November 12, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 86/12

The following correction has been made in EBM/86/12 (1/24/86):

Page 9, para. 1, lines 13 and 14: for "needed normalization...resources it"
read "needed mobilization...resources, it"

A corrected page is attached.

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Other Distribution:
Department Heads

Mr. Fujino remarked that the Fund-supported adjustment efforts of member countries with balance of payments difficulties, had been critical in coping with the serious debt problem in recent years. However, in many countries that had adopted Fund-supported programs, satisfactory progress had not been made toward balance of payments viability. The difficulty and magnitude of adjustment might have been partly responsible for the lack of progress. It had to be emphasized at the outset that the resolve and determination of the countries concerned were essential in securing progress. Indeed, many countries had managed to achieve adjustment despite the adverse external environment. Perseverance with the adjustment effort was particularly important for those countries experiencing continued capital outflow in order to restore confidence in their economic management. Capital flight not only hampered the much needed mobilization and utilization of scarce domestic resources, it also reduced the volume of capital inflows. If a lack of domestic confidence in adjustment efforts was the cause of domestic capital outflow, the regaining of confidence and reversing the capital flow would have to be the start of an effort to restore the confidence of international creditors, a necessary precondition for continued capital inflow.

The Baker initiative clearly recognized the difficulties associated with adjustment and attempted to alleviate those difficulties through cooperation among debtor countries, international institutions, and creditors, Mr. Fujino noted. He agreed that Fund programs should include structural and growth-oriented adjustment on a more regular basis. But emphasis on growth should not go so far as to favor relaxation of the adjustment efforts. Closer cooperation with the World Bank would be essential in both planning and implementation of adjustment programs aimed at structural reform and economic growth. Further studies would be required on the specific policy measures to be adopted in the framework of growth-oriented adjustment programs. In addition, it would be useful if the Fund staff, independently or in cooperation with the World Bank, carried out a detailed analysis of the effectiveness and problems of implementation of typical structural adjustment policy measures. It should make specific proposals on ways to overcome the difficulties of implementation. The diagnosis and prescription should not be generalized. It was important to identify specific constraints and bottlenecks to growth and economic efficiency in each country. He was not advocating a major departure from traditional Fund policy on conditionality but was emphasizing that more attention should be given to the unique problems of each country and that direct policy measures should be geared to a country's individual circumstances. It was reassuring to note that Mr. Dallara, following the same lines of thought, was of the view that sound macroeconomic policy was at the heart of any economic program. The strengthening of adjustment, with the rapid implementation of sound measures, would result in a quick and tangible improvement in some important areas and would be essential to secure continued domestic and international support. The acceleration of adjustment efforts under such a strategy would, through heightened international confidence, contribute to increased capital inflows and would benefit debtor countries by shortening the period of adjustment and facilitating a return to sustainable growth.

The roles of the appropriate exchange rate and interest rate policies were important in stemming net domestic capital outflows, Mr. Fujino considered. However, in view of the seriousness of the problem, other measures should be considered, including the introduction of some form of capital controls and of mechanisms for closer monitoring of those flows. Assumptions underlying medium-term projections should be outlined in detail.

He shared the concern expressed by other Directors about the problems of arrears to the Fund, Mr. Fujino indicated. There was clearly a need to monitor more closely developments in a country's reserve position under a Fund program and beyond. The staff suggested that a specific target for reserves should be set at the end of the program period in an effort to prevent the occurrence of arrears to the Fund. Another approach would be to establish target reserve levels beyond the program period and to monitor compliance through a process of policy dialogue in the period following the program.

On the question of prolonged use, it would be helpful if the staff provided in its papers more comprehensive reviews of a country's previous performance and economic developments in order to help the Executive Board understand the nature of the problems that the new program was likely to encounter, Mr. Fujino commented. It was also desirable to maintain a dialogue between the country and the Fund after the completion of the program. In considering the frequency and modality of such a dialogue, the implications on the work load of the staff should be borne in mind. Finally, he endorsed the other staff proposals with respect to prolonged use, including encouraging the adoption of shadow programs, limiting access to the Fund resources, and requiring prior actions.

Mr. Suraisry noted that in recent years many developing countries had experienced unprecedented current account deficits. Tackling those deficits had called for concerted and coordinated efforts by all parties--debtors, creditors, and multilateral organizations. The Fund, in particular, had played a central role in the adjustment process.

The outcome of those efforts had been encouraging, Mr. Suraisry considered. Not only had many individual countries made major strides in reducing their imbalances, but the spirit of cooperation, which had been much in evidence over the past few years, had helped to preserve the integrity of the international monetary system. Notwithstanding that success, however, the adjustment efforts of many countries had been less successful than expected. The failure of those countries to achieve a viable balance of payments position was a cause for concern and represented a major challenge. In recognition of the need for growth-oriented adjustment, emphasis was increasingly being placed on making institutional and structural reforms an integral part of Fund programs. Unfortunately, policies associated with such reform required considerable time to be successfully implemented, and benefits could be realized only in the medium term.