kafka remarked. As far as industrial countries were concerned, the staff looked forward to improved fiscal balances to give room for increasing ODA. In dealing with developing countries, the staff was more affirmative about the need for increased ODA. Along with ODA, World Bank credit, which was not the same but was relatively cheap, was becoming more and more important for the developing countries, including even medium-income developing countries because the amount of foreign borrowing that a country could absorb depended very much on the terms on which it was available.

He agreed with Mr. Sengupta's views on protectionism, Mr. Kafka stated. The need for a rollback of protectionism in industrial countries and for meeting the unfulfilled promises of the Tokyo Round could not be emphasized too strongly. Whatever new multilateral trade and/or trade and service negotiations were decided upon would not produce concrete results until the early 1990s; results were needed urgently in 1985-86.

There were a few points that had not been mentioned in the otherwise appropriate background paper, Mr. Kafka commented. One was the modest advantage to be drawn from portfolio equity investment as well as from foreign direct investment. In addition, no idea had been given of the quantitative significance of foreign direct investment in supplying capital to developing countries. He did not expect the staff to provide estimates, however, because it was not realistic to expect foreign direct investment to be of major importance in making up for the loss of borrowed resources needed by those countries.

The section of the background paper on multilateral action was praiseworthy, Mr. Kafka considered, not with respect to so-called firm surveillance, about which he remained skeptical, but on the need for multilateral organizations to encourage increased emphasis on multiyear rescheduling agreements and on modifications in export credit policies, although a more precise idea of what the staff had in mind referring to "modifications" of the latter policies needed to be brought out more clearly.

Mr. Mtei noted that most of what his chair had said during the discussion on the World Economic Outlook applied also to the background paper, which was by and large a condensed version of the survey on the World Economic Outlook. However, a few points should be stressed so that the staff could take them into account in revising the paper for the Development Committee. First and foremost, the Development Committee was meeting in April primarily out of concern that economic conditions in developing countries had become precarious or even intolerable in low-income countries. The tone of the paper should therefore convey more emphatically the message that the global economy had not yet recovered fully. A large number of member countries, mainly those that were highly dependent on primary commodity exports and on financing from official sources, continued to find themselves in a very difficult position. Accordingly, it was essential to avoid leaving the impression, by placing too much attention on the average situation in developed and developing countries, that there was room for complacency.

Another important issue was the need to focus more sharply on the question of poverty and why it was a major constraint on the ability of low-income countries to carry out adjustment programs based on policies geared basically toward demand management that compounded the social and political costs of adjustment, Mr. Mtei continued. Therefore, it was important to emphasize growth and development and the improvement of living standards as a necessary condition for the smooth implementation of adjustment policies. The background paper could show what could be done to reorient Fund policies and improve program design to make it consistent with such objectives and more relevant to conditions in low-income countries.

Furthermore, it might be useful if the paper outlined more precisely the ways in which the Fund could work with the World Bank in supporting adjustment programs in developing countries, Mr. Mtei added. At the same time, the limitations of the Fund's ability to deal more directly with the long-term problems of developing countries could be mentioned, the Fund not being a development institution per se, as the Chairman had often recalled. Nevertheless, more could be said about the financing role of the Fund in developing countries.

The background paper might have gone further when recognizing the need for increased flows of ODA to low-income countries, in urging industrial countries to honor their commitment to set aside 0.7 percent of their GNP for ODA, Mr. Mtei noted. In addition, it would be useful to have the Fund's views on how such aid could be used to supplement its own assistance as well as on the type of aid that might be more appropriate to the circumstances of developing countries. The areas in which aid should be extended could also be mentioned, bearing in mind that some part of ODA would have to be used for projects to meet certain basic needs. A related question was the issue of the rescheduling of debt owed to members of the Paris Club. The catalytic role of the Fund, as his chair had noted in the discussion on the World Economic Outlook, could be extended to persuading the Paris Club to consider the benefits that could accrue to indebted developing countries from multiyear rescheduling.

The final point to be taken into account in the background paper, Mr. Mtei considered, was related to direct foreign investment. He agreed that that type of capital flow to developing countries could play a role in the development process and should be encouraged. However, the impression should not be left that foreign direct investment could substitute for other forms of capital inflows geared toward financing the balance of payments deficits of developing countries. It was also necessary to recognize the role that political considerations played in determining the extent to which a country opened up its borders to foreign investors or in determining the types of business in which foreign investors could hold a controlling interest.

Ms. Bush, following up certain comments by previous speakers, noted that the statement in the final paragraph of the background paper on the responsibility borne by the multilateral financial institutions and other forums for encouraging the pursuit of needed adjustment strategies in conjunction with ODA was of great importance. The view of her authorities was that while ODA should be directed more particularly toward the neediest or low-income countries it was also important that it be directed toward those implementing economic policy reforms. Such a two-pronged approach would help to assure the growth and development prospects of those countries. The U.S. authorities had also urged that the World Bank devote an increasing share of its resources to the neediest countries and to those following constructive policies of economic reform.

In referring to the reduction in administrative regulation of markets as a way of dealing with structural problems, Mr. Sengupta had suggested that the United States did not place much emphasis on such action, Ms. Bush observed. She wished to point out that the United States attached great importance to deregulation, as evidenced by its recent efforts in removing many administrative barriers in various sectors of the economy, including transportation and financial services. One factor contributing to the flexibility of the U.S. economy, and that had been mentioned in the summing up of the world economic outlook as having contributed to the strength of the recovery of the U.S. economy, was the removal of rigidities inherent in administrative controls, which impeded competition and detracted from the ability of other economies to experience similar growth.

Mr. Clark said that he was generally content with the background paper. If anything, it was a little too bland in places, but not complacent, and perhaps necessarily so because of the need to reflect a range of views on the various issues. However, a number of references were made in the paper to the role of the exchange rate in adjustment policies that were rather less clear than we would have wished. It was noted on page 9 that "it is essential to avoid allowing major prices to become misaligned, in particular real exchange rates ...", and on page 13, that it was important "the exchange rate is not allowed to become overvalued." He would like those points to be made slightly more positively; it should be recognized that in some cases where the exchange rate was already clearly misaligned, a substantial change was required as a first step in setting the adjustment process effectively in train. One possibility would be to insert one or two sentences on page 9; following the paragraphs identifying fiscal policy as one key element of the adjustment process, and stressing the need for greater efficiency of resource use, the exchange rate could be singled out as a particularly important source of the distortions which policy must aim to remove.

Finally, Mr. Clark noted in passing that it was wrong to equate net cash flows with resource transfers, as some earlier speakers had appeared to do.

Mr. Wijnholds remarked that it was useful to have the opportunity to discuss the Fund-related issues of relevance to the meeting of the Development Committee, which was a joint committee of the World Bank and the Fund, even though most of the points raised in the background paper had already come up in the Executive Board's recent discussions.

Before making a few specific observations, he wished to endorse Mr. Clark's comments about the reverse flow of resources, Mr. Wijnholds said. Continuing, he noted that the staff had underlined the importance, if higher growth rates were to be achieved, of both industrial and developing countries being able and willing to bring about the right kinds of structural change in their economies, despite the socially and politically painful consequences, which were in fact often the main stumbling block to structural adjustment. Sustained growth over the long run was likely to require relatively frequent changes in the economic structure of countries in the years ahead in a world experiencing rapidly changing technology and numerous innovations. For industrial countries, to resist such changes because of the social repercussions would imply falling behind; for developing countries, it would mean setting back development aspirations. The Fund and Bank had an important task to carry out in that respect by helping to convince policymakers in individual countries that creating the conditions for high and sustained growth might not be politically rewarding in the short run but that it was the only path to economic success in the longer run.

In the discussion on capital flows to developing countries, beginning on page 11, multiyear reschedulings of commercial bank debt were mentioned in connection with the normalization of debtor-creditor relations, Mr. Wijnholds observed. Although he agreed with the staff statement that multiyear rescheduling arrangements were necessary for such normalization, and that the parties involved should work toward them, it should also be pointed out that such arrangements would have to be justified; in other words, a country would have to be undertaking a sufficient adjustment effort that could reasonably be expected to be sustained--or at least not be undone--over the life of the arrangement. Unless that point was mentioned in the background paper, it might be understood, mistakenly, that it would be sufficient to have an amortization hump to qualify for a multiyear rescheduling arrangement with commercial banks.

The discussion in the paper of commercial bank lending to developing countries and export credit flows made no mention of cofinancing with the World Bank and other development finance organizations, Mr. Wijnholds noted. Yet such cofinancing could be very useful, particularly in view of the greater weight that was expected to be given to trade-related and project-related credits. It would be helpful to include a positive reference to cofinancing because it was to be discussed in the Development Committee.

Finally, on development aid, Mr. Wijnholds said that he agreed with the statement in the background paper that industrial countries in the process of reducing their budget deficits should nevertheless continue to give priority to aid programs. The references in staff reports for Article IV consultations to aid performance constituted a useful means of keeping track of the record of industrial countries in that field. Perhaps a sentence to that effect could be added to the paper, although he did not feel strongly about it. He also endorsed the staff's view that the industrial countries should attempt at the same time to improve the quality of their assistance, which in bilateral programs in particular had not been as high as desirable. Of course, although development assistance could add greatly to the resources of low-income developing countries, it was even more important for such countries to mobilize domestic savings, enabling them to increase productive investment, which was so crucial. Emphasis should perhaps be not so much on raising domestic savings rates as on mobilizing savings in economically useful forms and the efficient use of savings, as Mr. Ortiz had pointed out in the discussion in the Executive Board of the World Economic Outlook.

Mr. Salehkhou said that he would confine himself to one question relating to the sentence on page 2 of the background paper reading: "The rapid adjustment pursued by many developing countries in recent years, and in particular by most of the major borrowers among them, has resulted in a dramatic improvement in their combined current account position, which has now in aggregate terms reached a level financeable by official and nondebt-creating flows." Even though the statement in the latter part of the sentence seemed to be borne out by the statistical appendix to the World Economic Outlook, he nevertheless wondered whether he was correct in inferring that there was currently a net flow of resources in aggregate terms to developing countries. If so, his next question was how to match the statement in that sentence with the last sentence of the first full paragraph on page 3 reading: "Many countries relying principally on primary commodity exports and official financing will remain in a more difficult position, with growth rates expected to stay below the average, and no overall improvement in the ratio of debt to exports."

The Deputy Director of the Research Department remarked that the two statements were consistent. The statement quoted by Mr. Salehkhou from page 2 referred to the aggregate position of all developing countries and to the fact that the two sources of capital flow mentioned--official development assistance and nondebt-creating flows, which were mainly grants and direct investment--were larger in total for the indebted developing countries than was their aggregate current account deficit. Of course, developing countries also needed to build up their reserves, and longer-term capital inflows might not fully meet their financial requirements. The second statement on page 3 made the point that among developing countries as a whole, some countries--particularly those relying on official balance of payments assistance--remained in a difficult situation. The actual words used, "a more difficult position," referred back to the statement in the previous sentence. That sentence had noted that countries whose exports consisted predominantly of manufactures had faster than average growth rates compared to those that were more dependent on primary commodity exports, had lower than average growth rates, and--as stated in the sentence cited by Mr. Salehkhou--had no overall improvement in the export/debt ratio.

Mr. Salehkhou remarked that some clarification was needed.

The Chairman said that an effort would be made to meet Mr. Salehkhou's point.

Mr. Grosche considered that the background paper was excellent and far from being complacent. On the contrary, the need for action in different areas by both industrial countries and developing countries was clearly set out. With a few clarifications the paper should serve its purpose well. His only suggestion for possible clarification concerned the reference on page 15 to the initiative of the Bank in establishing a "Special Facility for Africa" to support policy reform and structural adjustment efforts, to which the contributions already pledged would also play an important role. It would be misleading to leave the impression that those contributions were the only ones; parallel contributions were also being pledged, and they should be mentioned for the sake of precision.

Mr. Joyce remarked that he too considered that the background paper was well balanced and, like Mr. Grosche, he detected no undue complacency in the paper overall. Indeed, the issues and problems to be dealt with had been set out quite pointedly in a way that was particularly suitable for a ministerial discussion.

Referring to two issues related to trade, Mr. Joyce went on, it was of course absolutely right to stress, as Mr. Nimatallah and many others had, the particular importance of external markets for developing countries because their domestic markets were in many cases not adequate. Mr. Nimatallah had noted that both sides would have to realize the need for action in that respect, meaning presumably on the side of industrial countries as well. Yet it should not be forgotten, as he felt sure that Mr. Nimatallah had not, that it was equally important to explore the possibilities for stimulating trade between developing countries. If the full onus for providing markets was placed on the industrial countries, the end result was more likely to be increased pressures for protection in those countries. Much of the expansion in the economies of the Third World could be based on greater trade within the Third World.

He had a great deal of sympathy with Mr. Sengupta, who had expressed the feeling of many developing countries about multilateral trade negotiations, Mr. Joyce continued. It was true that the arrangements entered into in the Tokyo Round had not been carried out as fully as they should have been. But although work on that Round was urgent and must continue, it was not a reason for delaying the onset of what would clearly be an extensive and probably lengthy negotiation in the second round. The two exercises should proceed in parallel. He could however agree with Mr. Sengupta that there should be no implication anywhere in the background paper that it should be an established objective to make the rollback of protectionism or further measures of trade liberalization await the outcome of the new round of trade negotiations, even though that might in fact be what happened in many fields.

Mr. Fujino said that he could endorse the main thrust of the background paper; most of the issues had been covered extensively in the Executive Board's recent discussions, and he would limit his remarks to the paragraph in Section VI on the World Bank's establishment of a Special Facility for Africa which would, of course, be of major importance, as his authorities would agree with the staff. However, they also believed that the Special Facility was but one of various types of appropriate external assistance that should be provided both bilaterally and through other multilateral organizations--including the International Development Association and the African Development Bank--to support domestic policy reform in African countries, as had rightly been pointed out in the report on the Joint Program of Action for Sub-Saharan Africa, issued by the World Bank in August. The staff would have to evaluate properly the effort to mobilize those financial resources. Of course, although the Special Facility was at present small in size, it could be of use in catalyzing the mobilization of such resources. Finally, he mentioned that he fully shared the views expressed by Mr. Wijnholds on the importance of cofinancing with the World Bank.

Mr. Nguyen remarked that it was hard to understand the precise relationship between the extent of the public sector and structural problems, to which reference had been made in Section IV on adjustment in industrial countries. How could the scope of the public sector be at the origin of the structural problems, as the staff seemed to suggest?

Mr. Alfidja noted that like previous Directors he had found the background paper to be satisfactory although it could be improved by taking into account the summing up by the Chairman of the Board's discussion of the World Economic Outlook, together with comments made by Mr. Kafka, Mr. Mtei, and Mr. Sengupta in particular during the present session. He had had some trouble understanding the sentence in Section II, stating that "while most major debtors have now adopted comprehensive programs of economic adjustment, some other countries which have in the past relied heavily on commercial borrowings have not yet succeeded in stabilizing their financial situations." It was not clear whether the countries having adopted comprehensive adjustment programs had actually succeeded in stabilizing their economies.

Referring to Section V on adjustment in developing countries, Mr. Alfidja suggested that the statement on page 10 that considerable concessional assistance "may be required" for some of the poorest countries to support measures to improve resource use seemed somewhat weak, especially in light of the recognition in the same paragraph of the complex, politically sensitive nature of several measures and the generally long time necessary to implement them and see them bear fruit.

Mr. Romuáldez commented that the background paper competently tied together in one relatively small and tidy package the more important issues which the Executive Board had had to probe during the past few weeks in preparation for the coming meetings of the Interim and Development Committees. Every issue of significance had been mentioned, punctuated with enough emphasis to be meaningful but not so much as to satisfy fully any one point of view. It was clear from other Directors' reactions that the paper had served its purpose well, being evocative of the ideas to be followed up without being in any way provocative.

All the significant issues were covered in the background paper, Mr. Romuáldez noted: for example, the survey of the upturn in the world economy in recent years and the focus on major problem areas existing as much among industrial as among developing countries; also, the expectations for 1985 and 1986, including a few glances at the years beyond 1990 and the fears that adjustment could falter--even the hopes for better outcomes. In addition, the paper discussed the challenges posed for industrial and developing countries alike to muster the political strength to achieve the right kind of structural change in their economies and the special call to responsibility addressed to industrial countries, especially the largest, which exercised the predominant influence over the environment in which developing countries must conduct their policies. It included the caveats about the illusory benefits of protection in all its forms but especially in its most hidden guises and the inefficiencies that it engendered. It admonished developing countries to persevere in adjustment toward efficiency in resource use and mobilization. It recognized that it was essential that the international community afford developing countries the external support they needed to carry out their adjustment programs. It reminded us of the exigency inherent in adjustment and development of an appropriate mix of capital flows from commercial banks, overseas development assistance, and the international financial institutions, with the appropriate implications for creditworthiness, project feasibility, and the need to adhere to aid commitments. Finally, it referred to the special needs of the least developed countries, particularly in sub-Saharan Africa.

He had been pleased to note that the role of such multilateral institutions as the GATT, the Fund, and the World Bank had not been overlooked in the background paper, Mr. Romuáldez remarked. In the midst of the attention being paid to structural adjustment, the proper roles of those institutions could easily become confused. It was therefore appropriate that the paper had stressed that each institution had been designed to carry out a particular role. Insights on the part of each institution into the work of the others were welcome as long as their roles were never allowed to become blurred. What should perhaps have been emphasized more strongly was the need for each member of the international community to be more forthcoming in its support of those institutions.

Mr. Finaish remarked that he would rest for the most part on his understanding that the staff would review the background paper in light of the present discussion and of the summing up of the World Economic Outlook. Referring to the question of official development assistance, he agreed with Mr. Sengupta and Mr. Lundstrom that the failure of ODA to increase could hardly be attributed to the so-called shortage of good development projects in recipient countries. Clearly, donors' unwillingness to expand commitments was the more valid reason which, along with the need for greater ODA flows, should be given greater emphasis. On direct foreign investment, he joined Mr. Mtei in noting that there were limits to such investment as a substitute for other flows of capital and as a viable option for some countries. For instance, the experience of some countries with direct foreign investment had given rise to certain apprehensions that limited their willingness to host such investment unless owned and managed jointly. He suggested that the staff reflect upon the factors limiting the size and usefulness of direct foreign investment. Indeed, it had been noted in the background paper that the relative importance of direct foreign investment in capital flows to developing countries had declined during the 1970s. In point of fact, the relative importance of other flows of capital had also declined greatly, as a result simply of the substantial increase in the importance of commercial bank lending. But as Mr. Nimatallah had observed, the distribution of balance of payments surpluses also had implications for the amount and quality of ODA, the flow of labor and of remittances and other capital flows. The assistance provided by some OPEC countries, for instance, had at a given time represented as much as 8 to 10 percent of GNP and had been basically concessional in nature; and the related flows of labor and remittances had also made special contributions to the non-oil developing countries.

Finally, Mr. Finaish noted the reference on page 15 to the possibly "disastrous effects" of policy slippages in Africa, such as weakened efforts to maintain appropriate real exchange rates. He suggested that the language be recast in more appropriate terms.

The Director of the Exchange and Trade Relations Department stated that there had been no intention, and there was indeed no reason, for leaving the impression in the background paper that the staff was complacent about the problems of developing countries in Africa, Latin America, or elsewhere. Rather, the intention had been to convey the idea that the major efforts being made by those countries were not only encouraging but had changed the situation from what it had been three years previously.

A number of important points had been made by Executive Directors, the Director of the Exchange and Trade Relations Department observed, and the staff would revise the background paper as necessary to clarify those points.

Mr. Msadek recalled that Mr. Joyce had mentioned the question of trade between developing countries. It would be interesting to know how the staff evaluated the prospects for such trade, in view of the historical rigidities and the inevitably competitive nature of trade between developing country economies. Although some efforts had been made to avoid duplication of resource development, the long historical orientation of economic activities toward metropolitan areas, including transportation, compelled developing countries to continue to trade along established routes. No doubt trading among each other would take much longer to achieve; meanwhile, developing countries would have no option but to exchange goods with the industrial countries, which themselves needed to export to the developing countries.

The Director of the Exchange and Trade Relations Department responded that the rapid growth in many of the industrial sectors in developing countries suggested that the degree to which those developing countries could open up their own markets would be an issue for consideration in the new round of trade negotiations.

The Deputy Director of the Exchange and Trade Relations Department added that the point made by Mr. Joyce was reflected in the sentence on page 10 of the background paper, which referred to the other aspect of the liberalization of developing countries' trade regimes, namely, the provision of markets for exports of other developing countries.

The Executive Secretary of the Development Committee noted that the Chairman had recently transmitted to members and the Executive Directors a copy of his statement to the Development Committee, in accordance with his letter to Committee members dated February 13, 1985, in which he had outlined the procedures for the conduct of the meetings (DC/85-12, 4/4/85).

The Chairman had explained that the main purpose of the extended spring meeting was to provide a free and open dialogue in an appropriate framework. The hope was to set a process in motion which would allow meaningful progress on the issues discussed from one meeting to another.