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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/92

10:00 a.m., July 7, 1982

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	O. Kabbaj
	H. Alaoui-Abdallaoui, Temporary
	C. Taylor
A. Buira	E. Portas, Temporary
	L. E. J. Coene, Temporary
	A. Le Lorier
R. D. Erb	T. A. Connors, Temporary
M. Finaish	
T. Hirao	T. Yamashita
J. C. Iarezza	R. T. Salazar
R. K. Joyce	
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
	F. Sangare
	E. A. Ajayi, Temporary
	P. Kohnert, Temporary
	C. P. Caranicas
	C. Bouchard, Temporary
M. Narasimham	V. K. S. Nair, Temporary
	J. E. Suraisry
	S. El-Khouri, Temporary
	T. de Vries
A. R. G. Prowse	B. Legarda
J. Sigurdsson	
Zhang Z.	Tai Q.

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

Also Present

African Department: R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; S. M. Nsouli. Asian Department: B. B. Aghevli, K. A. Al-Eyd, R. G. Kincaid. Central Banking Department: P. N. Kaul, Director; L. M. Koenig, Deputy Director. European Department: H. O. Schmitt, L. E. deMilner. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; M. Allen, D. J. Donovan, H. W. Gerhard, S. Kanesa-Thasan, P. M. Keller, D. Lipton, C. M. Loser, J. Odling-Smee. External Relations Department: A. F. Mohammed, Director; A. M. Abushadi. Fiscal Affairs Department: A. A. Tait, Deputy Director; G. Blöndal, A. Feltenstein, M. R. Kelly. IMF Institute: U Tun Wai, Deputy Director. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy Director; Ph. Lachman, S. A. Silard, J. V. Surr. Middle Eastern Department: A. S. Shaalan, Director; G. T. Abed, J. E. Blalock, J. G. Borpujari, S. H. Hitti, D. B. Noursi, M. Yaqub. Research Department: N. M. Kaibni, A. Lanyi. Treasurer's Department: H. Flinch. Western Hemisphere Department: E. W. Robichek, Director; C. E. Sansón, Deputy Director; M. Caiola. Finance and Development: B. Nowzad, Editor. Bureau of Statistics: J. B. McLenaghan. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, C. J. Batliwalla, S. E. Conrado, F. Sarraf, Wang E., F. Yeo T. Y. Assistants to Executive Directors: I. Fridriksson, F. G. Guena, J. M. Jones, M. J. Kooymans, J. S. Mair, W. Moerke, J. R. Novaes de Almeida, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, C. N. Pinfield, M. Z. M. Qureshi, J. Reddy, J. Schuijer, H. Suzuki, P. S. Tjokronegoro, J. C. Williams, J. F. Williams, A. A. Yousef.

1. PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN - PURCHASE TRANSACTION

The Executive Directors considered a request from the People's Democratic Republic of Yemen for a purchase equivalent to SDR 15.375 million (EBS/82/104, 6/15/82; and Sup. 1, 6/30/82).

Mr. Finaish stated that Yemen's request was for a purchase of 25 per cent of quota under the Fund's policy on emergency assistance related to natural disasters. The request, described in detail in the staff paper and in its attachment, was a straightforward one and met all the criteria applicable to similar purchases. The floods that had devastated the country in late March were obviously a natural calamity. Yemen clearly had a balance of payments need caused by those floods. The overall balance of payments deficit for 1982 had been projected at $30 million before the floods, and the additional burden attributable to the floods was tentatively estimated at $55-60 million.

The extensive damage to agricultural infrastructure and crops had compelled the country to step up imports of replacement equipment and foodstuffs, including cereals, while it was sustaining losses of foreign exchange receipts derived from an already narrow export base, Mr. Finaish added. The request for the purchase contained a statement by the authorities indicating their intention to take appropriate corrective measures and to "collaborate with the Fund in finding a solution to the balance of payments problem...." The general approach of the authorities in dealing with the emergency was sound and comprehensive. The measures already taken and those envisaged by the authorities were appropriate for coping with the situation. They appeared to be more than adequate in comparison with those envisaged in other requests for emergency assistance that the Executive Board had discussed in the past and that had in many cases involved purchases of up to 50 per cent of quota. Yemen's request, in his view, deserved the strong support of the Executive Board.

Mr. El-Khouri said that he supported the request by the People's Democratic Republic of Yemen for the use of Fund resources under the Fund's policy on emergency assistance related to natural disasters. His own authorities had gladly provided emergency assistance to Yemen at the time of the floods. The Yemeni authorities were pursuing policies to cope with the consequences of the floods without endangering domestic financial stability. In terms of domestic financing, resources within the development program would be shifted from ongoing or imminent projects to repair and reconstruction projects in the areas affected by the floods. That was a wise policy which would not only ease the pressures on domestic resources and the budget but also contribute to the restoration of agricultural production, with consequent positive effects on the balance of payments. The authorities were seeking to secure the necessary external financing to meet the additional costs created by the floods without heavily burdening their external payments position and without having to resort to exchange restrictions. To that end, they were seeking grants and concessional loans and had already obtained some from Arab governments.

Balance of payments support from the Fund was not only appropriate but essential to enable the authorities to conduct their adjustment efforts successfully.

In sum, Mr. El-Khouri expressed confidence that with the help of emergency assistance by friendly governments and international organizations, the authorities of the People's Democratic Republic of Yemen would be able to overcome the temporary difficulties created by the floods. Finally, was there any way in which the process of providing emergency assistance to a country afflicted by a natural disaster could be speeded up? He noted that the floods in Yemen had occurred more than three months previously. Given the magnitude of the balance of payments need of the country and its relatively weak reserve position, he wondered why the request for emergency assistance had not been for 50 per cent instead of the proposed 25 per cent of quota.

Mr. de Vries said that he could also support the request by Yemen. The natural disaster seemed real enough, but it was less clear how the authorities could overcome the difficulties that had overtaken them. There was little precise information in the staff paper. Mr. Finaish had noted, like the staff, that the Yemeni authorities were pursuing sound and appropriate policies. Mr. El-Khouri had stated more specifically that they were trying to deal with their difficulties without burdening the balance of payments by seeking grants and concessional loans. The question was how the Yemeni authorities would repay the credit that they were seeking if those grants and loans did not materialize. In a sense, those aspects could not be spelled out clearly in an emergency assistance program, although it would inspire confidence to know that they were going to be dealt with.

Finally, Mr. de Vries commented, the brevity of the staff paper and the little that was being demanded of the authorities led him to ask why it had taken three months to approve the request and why it could not have been submitted to the Executive Board much earlier.

Mr. Sigurdsson declared that the staff had made a concise and convincing case for the requested emergency purchase. He had no problem in supporting the proposed decision.

Against the background of a tentatively estimated balance of payments burden of between $55 million and $60 million caused by the floods in late March, the proposed purchase of about SDR 15.5 million seemed moderate, Mr. Sigurdsson considered. Because the authorities had stated their intention to cooperate with the Fund in finding a solution to the balance of payments problem and in formulating an adjustment program as needed, he, like Mr. El-Khouri, felt that a more substantial request might have been expected.

At the discussion in the Executive Board of emergency assistance related to natural disasters (EBM/82/15 and EBM/82/16, 2/10/82), Mr. Sigurdsson recalled, several Directors, including himself, had had some difficulty in understanding the full implications of the staff's proposal for integrating emergency assistance drawings with existing facilities. Among the questions raised had been how to take into account emergency assistance from other sources. The staff at that time had been asked to study more closely some specific suggestions for simplifying the method of overcoming the problem of double compensation relating to compensatory financing drawings. What was the status of that study? Finally, he would be interested to know whether the Yemeni authorities were expected to request a compensatory financing drawing at a later date, exercising the cereal imports option.

Mr. Taylor added his support for Yemen's request. He had noticed from the staff's description of recent developments that there were quite large imbalances in the economy, such as a large and increasing government deficit and an apparently deteriorating current account. He wondered, as others had, whether the imbalances were likely to become matters for serious concern, and whether corrective measures might not have been in order. During the discussion of Fund policies with respect to emergency drawings, the staff had said that it needed to be sure that in the event of a request the member's policies were appropriate to its particular circumstances. It had also noted that there was an expectation that a member requesting an emergency drawing would in due course agree on a program with the Fund. There was a reference in EBS/82/104 to Yemen's adopting an adjustment program as soon as circumstances permitted, and the authorities had stated their intention to collaborate with the Fund in the formulation of that program. As a general matter, it was important for such collaboration to be genuine in cases of emergency drawings just as much as for other uses of the Fund's resources. He sought assurance from the staff that that was indeed the case with Yemen.

It might be useful if something more could be said about the program to which reference was made in the staff paper and Attachment I, Mr. Taylor went on. Did the program have the staff's full agreement and support? Would the program involve future financial support from the Fund? Would the program be looked at when the Article IV consultation took place, perhaps toward the end of 1982? As part of that consultation, would the staff address itself to the adequacy of the measures taken in the context of the guidelines for emergency drawings? He raised those questions for clarification; they in no way detracted from his agreement that Yemen had a real need to draw.

Finally, Mr. Taylor joined Mr. Sigurdsson in reminding the staff that some items of work had been left over from the discussion of emergency assistance related to natural disasters. He hoped that the staff would not be too long in bringing proposals before the Executive Board.

Mr. Tai also supported the request by the People's Democratic Republic of Yemen for an emergency purchase as a result of the destruction and economic disruption caused by the floods. It was clear to him that the purchase was consistent with the Fund's policy of providing financial assistance in case of natural disasters.

Mr. Kohnert expressed support for the request for use of the Fund's resources by the People's Democratic Republic of Yemen. He agreed with the staff that Yemen could not be expected to reduce its reserves from their present level, as the country's external receipts--mainly grants and other kinds of foreign assistance--were not certain to cover the substantial current account deficit.

The broad guidelines drawn up by the staff in January 1982 (SM/82/7, 1/8/82) seemed to have been met, Mr. Kohnert observed. First, there was obviously an emergency in Yemen. Second, the proposed drawing was limited to the equivalent of one credit tranche. Third, the Yemeni authorities had indicated that they would not impose new restrictions on payments and transfers for current international transactions. However, the extent of their envisaged collaboration with the Fund in formulating an adjustment program was not clear from the staff paper. Certainly, the size of the government budget deficit and the weak external performance showed a significant need for adjustment in the near future.

Collaboration with the Fund should be meaningful even in cases of emergency drawings, Mr. Kohnert said, as Mr. Taylor had remarked, without however defining how collaboration could be carried out in those circumstances. An emergency request required in practice a quick response. During the discussion in February 1982, his impression had been that the Executive Board had reached an understanding that it would deal with disasters on an ad hoc basis. There had been no support for making additional Fund resources available on a virtually unconditional basis. If that was what Mr. Taylor intended to underline, he would support him strongly.

Mr. Nair noted that the request from Yemen fully satisfied Fund policies on emergency assistance. The request emanated from circumstances beyond the control of the authorities in that there had been destruction and economic disruption as a result of the floods. The authorities had indicated that they would collaborate with the Fund in formulating an adjustment program. The expectation of cooperation was thus also met. Therefore, he had no hesitation in supporting the Yemeni authorities' request for emergency assistance.

Mr. Ajayi stated that the case for Yemen's emergency purchase under the Fund's tranche policies were clearly presented in the staff paper, and he had no problem in lending his support to the proposed decision. The request by the Yemeni authorities had been occasioned by flooding resulting from an unusually heavy four-day rainfall which had inflicted heavy damage on the country's agricultural infrastructure and crops. A preliminary estimate had put the balance of payments effects of the floods at $55-60 million. Consequently, the overall balance of payments position, in surplus in the past, was expected to be in substantial deficit in 1982.

The Fund's assistance in conjunction with other resources that could be mobilized would help the authorities to finance the needed emergency reconstruction and rehabilitation program in the affected areas, Mr. Ajayi continued. The authorities had provided details of the measures that they intended to take, including, as soon as circumstances permitted, the formulation of a detailed financial program in order to find a solution to the balance of payments problems arising from the flooding.

In conclusion, Mr. Ajayi noted that the staff had also agreed that Yemen's request was consistent with earlier Fund practice on emergency assistance relating to natural disasters.

Mr. Portas said that his chair supported Yemen's request for emergency assistance, which clearly met all the criteria. The aspect of collaboration with the Fund should be interpreted in a flexible way, and he noted that the Yemeni authorities had expressed their intention to collaborate.

Mr. Gabriel-Peña regretted deeply the human and material loss suffered by the People's Democratic Republic of Yemen as a consequence of severe flooding. His chair fully supported the proposal to assist the country under the Fund's policy on emergency assistance related to natural disasters.

The staff paper, as well as the letter addressed to the Managing Director by the Yemeni authorities, Mr. Gabriel-Peña noted, clearly showed that the member urgently needed aid to help relieve the balance of payments pressures shown in the increase in the current account and overall payments deficits. He had taken note of the authorities' intention to formulate an adjustment program as soon as circumstances permitted. Meanwhile, the authorities' reconstruction efforts under the current circumstances had to take place without further impairing the balance of payments. Finally, he would be interested in hearing an explanation by the staff of the length of time it had taken to deal with Yemen's request for a drawing.

Mr. Kharmawan expressed his full support for the request submitted by the Yemeni authorities. Both the staff paper and Mr. Finaish's statement had shown convincingly that Yemen had a need for the purchase. It would be interesting to know why it had taken so long to bring Yemen's request to the Executive Board, Mr. Kharmawan said. As for the difficult issue of what was meant by cooperation, his concern was that the Fund should not unduly burden a country that was already going through a difficult period after experiencing a natural disaster.

Mr. Iarezza gave the support of his chair to the request from the People's Democratic Republic of Yemen. He joined other Directors in asking about the time that had elapsed between the request and submission to the Executive Board. As for the matter of cooperation that others had raised, he considered that there was a trade-off between the need for a speedy response to the request of a country in an emergency situation, and cooperation. In an emergency, it was speed that was of the essence.

Mr. Alaoui-Abdallaoui, speaking on behalf of Mr. Abdollahi, expressed warm support for Yemen's request.

The staff representative from the Middle Eastern Department said that although the floods had taken place on the last two days of March and the first day of April 1982, the staff had been unable to visit Yemen until May 8-11 because of other commitments in the area. The staff member who had visited Yemen had returned to headquarters on May 17. The paper had been prepared as expeditiously as possible. The authorities had been reviewing the letter of intent and the statement of policy and had informed the staff on May 23 that it should proceed with the paper, which had then been cleared by various departments in accordance with the normal procedure, and then issued to give the Executive Board three weeks' notice of the discussion.

The authorities had indicated the approach they intended to take in dealing with the economic impact of the severe floods, the staff representative stated. They were receiving concessional aid in the form of grants, a substantial part of which was in kind. Part was also in cash given by neighboring countries and UN agencies, including the World Food Program and the Food and Agriculture Organization. The latest estimate of concessional aid that Yemen would receive was on the order of $15 million, subject to further confirmation. In addition, the country had reasonably adequate reserves, which it could use if need be; Fund assistance would of course play a critical role in that respect.

The adjustment program mentioned in the staff paper would, the authorities had explained, be an indicative program to deal with the emergency that had arisen, the staff representative continued. The details of the program had not been discussed because the requisite data had been unavailable in view of the difficult circumstances prevailing at the time in the country. However, the program did contain some targets, as indicated in the Minister's statement. With respect to the balance of payments, the intention was to reduce the current account deficit by about $25 million from what it would have been had no measures been taken. The overall deficit, which had originally been forecast at $30 million and with the floods would have been $90 million, was to be reduced to about $70 million. The staff believed that it might even be reduced further to $60 million or $65 million. Those tentative targets implied that certain corrective measures would have to be taken. Beyond that, the authorities would remain flexible in dealing with the emergency by shifting resources toward the reconstruction and rehabilitation of facilities. The staff believed that that was adequate assurance in the circumstances. Article IV consultation discussions would be conducted with the Yemeni authorities in late October and early November. At that time, the staff would make a more thorough and perhaps more comprehensive assessment of the damage done by the floods, their impact on the fiscal and balance of payments positions, and the measures already undertaken as well as those contemplated by the authorities. It could not yet be foretold how detailed or comprehensive the program to be presented to the staff at that time would be, but the results of the discussions would be reflected in the staff report for consideration in the Executive Board.

The authorities of Yemen were not expected to submit a request for a compensatory financing drawing, the staff representative continued. It so happened that the greatest impact of the floods had been on the import side of the balance of payments, with a relatively small impact on cereal imports. The floods had hit prime growing areas for cotton, an export crop, and those for vegetables, legumes, fruits, and other industrial crops such as sesame. Although damage to the export crop had been extensive, Yemen's exports were small.

The imbalances in the economy had been described in the staff report for the 1981 Article IV consultation (SM/81/214, 11/9/81 at EBM/81/158, 12/16/81), the staff representative from the Middle Eastern Department recalled. The authorities were aware of the views of the staff and the Executive Board on those underlying imbalances, and after evaluating the impact of the floods, the staff would return to them in the course of the discussion for the 1982 Article IV consultation. However, despite those imbalances the Yemeni authorities had been able to maintain a reasonably comfortable balance of payments position. The budget deficit, although large, had been financed to a large extent by substantial concessional aid and by grants from abroad. The pressure on resources had been kept at a fairly low level. Domestic liquidity expansion, as indicated in the staff paper, had been only 12 per cent in the past year, and price increases had been moderate.

The Deputy Director of the Exchange and Trade Relations Department recalled that it had been agreed, during the general discussion in the Executive Board on emergency assistance related to natural disasters, that emergency drawings should normally be confined to one credit tranche, larger drawings being made available only in exceptional circumstances. It was true that the balance of payments impact of the emergency in Yemen was larger than one credit tranche, but Yemen was fortunate in having a moderate level of reserves. In February 1982, foreign exchange reserves had been equal to almost four months of 1981 imports. The authorities planned therefore to draw on those reserves to cover any remaining deficit.

The staff representative from the Research Department said that it was taking longer than had been expected during the policy discussion in February 1982 to prepare a staff paper on ways to avoid double compensation between emergency and compensatory financing drawings. The staff had had preliminary discussions with some of the Executive Directors who had made suggestions concerning the relationship between emergency drawings and compensatory financing drawings. At the present time, the staff was in the process of completing a paper, in which the emphasis would be on a simpler method for avoiding double compensation than the one described in the appendix to the staff paper discussed by the Executive Board (SM/82/7, 1/8/82 at EBM/82/15 and EBM/82/16, 2/10/82). The issue of double compensation was not expected to arise in the case of Yemen. Having explored the possibility of a drawing by Yemen under the compensatory financing facility, either on the basis of an export shortfall only, or including the cereal import option, the staff had concluded that Yemen was not likely to qualify for a compensatory financing drawing in the near future.

Mr. Finaish recalled that the general question of how to meet requests for emergency drawings had been discussed by the Executive Board in February, and emphasis had been given to dealing with such requests as fast as possible. It would be helpful if ways could be found to expedite future requests. One possibility would be to shorten the requirement for three weeks' notice of the discussion in the Executive Board.

With respect to the size of the drawing, Mr. Finaish observed that while half of previous emergency drawings by other members had been for up to 50 per cent of quota, the People's Democratic Republic of Yemen had been offered 25 per cent of quota even though the balance of payments impact of the emergency was estimated to be larger than one credit tranche. The staff had considered that a drawing of 25 per cent was of an appropriate magnitude in view of Yemen's moderate level of reserves. But the latter had been made possible over the previous few years in large part by inflows of remittances and external concessional resources. The authorities had always tried to avoid undue reliance on those inflows, the volume and timing of which were difficult to determine with reasonable certainty. On the general question of limiting emergency drawings to 25 per cent of quota, different views had been expressed in that respect during the February discussion, as a result of which several matters were still being studied by the staff.

On the question of collaboration with the Fund, Mr. Finaish continued, the Director of the Exchange and Trade Relations Department had stated at EBM/82/16, "Fund programs should be properly thought through and endorsed by the authorities. It would not be appropriate for countries to be forced into a program under the pressure of an emergency situation." It was worth noting that the Yemeni authorities had already started taking adjustment measures on their own. On the external side, they were initiating shifts in the composition of imports, as described to some extent in the letter from the Minister of Finance. The authorities intended to take budgetary measures, both on the revenue and on the expenditure sides, to limit the total budget deficit and bank financing of it. In general, the authorities' intention to shift resources toward the immediate task of reconstruction should contribute to easing the pressures on resources.

In conclusion, Mr. Finaish stated that the measures outlined in the letter from the Yemeni authorities appeared to be more than adequate, compared with those contemplated in respect of other requests for emergency assistance that the Executive Board had discussed in the past. Beyond that, the staff would have an opportunity to review the situation with the authorities in the context of the discussions for the 1982 Article IV consultation. It was in the light of the outcome of such a review that a judgment might be made of what other measures, if any, were needed.

The Executive Board then took the following decision:

1. The Government of the People's Democratic Republic of Yemen has requested a purchase equivalent to SDR 15.375 million.

2. The Fund notes the intention of the Government of the People's Democratic Republic of Yemen as stated under paragraphs 6, 7, and 8 of Attachment I dated May 10, 1982, to EBS/82/104, and approves the purchase in accordance with the request.

Decision No. 7151-(82/92), adopted
July 7, 1982

Mr. de Vries sought confirmation of his assumption that the statement in Attachment I to the letter of the Minister of Finance had no legal validity. In his letter, the Minister had said that his attachment described the situation in Yemen in as much detail as was available at that time. The policy that the authorities intended to follow was also outlined in the Attachment. Nevertheless, should circumstances make it necessary, he understood that no legal obstacle would prevent the pursuit of a different policy.

Like others, Mr. de Vries remarked, he attached great importance to the ongoing work by the staff subsequent to the Executive Board's discussion in February. Yemen's request for emergency assistance relating to natural disasters was the first since that discussion at EBM/82/15 and EBM/82/16. Mr. Iarezza had referred to the need for the Fund to make a trade-off between a speedy response and the degree of cooperation with a member. The trade-off in Yemen was particularly unsatisfactory, he conconsidered. The response to the request had been far from speedy, and nothing very concrete had been agreed by way of cooperation. Thus, those concerned about the large degree of unconditionality in the emergency drawings and those concerned about the delay in acting were probably both equally unsatisfied. The Executive Board might have to return to the matter after more experience had been gained with the procedures for emergency drawings.

The Director of the Legal Department confirmed that the representations in the letter and attachment had no direct legal implications. Of course, all statements of policy included in a declaration by a member government when it made a purchase, even though they might not become legal conditions, were relevant in the subsequent determination that a government was cooperating with the Fund. Such statements were also relevant as a legal matter if there was any possibility that a member might not be using the Fund's resources in accordance with the purposes of the Fund.

Mr. Finaish remarked that the suggestion seemed to be that the Fund was providing conditional resources to countries making emergency drawings, and that such countries should be expected to agree on a program with the Fund. Surely no country in the world would bring a natural disaster on itself simply for the sake of using the Fund's resources. All member countries were entitled, once they had experienced a disaster, to seek emergency assistance from the Fund, which in that sense was maintaining its principle of uniform treatment of members. The emphasis on conditionality did not seem helpful, especially when it would take many years for countries to recover from extensive earthquakes or floods. As for Yemen, it had already taken extensive measures, as indicated in the Minister's letter. It was up to the Executive Board to translate into action its expression of sympathy at its discussion earlier in the year for countries having to cope with the impact of natural disasters.

Mr. Caranicas said that he shared Mr. Finaish's views. Emergency assistance would be more useful to the country concerned if it was not confused with the issue of conditionality, which would more appropriately be discussed in the context of other uses of the Fund's resources.

Mr. de Vries explained that he was in fact concerned about the mixing up of pseudoconditionality with emergency drawings. Evenhandedness was not the issue. If there was a majority in the Executive Board for making emergency drawings unconditional, a clear understanding to that effect should be reached. It should not be necessary for members to wait three months before being granted emergency assistance. But a number of Executive Directors had made proposals for handling emergency drawings that would make provision for a follow-up procedure. As long as the emergency drawing itself was contingent upon the determination that there had been a natural disaster, he saw no reason for such long delays and statements of policy that would necessarily have to be qualified as the situation became clearer and the emergency began to be tackled in a longer-term perspective. To use Mr. Iarezza's formulation, the Fund had found the wrong trade-off between speed and unconditional drawings on the one hand, and tardiness combined with conditionality on the other.

The Director of the Legal Department noted that, except in the reserve tranche, all purchases, including first credit tranche purchases, compensatory financing purchases, and emergency purchases, were subject to what might be called the Fund's conditionality. In the course of the First and Second Amendments of the Articles of Agreement, it had been made clear that all purchases in the credit tranches would be subject to certain conditionality. Therefore, as a strictly legal matter, it was not correct to say that emergency drawings were unconditional, although the conditionality attaching to them was minimal.

The significance of statements by member countries relating to emergency assistance was similar to that of statements obtained by the Fund for first credit tranche drawings, the Director of the Legal Department said, in the sense that a member's right to make the purchase did not depend on its adherence to the statement. For that reason, there was no similarity with the statements made by members entering into stand-by arrangements. Nevertheless, the statements relating to emergency drawings were relevant because a minimal degree of conditionality was legally required. The statements indicated the willingness of the member to cooperate with the Fund and to take certain measures as soon as possible after the emergency was over. The Fund could judge, in relation to those statements, whether or not the member was carrying out its intentions in the event that the member required any future assistance from the Fund.

In addition, if the Fund for one reason or another were to decide that there had been a blatant misuse of its resources, those statements would again be relevant. He was explaining the possible legal significance of such statements in general terms; he did not have any specific case in mind.

Mr. Kharmawan remarked that it was helpful to be reminded of the legal framework under which emergency drawings took place. It should be reassuring to those who were concerned about the unconditional use of the Fund's resources to understand that no drawings were without conditions. The nature of Fund conditionality differed, depending on the amount and the nature of the drawing. Thus, conditionality relating to an emergency drawing was similar to that for a first credit tranche drawing. In an emergency, a member was permitted to draw and, in due course, to prepare a program that would not be meaningless. A country would feel compelled to abide as much as possible by its program because its track record might affect its future ability to use the Fund's resources. He saw no cause for concern as long as an emergency drawing did not call either for cooperation with the Fund or for conditions that would include a program with phasing and performance criteria. Such programs would not be legally imposed on a country struck by an emergency, despite the perhaps understandable concern of some Directors about the need for conditionality in drawings in the upper credit tranches.

He deplored the delay by the staff in visiting Yemen following the floods, Mr. Kharmawan declared. He felt sure that countries to which the staff had commitments would understand if, because of an emergency in another country, it had to deviate from those commitments. Perhaps the provision for three weeks' notice to the Executive Board could be reduced to 14 days for requests for emergency drawings.

Mr. de Vries inquired whether, under Article V, Section 3(a), the Executive Board could, if it wished, adopt a policy stating that in cases of emergency, drawings could be made without any further conditions than that there should be an emergency and a balance of payments need.

The Director of the Legal Department stated that the Fund was required, under the Articles, to adopt policies regarding all uses of Fund resources that would ensure that the member would follow policies enabling it to repay the Fund within an agreed period. Those were concepts requiring a great deal of judgment, and the Fund had exercised its judgment in a flexible way. The requirement that the Fund adopt such policies was the basis for examinations of a member's situation by the Fund. In establishing its policies, the Fund could provide for strict conditionality in the upper credit tranches, and minimal conditionality in the first credit tranche, when the amounts drawn would be large or small, respectively. That was the course that the Fund had taken. The Fund could not state simply that, whenever a member faced an emergency, it could draw on the Fund's resources; the policy had to be directed toward the ability of the member to repurchase. It was possible that, in its judgment, the Fund would be satisfied with the declaration of a member requesting an emergency drawing that it would cooperate in the future and would take appropriate measures as soon as the emergency ended.

Mr. Coene supported the position that timing was all important for a request for emergency assistance. Even if the conditionality for an emergency assistance drawing was similar to that for a first credit tranche drawing, the Executive Board would surely want to emphasize the difference between the two types so far as timing was concerned. Otherwise, emergency assistance could be incorporated in the first credit tranche. If timing was important, it would be difficult to go much further than to ask for a commitment by the authorities to collaborate with the Fund.

Mr. Caranicas observed that it had been most useful to clarify the legal issues. In a dire emergency, the management of the Fund had enough flexibility to proceed to an immediate judgment, and to collaborate with the member on whatever measures were necessary later.

The Chairman noted that Yemen's request should perhaps have been dealt with more expeditiously, although it was not always easy to find the qualified staff member to visit a country at the right moment; delays were sometimes inevitable. Moreover, the policy of the Fund on emergency drawings had not been to accept a simple statement that a member would collaborate. An assessment had always been undertaken to determine the facts, the extent to which the member needed to use the Fund's resources, the types of policies the country intended to undertake, and other programs for external assistance that might be under way. He took note of the points made by Executive Directors; an attempt would be made to speed up the processing of any future requests for emergency assistance that might arise.

2. EXTENDED AND UPPER CREDIT TRANCHE STAND-BY ARRANGEMENTS - REVIEW

The Executive Directors considered a staff paper reviewing recent extended and upper credit tranche stand-by arrangements, together with supplementary background material (EBS/82/97, 6/9/82; Cor. 1, 6/30/82; and Sup. 1, 6/10/82). They also had before them as background material a staff paper on adjustment programs, their broad design, and key indicators (EBS/82/98, 6/9/82).

Mr. Sigurdsson stated that his chair was in broad agreement with the stated views expressed in EBS/82/97. He could readily support the proposed decision. However, he did feel that the paper contained too much purely descriptive material and too little constructive analysis. Some aspects dealt with in the interesting paper on the broad design of adjustment programs and key indicators (EBS/82/98) might have been brought with benefit into the main paper.

He had noted with interest, Mr. Sigurdsson continued, that commitments under the extended Fund facility had fallen off sharply in 1982, and that only one extended arrangement had been approved so far during the year. Was that a reflection of a change in the staff approach to adjustment programs? Against that background, could the staff elaborate on its statement in the penultimate paragraph of EBS/82/97 that "where a country is able to formulate a coherent medium-term strategy of adjustment, the extended Fund facility continued to be a suitable vehicle of Fund assistance"? He asked whether the staff was possibly shying away from the extended Fund facility, when on the face of it the facility was still needed. It was all too evident that structural adjustment was required, for instance, from the assessment of the economic situation of the non-oil less developed countries in the latest World Economic Outlook paper. In view of the predominance of structural features in the balance of payments problems of those members, reliance on shorter arrangements in circumstances requiring medium-term solutions would--as the staff had noted--seem to entail the danger of too narrow a scope of adjustment. The staff was undoubtedly right in proposing that, in all programs in which the medium-term horizon had become important, it should include projections beyond the immediate program period to demonstrate that the use of Fund resources was consistent with temporary financing of balance of payments adjustment and would not lead to debt service problems later on. That kind of technical projection might, however, be insufficient, and he considered that the extended Fund facility was still very much needed.

In Section IV, on programs and policies, Mr. Sigurdsson continued, he had been interested to note from the last paragraph of subsection 2 that the frequency of specification of exchange rate and trade policies had been lower in the period under review than in the stand-by arrangements approved in 1978-79. He would be grateful for further information and comments by the staff on the background to that change. Perhaps greater attention should be devoted to the question of the proper exchange regime for countries with programs. There might often be a need for introducing a system providing for the continuous review of the exchange rate, and not only for making proposals on a "correct" rate.

As for the question of prior action and preconditions, Mr. Sigurdsson noted, the staff had suggested that greater emphasis should be placed on prior action, the better to secure program implementation. The staff clearly had a point. But the use of preconditions was a difficult issue in terms of the Fund's guidelines on conditionality. Using preconditions on a wider scale would, in his view, necessitate improvements in the form of reporting to the Executive Board on the staff's discussions with members in order to provide the necessary assurances that preconditions were in keeping with the guidelines on conditionality. Perhaps the staff would care to comment further on its suggestion. What could be regarded as the main conclusion of EBS/82/97 was brought out in Table 7, namely, that the extent to which programs were implemented was fairly closely related to the degree of progress made toward balance of payments viability. The staff's analysis suggested that although observance of performance criteria might not be a sufficient condition, it seemed close to being a necessary condition for the attainment of program objectives.

Five major causes had been listed in Section V for interruptions in drawings, Mr. Sigurdsson observed. They were: unforeseen shocks; lack of political commitment, weak administrative systems, errors in projections, and delays or shortfalls in development assistance. Three of those five factors fell largely outside the Fund's ambit. Technical assistance from the Fund could and should help members to strengthen administrative systems, and efforts should of course continue to be made to improve the technical quality of projections as well as to avoid wishful thinking. In that connection, there was an illuminating observation by the staff on page 20 of EBS/82/97 that "the proximate cause of the great majority of the nonobservances of credit ceilings lay in the government or public sectors...." That was an area in which the Fund should strive to improve analysis and consequently the design and implementation of programs. The improved presentation of the biweekly paper from the Treasurer's Department on selected data on the Fund's holdings and commitments under stand-by arrangements and extended Fund facilities, giving a breakdown of the reasons for interruptions in drawings, was helpful.

The staff had been properly cautious in its claims for the results of Fund-supported programs in general, Mr. Sigurdsson considered. He certainly agreed with the statement at the top of page 27 of EBS/82/97 that "the Fund cannot be complacent about a situation in which almost half of the cases had not shown any progress toward balance of payments viability." As the staff said, there was a clear need to improve the success rate, or perhaps, to put it more realistically, to reduce the failure rate. It would have been helpful to find more explicit suggestions in the staff paper on how that could be done.

The conclusions of the main staff paper on the adequacy of programs had been much more restrained and qualified than the positive conclusion drawn in Section H of Supplement 1, which had incidentally been taken verbatim from page 25 of the interesting departmental memorandum on the experience in the 1970s with macroeconomic performance and adjustment under Fund-supported programs (DM/82/26, 4/16/82). That much more positive finding would seem to indicate that all was well with Fund conditionality, but the departmental memorandum covered the whole of the decade, whereas EBS/82/97 covered only extended Fund arrangements approved in 1978, 1979, and 1980, and stand-by arrangements approved in 1980. A simplistic comparison, on which the staff might care to expand, would suggest that the Fund's programs had become less successful of late.

Mr. Kharmawan noted that apart from the papers under discussion, in which the staff had analyzed the considerable data at its command, a different departmental memorandum from that mentioned by Mr. Sigurdsson deserved consideration. He referred to DM/82/37 (6/22/82) entitled "Some Theoretical and Empirical Issues Relating to Economic Stabilization in Developing Countries," which attempted to analyze the problem of conditionality. He had discerned a difference of view between that paper and EBS/82/97. According to EBS/82/97, the policy content of programs had changed little since earlier years; but in the opening paragraph of DM/82/37, it was stated that "many stabilization programs now differ quite markedly from those of earlier years, in terms both of their economic goals and of the policies that are utilized to achieve them." He too believed that some changes had taken place, but whether or not they were fundamental was a matter to which he would return.

First of all, Mr. Kharmawan mentioned, the analysis in EBS/82/97 did not cover centrally planned economies. The Executive Board had held an extensive discussion on the application of Fund policies in centrally planned economies (Seminars 82/3 and 82/4, 6/25/82), which had been inconclusive simply because the staff had not yet developed a definite view on how those economies functioned. Thus, the staff paper reviewing extended and upper credit tranche stand-by arrangements was based on a concept of programs related to market economies. The theoretical framework of programs was related to a situation in which there was too much liquidity in an economy; the excess liquidity exerted upward pressure on the price level and the balance of payments, thereby hampering the process of economic growth and leading to the introduction of subsidies and distorted prices, and by extension to an unrealistic exchange rate. He had little quarrel with that theoretical approach, which was on the whole correct, as long as the situation for which it had been conceived was borne in mind. It was relevant, in the situation he had described, to have a program based on demand management, using instruments such as total credit ceilings, subceilings on government expenditures, making recommendations to look at interest rates and exchange rates, and to liberalize the payments system, while avoiding large foreign borrowings that might burden the balance of payments.

Over time, economic and financial problems had become more complicated, and the instruments used by the staff had therefore also become more sophisticated, Mr. Kharmawan noted. In the outside world, there were critics who claimed that the Fund might be overemphasizing demand management in its programs. In DM/82/37, an analysis had in fact been made of the changes taking place in the situation of countries in the 1970s; the staff had responded to the argument by Sidney Dell, and had concluded on page 5 that "...the worsening current accounts of the developing countries in the 1970s were related to deteriorating terms of trade." Again, on page 7, it summarized: "we find that if one extends the analysis to cover the longer period 1973-80, there remains a substantial measure of support for Dell's thesis that the current account deficits of developing countries have been associated with deteriorating terms of trade." However, the staff went on, "the role played by domestic factors cannot be neglected."

Nevertheless, Mr. Kharmawan remarked, if it was true that changes had taken place in the later 1970s, in the sense that external factors such as the terms of trade had played an increasingly more important role in the balance of payments problems of developing countries, it became a matter of how to deal with those developments within the conceptual framework for programs that had been developed by the staff. The staff had recognized that in certain circumstances a country needed to be given more time to make structural adjustments, apart from taking corrective measures in the financial and monetary fields. What the staff had in mind was that if a sustainable balance of payments deficit was to be achieved when strong external forces were at work, a country had to redirect its output by increasing export revenues and if possible by import substitution when conditions permitted, or both. Emphasis had therefore been given in later programs relating to structural adjustment to improving the balance of payments by increasing revenues and by saving on imports. However, the instruments that the staff used for that purpose were mainly related to pricing policies. For instance, reference was made--and rightly--to the fact that faulty pricing policies could be detrimental to growth, as well as to the need to revise procurement prices for food crops, for instance. But it was not enough to seek to increase productivity by removing disincentives or creating incentives. The return on existing investment should certainly be improved, but additional investment would be needed in order to achieve the structural adjustment for which provision was made in programs under extended or stand-by arrangements. At that point, the Fund needed to work with the World Bank, which could actively promote structural adjustment by investing in certain export and import sectors in order to bring about the desired structural adjustment and increase in external receipts.

The question in his mind, Mr. Kharmawan said, was whether in those circumstances it was always correct to recommend that countries limit the expansion of credit and government expenditures. The need for additional investment should surely also be met by an increase in investment based on domestic resources. And one source of investment in many developing countries, whether the Fund liked it or not, was for the time being the government. Was it not contradictory to restrain a government from increasing expenditure for the sake of production? Of course, much depended on conditions in the domestic economy, as had been recognized also in DM/82/37. If both external factors and excessive domestic liquidity and inflation were afflicting an economy, credit policy would have to be restrained, but not, he believed, in the same way as when countries were suffering mainly from domestic imbalances. He asked the staff to reflect further on the consequences of the demand management policies that it had developed for application in programs in the past, rightly in certain circumstances, with a view to considering whether or not new factors should not be taken into account, in light of the recognition that external factors also played a role in destabilizing the economies of many developing countries.

Unfortunately, Mr. Kharmawan went on, it was revealed in the staff papers that a considerable number of programs had failed. In its attempt to analyze the causes, the staff had rightly noted that governments had often not been able to summon up the political courage to meet the requirements of programs, and that their administrative machinery was sometimes weak. Implicitly, the staff had also recognized mistakes by the Fund, in the sense that projections were not always borne out by the facts. For instance, if exports were smaller than projected, the whole program could be upset; government revenue was dependent to a certain extent on export receipts, and if export projections were wrong, countries could not fulfill many performance criteria. An objective assessment of the causes of program failures would therefore have to attribute blame partly to member governments, partly to the Fund, and partly to both.

It would be advantageous if the Fund recognized the shortcomings of programs, Mr. Kharmawan considered, because it could then move on to improving its policies and projections. In the meantime, there was the question of how to deal with the failure of programs. The staff had mentioned that small deviations from performance criteria could be dealt with by granting waivers, but he was reluctant to move far in that direction. The modification of inoperative programs depended greatly on judgment, which had to be tempered by the facts. One of those facts, as the staff had observed, was that fulfillment of all the performance criteria in a program did not necessarily mean that targets--for economic growth, inflation, or any number of other factors--had always been achieved. The reverse could also be true; one or two performance criteria might be violated, but the targets--for the balance of payments, inflation, and even economic growth--might on the whole have been met. In such cases, great care had to be taken in proposing modifications in a program. As the staff itself had recognized, it was the overall situation that had to be considered. If the program had produced good results despite the nonobservance of one or two criteria, its modification should be approved speedily, without too many new conditions being attached. In that respect, a distinction also had to be made between countries that had frequently agreed on programs with the Fund and had often not observed performance criteria, even if parts of their programs had been successful, and countries that had come to the Fund for the first time and had not observed one or two criteria but had on the whole achieved the targets under a program. The Fund should, he believed, take a more flexible attitude to the latter.

Mention had been made in the staff paper of the phenomenon of crowding out, Mr. Kharmawan noted. The staff should bear in mind that many developed countries could draw on a pool of savings to finance budget deficits; in a number of developing countries, deficits were sometimes simply financed by the creation of money, so that there would seem to be no crowding-out phenomenon. Moreover, it was necessary to take account of the large role that governments played in spearheading economic development in many developing countries. It was irrelevant to explain to such governments that they were crowding out the private sector if that sector was still weak.

Another matter for consideration was the correct relationship between certain variables and GDP, Mr. Kharmawan commented. The concept was valuable; the problem was how to select the right ratio of, say, the current account deficit to GDP.

Finally, Mr. Kharmawan said, he was unable to support the proposed decision until he knew whether or not its adoption would mean that the Executive Board agreed with the contents of the staff paper, or whether it referred only to the specific arrangements reviewed. Given his doubts about the value of Fund programs, because of the need under certain circumstances to introduce new elements into programs, he could not go along with the proposed decision if it implied approval of EBS/82/97.

Mr. Finaish considered that the present set of staff papers reviewing stand-by and extended arrangements represented an improvement over previous ones in its more detailed analysis of factors underlying deviations from performance criteria and the resultant interruptions to purchases under Fund programs. Reviews were useful as they allowed an assessment to be made at reasonable intervals of the composition and performance of Fund-assisted programs, thus helping to identify areas in which further improvements could be made in program formulation and implementation.

Before commenting on some specific issues arising from the review papers, Mr. Finaish continued, he wished to make a general observation. As had been noted in the staff papers, care was needed in deriving general conclusions from the experience of the particular economies under review. It was always difficult to draw policy generalizations from a relatively small sample of economies. In the present case, the task was rendered even more difficult by the lack of full information on the relevant economic magnitudes in the sample countries, by the short span of time over which the performance and responses in their economies had been evaluated, and by the difficult situation obtaining in the world economy over the relevant years.

The present review papers gave special attention to the problem of interruptions to purchases under Fund programs resulting from the nonobservance of performance criteria, Mr. Finaish observed. It was noted that the incidence of interruptions per program had increased recently: the average number in the sample of arrangements under review was just under one a year per arrangement. The problem, therefore, merited serious attention. Of all the cases of nonobservance of performance criteria, nearly three quarters were related to domestic credit ceilings; in a great majority of such cases, the staff reported, the chief cause of nonobservance was larger than planned government deficits. Where a number of factors were at work simultaneously, it was not easy to identify the causes of breaches of those criteria. However, the staff had attempted an assessment, the results of which appeared in Table 6 of EBS/82/97. Although the entries in the table took into account only the direct impact of unforeseen adverse shocks--external and internal--such developments were shown to have been the most important factor in about one quarter of the cases of breaches of credit ceilings. Of course, the proportion would be much greater if the indirect effects of such disturbances could also be ascertained. As one would expect, political constraints, and institutional and administrative weaknesses, had been another important factor. Furthermore, it was noteworthy that optimistic and incorrect projections, and hence errors in the specifications of the criteria, had been a factor in over one third of the breaches.

Interruptions in the implementation of programs had their costs, Mr. Finaish commented, even when the programs were subsequently resumed. Interruptions might lead to a relaxation of the adjustment effort; they might even undo some of the gains previously made under the adjustment program. To the extent possible, therefore, interruptions should be avoided. As he had already noted, a number of interruptions had resulted from breaches of performance criteria caused by unforeseen disturbances. Some interruptions had also been caused by shortfalls in external assistance or capital inflows. In situations in which a country had already been affected adversely by factors beyond its control, the question arose whether it was the appropriate policy to suspend a country's access to Fund resources for the sole reason that one or other of the performance criteria had been breached. He would tend to agree with the staff that, where such exogenous developments resulted in large divergences from the performance criteria and, furthermore, where the divergences were considered irreversible, suspensions might be unavoidable; the appropriateness of the existing program in the changed circumstances might need to be assessed, and a new arrangement might even be called for.

Where the breaches had not been large, the Executive Board had taken a fairly flexible attitude toward waivers and modifications, with the result that many of the affected programs had subsequently been resumed, Mr. Finaish noted. The costs associated with interruptions might perhaps be reduced in such cases, through greater use of contingent performance criteria. Admittedly, it would not be possible to establish contingency provisions for a wide variety of external or internal shocks. Such provisions could nevertheless be usefully employed with respect to several important types of exogenous developments, such as a deterioration in the external terms of trade and shortfalls in capital inflows. The staff comments on that point would be helpful. The potential usefulness of contingency provisions had increased in recent years as developing countries had faced an increasingly difficult and unstable external economic environment.

Another factor that might account in part for the difficulties in reaching program criteria and targets, Mr. Finaish remarked, was that many countries avoided approaching the Fund until forced to do so by the increasing seriousness of their problems, a reflection perhaps of their perception of Fund conditionality as being too strict or demanding. Where that was indeed the case, the results of Fund programs could be improved by increasing the Fund's ability to attract members at an early stage of their problems. Since that had not been specifically mentioned by the staff in its analysis of program interruptions as a factor, alongside others, such as those indicated in Table 6 of the main staff paper, the staff might wish to comment on its relative significance.

To the extent that breaches of performance criteria, and hence interruptions, were caused by errors in economic forecasting and program specification, Mr. Finaish noted, the problem could be alleviated by reducing such errors, for instance, through the use of a more comprehensive data base, where possible, and through appropriate adjustments in the underlying economic models or program designs. It should be recognized, however, that some errors in economic forecasting were inevitable and that it was difficult to model all the relevant relationships in an economy with much precision. It was also possible that the difficulties associated with those tasks increased with the seriousness or the scale of imbalances in an economy. Furthermore, to the extent that breaches in performance criteria resulted from political and administrative weaknesses, the outcome of programs would improve with a more careful and realistic assessment of the political, institutional, and administrative constraints on their implementation.

As for the degree of achievement of program objectives, Mr. Finaish went on, it emerged from the review--for instance from Table 4 in the main paper--that actual performance had in the aggregate fallen significantly short of the targets for most of the variables. The decline did not necessarily imply that the application of conditionality had been lax or that it needed to be tightened. The mere fact of a shortfall in performance could just as well imply overtight conditionality, reflected in unrealistic performance criteria and targets. Indeed, as he had already noted, the lack of realism in projections and in the specification of criteria and targets had been mentioned by the staff as a major factor underlying the less than expected performance in many cases. To derive any meaningful conclusions about conditionality from performance shortfalls, they would have to be analyzed in detail, with due regard to the role played by adverse exogenous developments, institutional and political constraints on program implementation, and flaws in program design. Even where conditionality was to blame, the problem might be one of the appropriate policy mix than of general laxity in its degree. The general perception among the membership was that conditionality had been significantly tightened over the previous year or so, and many would argue that present conditionality might already be strict enough to deter potential borrowers from approaching the Fund at an early stage of their problems.

Findings about the progress made toward balance of payments viability by countries under review had led the staff to conclude that, in general, the greater the degree of program implementation and observance of performance criteria, the greater the progress made by a country toward balance of payments viability, Mr. Finaish remarked. However, it was also readily acknowledged that there had been several cases in which little progress had been made despite full implementation of the program. Conversely, there had been cases in which significant progress toward balance of payments viability had been made even though the program had not been fully implemented and some of the performance criteria had been breached. The staff acknowledged that some of those cases implied errors in program specification, either as the result of errors in economic projections and modeling, and/or of internal inconsistencies in the program. While no detailed explanations had been provided, he trusted that the staff was studying how to avoid such errors in the future.

The relatively weak correlation in many cases between the observance of performance criteria and the degree of success in attaining program objectives raised questions about the appropriateness of the emphasis generally placed by the Fund on the fixing and observance of performance criteria with near-mathematical precision, Mr. Finaish said. Indeed, the staff acknowledged that "whether or not performance criteria were observed could not always be used as a pure signal that the program was or was not producing the intended outcome." That would lead to the conclusion that so long as the implementation of a program was moving broadly in the desired direction, a more flexible approach to the observance of performance criteria would be helpful. That frequent waivers and modifications might be considered necessary, even while a program was broadly on track, suggested that problems could arise from too narrow an attitude to the application of those criteria. At the same time, it had to be recognized that performance criteria generally served a useful function in monitoring the implementation of a program. One middle way might be to define the criteria in terms of a broad range, where possible, rather than in precise figures. In that way, problems caused by program interruptions resulting from minor breaches of performance criteria would also be eased. An objection that would be made to that course, however, was that countries might always opt for the higher end of the range and would interpret the lower one as a signal.

Another issue raised in the paper related to the pros and cons of multiyear arrangements vis-à-vis successive one-year stand-by arrangements, Mr. Finaish observed. As noted in the staff paper, there had recently been relatively more one-year than multiyear arrangements. The choice might sometimes have been dictated by the lack of room for maneuver because most of the adjustment had to take place in the short run. However, it might also have reflected what the staff called "lessons drawn from experience with interruptions of multiyear arrangements." True, purchases had been interrupted more often under extended arrangements than under stand-by arrangements, and a larger proportion of countries with extended arrangements might have failed to make much progress toward balance of payments viability than had countries with stand-bys. However, it was also true that adverse exogenous developments had a greater effect under extended arrangements than under stand-by arrangements, effects that were particularly severe for the relatively poorer performers having extended arrangements. Besides, as the staff had noted, the somewhat greater progress made toward balance of payments viability under stand-by arrangements might be a reflection of two aspects of those arrangements: relatively higher initial current account deficits and the high incidence of programs oriented toward demand restraint with a view to reducing the deficit in the short run. Yet as a reflection of the primarily structural orientation of external arrangements, important structural adjustments had been made in several cases, and the growth performance for the group of countries with extended arrangements had been much better.

It would be recalled, Mr. Finaish added, that the extended Fund facility had been established because of the recognition that for many countries facing payments imbalances, progress to a viable external position required important structural adjustments, along with demand management policies, that could best be accomplished only over the medium term. As had been noted in the Executive Board on many previous occasions, the need for supply-oriented adjustment policies was particularly great for many developing countries facing external disequilibria. However, the view had recently been expressed that the relative lack of specificity of the criteria during the latter years of extended arrangements could result in weaker conditionality compared with the first year. On that basis, it had been suggested by some that where there was a need for phasing adjustment over the medium term, a better arrangement might be successive one-year stand-by arrangements, which would combine the advantage of phased adjustment with strong and well-administered conditionality.

It was true, Mr. Finaish remarked, that given the medium-term nature of extended arrangements, performance criteria could not be laid down at the outset for the latter part of the program in as precise quantitative terms as might be possible for the first part. However, that procedure might not necessarily be a weakness but, indeed, offer flexibility to enable the criteria and targets for the latter part of the program to be established in light of developments in the earlier part. Besides, review clauses, on which increasing emphasis was being placed as performance criteria, would serve to ensure that the relative lack of specificity of criteria at the beginning of the program did not produce weaker conditionality in the later part of the program. In addition, as the staff had concluded in EBS/82/97, reliance on shorter arrangements in circumstances requiring medium-term solutions entailed the danger of too narrow a scope of adjustment. The staff went on to conclude that "where a country is able to formulate a coherent medium-term strategy of adjustment, the extended Fund facility continues to be a suitable vehicle of Fund assistance." The appropriate time frame and continuity provided by an extended arrangement for the formulation and implementation of a coherent and well-integrated medium-term adjustment strategy could not be fully replicated under successive one-year arrangements.

While the establishment of the extended Fund facility showed the recognition by the Fund that there were important structural aspects of balance of payments problems that could be tackled effectively only over the medium term, Mr. Finaish went on, there was a feeling among the developing countries that programs formulated within that framework did not generally go far enough in addressing structural problems. In many cases, the main emphasis remained on demand restraint, with supply-oriented policies playing a relatively minor role. The Fund's conception of supply-oriented policies was perceived to be much too narrow, and to be generally confined to price adjustments to enhance incentives to producers.

In the conclusions drawn in EBS/82/97, Mr. Finaish said, the staff had noted that greater emphasis on prior or early policy actions would be helpful because it would remove some of the uncertainties relating to the timing and degree of policy implementation. That approach might also have the advantage of sending strong early signals to help re-establish internal and external confidence. Besides, it might be difficult with a gradual approach to maintain political support for adjustment measures over an extended period. However, in the background paper on adjustment programs, their broad design and key indicators, the staff had acknowledged that in the choice of the initial package of measures or the sequence of measures over the program period, those arguments had to be balanced by other considerations. For instance, a rapid pace of adjustment might frequently involve higher costs in growth and employment, at least to begin with. The initial economic situation was also relevant: thus, the existence of significant unemployment might rule out strong deflationary measures at the outset. Another relevant consideration might be the speed with which the disequilibrium had developed over the preceding period, with chronic imbalances that had grown up over extended periods generally being less amenable to rapid correction--or, to borrow a term from development economics, to a big-push approach--than imbalances of fairly recent origin. The nature of the intended adjustment measures would also be a consideration: where major structural adjustments were a part of the program, the adjustment measures might have to be spread over a period of time. Too rapid an adjustment might also be politically less expedient for governments. Finally, the bunching of adjustment measures--some of which at times could be quite painful--at the outset of a program might have the effect of making countries wait still longer before deciding to approach the Fund. All such considerations needed to be kept in view in choosing the speed and sequence of adjustment, the selection generally having to be decided on a case-by-case basis.

As for the policy content of programs with respect to the public sector, Mr. Finaish remarked, the staff had noted in its papers that the emphasis in reducing fiscal deficits had been placed primarily on reductions in expenditure rather than on increases in revenue. Could the staff indicate its reasons? If revenue increases, which in most cases would involve tax reform, required more by way of institutional and administrative changes, they would take longer to achieve than the average duration of a Fund-supported program; greater use of revenue-increasing measures could then be expected under extended arrangements than under stand-by arrangements. Perhaps expenditure adjustments, within the relevant limits, tended to involve less difficult political choices than tax adjustments. If the factors obstructing tax reform were largely technical, the Fund could usefully provide technical assistance. Whatever the underlying reasons, it could be said that sustained improvement in the fiscal position would generally call for prudence on both the expenditure and the revenue sides.

The Fund seemed to leave the impression of tending to assume in its policy prescriptions a uniform need for greater reliance on free market forces and to de-emphasize the importance of the public sector, Mr. Finaish commented. That tendency should be resisted. It would be recalled from the recent Executive Board Seminar on the application of Fund policies in centrally planned economies that the guidelines on conditionality did allow some scope for differences in policy prescriptions without contravening the principle of nondiscriminatory treatment. Clearly, given the wide diversity of different types of economies, the proper approach would be to consider a variety of policy options and instruments in adjustment programs.

The Deputy Managing Director assumed the chair at 12:20 p.m.

Mr. Kafka said that he could concur with the proposed decision in EBS/82/97 if his interpretation of it was correct, namely, that the Executive Board was not committing itself to anything other than a further review not later than the date when the Eighth General Review of Quotas took effect. He did not agree with everything in Section 7 containing the staff's conclusions. In particular, he did not agree with the staff's unqualified support for preconditions.

A number of questions as to whether or not Fund policies were on the right track were left unresolved by EBS/82/97, Mr. Kafka considered. Table 4 compared the situation before a program with the targeted and actual change. Quite properly, that table and much of the analysis did not distinguish between programs that were implemented and those that were not. With respect specifically to balance of payments viability, as shown in Table 7, there was a clear correlation between noninterruption of purchases and progress toward viability. On the surface, the correlation seemed encouraging, but there were examples to the contrary. In any event, it could not be assumed that all programs that failed to be implemented were reasonable, even if the reason for their failure was not to be found in causes like world market developments or natural catastrophes. Not all programs could be implemented, irrespective of whether or not they were optimal. Quite apart from such questions, there were other criteria than the concept of balance of payments viability by which to judge a program, such as inflation and growth. In respect of the latter, comparisons of the "before and after" type were presented for all programs. The criticism of that approach in Section IV of DM/82/37 could not be invalidated. The only infallible prescription for testing the efficiency of a program would be to experiment with a structural model for each country; but there were no models for most individual countries as distinct from cross-country analysis. There was also the further question of the adequacy of estimates and the stability of the parameters.

Hence, Mr. Kafka continued, despite the interesting correlation between balance of payments viability and program implementation, it was doubtful whether the Fund knew enough about the effects of its programs to offer advice. Such a state of ignorance was characteristic not only of the Fund but of all economics. The inevitable conclusion was that since it was still necessary to develop programs and to give advice, the analytical methodology should be perfected to the best of the staff's ability. That conclusion had to be one of profound humility; since knowledge was limited, it was necessary at all times to be prepared to experiment and to give great weight to the opinions of the people on the spot.

The interruption of many programs had apparently suggested to the staff, as mentioned on pages 35-36 of EBS/82/97, the advisability of giving preference to stand-by arrangements over extended arrangements and multiyear programs, while putting the shorter stand-by arrangements, whenever appropriate, into a multiyear context, Mr. Kafka observed. The primary understanding would be that a succession of one-year arrangements would be the normal procedure. That might be one way to avoid waivers and renegotiations, but he was not sure that it was the best way. Why should the Fund not face up openly to the fact--as it had been prepared to do for a time--that in an unforeseeable world no stigma should be attached to waivers or even to renegotiations? Traditionally, programs had been structured so as to use as performance clauses items under the control of the Government. He had been attracted by the idea of contingency performance clauses mentioned by Mr. Finaish. But beyond that, he sometimes felt that what might be needed was a recognition that fewer things were under the effective control of governments than might have been thought. It was not only structural catastrophes and world market developments that were outside the control of individual countries. Effective control over other variables required not only governmental will, but the emergence of a consensus in support of government, whatever the form of the government. With the best of intentions and the strongest will, governments could err about the speed with which a consensus would emerge, quite apart from making errors in forecasts and the parameters of the behavioral equations that were used. Nor was it a solution to impose on governments the most pessimistic solution that the most pessimistic forecasts and the most pessimistic estimates of parameters would imply.

There was another aspect of program design that he found preoccupying, Mr. Kafka remarked. The limitation of the Fund's own resources and of those that could be raised from the market with the Fund's help or because of its presence might force the Fund to insist on more rapid and harsher adjustment than it would have otherwise, thereby perhaps interfering with the emergence of the necessary consensus in the country. The Fund could not rest content with the fact that the world had become a harsher place; it had an obligation to be conscious at all times that it had to go beyond the impressive supplementation of resources through borrowing that it had achieved. The Fund should continue actively to explore all types of borrowing, pending a major quota increase, and the time frame of its lending arrangements should also be under continuous review. Authorities and the media might be unduly pessimistic--he was sure that they were--but the Fund had to be ready to play the wider role that might be required of it in the future. He had been glad to note from a recent comment by the Managing Director that he and his staff had plans in hand for such eventualities.

Still, from the point of view of program design, he wished to bring up once again an earlier idea for a very short-term bridging credit facility--other than emergency credit--along the lines of the original form of the stand-by, Mr. Kafka said. Nevertheless, even if such a bridging credit facility were established, the Fund would not be relieved of the obligation to seek to speed up negotiations for arriving at financial agreements with members. The time required from the beginning of a negotiation for an arrangement to its approval by the Executive Board was by no means unsatisfactory, but it could perhaps be better. What had contributed to that fairly satisfactory record was that, for all practical purposes, although not in law, the Executive Board accepted the management's recommendations and rightly saw its role not in disavowing the management but in drawing the staff's attention to aspects that it wished not to see repeated in the future. In the same way, the management had, in practice although not in law, accepted arrangements negotiated by the staff and sought to avoid future errors without essentially disavowing a concluded negotiation. He hoped that those practices would continue to prevail in the interests not only of speed but also of the credibility of the arrangements and of the Fund. In that connection, the Fund should be careful that its collaboration with the World Bank did not become a cause for delaying negotiations and the conclusions of arrangements.

The practice that had recently become more prominent in the negotiation of arrangements concerned the so-called preconditions, Mr. Kafka remarked. They should be looked at pragmatically; they might be politically convenient or inconvenient, and economically advisable or inadvisable. It would certainly be a mistake to elevate mistrust into a modus operandi and insist on preconditions to assuage mistrust, instead of justifying them on technical grounds or, in extremely rare cases, because of earlier malfeasance. Nor should the Fund be insensitive to the fact that the demand for preconditions might discourage members from a timely approach to the Fund. As Mr. Buira had pointed out recently, the Fund might then be deluded into believing that its resources were more than adequate to meet all the needs that might be brought to it.

No one could fail to be impressed by the flexibility of the program design displayed in the staff paper on the characteristics of adjustment programs (EBS/82/98), Mr. Kafka stated. The Fund had come a long way from the stand-by arrangements of its early days; but, as others had noted, Mr. Kharmawan in particular, it had not come far enough. The difficult present, and perhaps the even more difficult future, would call for more daring and more sensitivity to new situations on the part of the Fund than it had shown in the past.

Mr. Joyce noted that the staff paper on the broad design of adjustment programs and key indicators provided a particularly useful indication of how the characteristics of a member's economy served to define a viable long-run balance of payments position for that member. In general, it seemed to him that the staff had pointed to an important trend that could only be described as disappointing. It was surely a matter of general concern to note that the staff considered that only about one third of stand-by or extended arrangements had been a success in that some adjustment had taken place and some progress had been made toward balance of payments viability. The one comfort was perhaps that there had been no discernible upward trend from previous years in the incidence of interruptions. In the circumstances, it seemed hard not to agree with the underlying premise of the staff papers, as he read them, that the goal of extended and stand-by arrangements had to be the restoration as quickly as possible of a member's balance of payments position to medium-term viability. That was essential not only if the countries concerned were to become self-sustaining but also if the Fund was to ensure the revolving nature of its resources and hence their availability to other members coming into difficulties.

The strength and weaknesses of different Fund programs were summarized explicitly in EBS/82/97, Mr. Joyce continued, but it was interesting to note that those countries in which Fund policies had been most fully implemented were those that had made the most progress in achieving balance of payments viability. The staff had quite rightly pointed out that the increased external indebtedness of many members left little room for prolonged financing of large current account imbalances; consequently, the need to press on with adjustment was even greater than it had been in earlier years. Moreover, a higher rate of success in Fund programs was vital if members were to continue to obtain adequate financing through international capital markets, as had recently been demonstrated in SM/82/105 (6/1/82) and Supplement 1 (6/3/82). Indeed, in coming years, the Fund might have to place still greater emphasis on its role in promoting adjustment rather than on its role as a financial intermediary.

Despite the importance of improving the balance of payments position of members using stand-by or extended arrangements, Mr. Joyce observed, the staff assessment was that, in half the cases in which that goal had not been satisfactorily met, the performance criteria had been breached and purchases interrupted, often at an early stage of the arrangement. With respect to the factors contributing to those interruptions, he had been struck by four points in particular. First, it had come as a slight surprise to note that adverse exogenous shocks had affected similarly those countries that had been successful in making progress toward balance of payments viability and those that had been unsuccessful. Clearly, there were ways, albeit difficult ways, for members to cope with the unforeseen and serious consequences of detrimental economic developments. Great self-discipline and determination were required, and the necessary measures might strain the social fabric of the country. Second, there was a need to seek other methods of encouraging greater political commitment to changes in policy and in administrative machinery. Shortfalls in those areas had often caused interruptions in programs. It was always difficult to assess the level of a member's political commitment to an adjustment program; however, it was important to stress the unfortunate consequences of anything less than active backing of the program by the authorities at the highest level.

Third, given the technical problems that appeared to have surfaced in many instances in implementing policies, particularly in the fiscal area, there was clearly a continued and possibly an expanded role for Fund technical assistance, Mr. Joyce said. Fourth, he had been impressed by the increasing need for contingency planning. In the present world, when it was necessary to put programs back on track as quickly as possible, there should be some understanding of what would happen if there were unsatisfactory developments. In that way, at least the direction of offsetting or corrective action would have been identified, even though the detailed measures might not have been worked out in advance. He recognized, of course, that inadequate implementation of a Fund program might reflect unrealistic program targets, often arising from the lack of data or the difficulty in forecasting accurately what might happen. Inevitably, all countries that had programs with the Fund tended to err on the side of optimism as to how soon they would pull themselves out of their difficulties.

As for how to deal with deviations from programs, Mr. Joyce remarked, he agreed broadly with the way in which waivers and modifications of existing programs were used. Particular attention should be paid to ensuring that waivers and modifications were granted only for small deviations from a program where the broad thrust of the adjustment effort was unchanged. Furthermore, it was important to understand that replacing an arrangement with a new one was not a vade mecum. Both the member and the Fund staff should realize the seriousness of failures under existing arrangements; starting anew would not necessarily mean that the revised program would be any more successful.

It was clear from the staff papers that there was value in placing greater emphasis on prior actions by a member, Mr. Joyce added, not only for new or modified programs, but also in constructing original programs. Prior measures often removed uncertainties about the timing and implementation of policies, and could often be a good measure of the degree of political commitment to the program at the highest level. In addition, prior action might frequently prove politically to be more acceptable to the authorities, while sending an important signal to the private markets, a signal that might be essential if the necessary private financial flows and indeed official donor flows were to come forward on time.

Contingency performance criteria also seemed to have a role to play in some cases by providing a useful degree of flexibility in Fund programs, Mr. Joyce said. On balance, however, he would tend to support the staff view that such provisions were generally difficult to design and to use because of the difficulty of anticipating the wide variety of potential exogenous shocks that might cause a member to deviate from the program targets. It seemed preferable to him for the Fund and the country concerned to deal with basic deviations from programs by examining the new circumstances brought about by adverse shocks and then reassessing the adequacy and applicability of the existing criteria. Such a procedure was particularly applicable to shocks likely to have irreversible effects on the economy and its outlook.

The staff had noted an increasing disposition to consider new stand-by rather than extended arrangements, Mr. Joyce observed. Given the somewhat higher failure rates of extended Fund arrangements in recent years, that course was perhaps understandable, and might well make good sense where it was difficult to project developments over a three-year period, or where the most pressing need was to stabilize or restabilize the economy to provide a firm foundation on which to build. Yet again, he would agree with the staff that even in such cases it was important to continue to attempt to take a longer-term view, even when a series of one-year programs was being linked. Moreover, he supported the staff view that where it was possible to formulate a coherent medium-term strategy, the extended Fund facility remained a suitable vehicle for Fund assistance.

His description of the Fund's lack of success recently with extended or upper credit tranche programs as dismal and disappointing did not mean that he saw cause for terminating such programs, for reducing their scope, or for insisting on tougher criteria or more demanding conditions, Mr. Joyce stated. Indeed, he agreed with Mr. Finaish that such actions might in many cases simply compound the damage. The message he took from the staff papers was that the Fund was still at an early stage of the process of learning how to mount successful programs, and that, apart from the pitfalls frequently occasioned by inadequate data or by sudden unanticipated developments, the main problem was often not the adequacy or inadequacy of a program itself but the failure to pursue its objectives with enough determination and perseverance to achieve success.

He had no problem with the intent of the decision, Mr. Joyce remarked, particularly with the view that the provisions of the extended Fund facility remained appropriate in present circumstances. His difficulty was with the proposal in paragraph 2 that the next review of those provisions and of the Fund's stand-by arrangements should take place "not later than the time when the Eighth General Review of Quotas becomes effective." According to the present timetable, the work on the Eighth Quota Review had to be completed by December 1983. There was of course always a possibility of unforeseen outside developments in that respect as well, and it might be wiser to require in the decision that the review take place by December 1983 at the latest. Many Fund members had programs, some of the earlier ones had run into difficulties, and the Executive Board should return to the matter in the not too distant future. If his idea found favor, he would suggest adding to paragraph 2 of the proposed decision the words "or, in any event, before December 1983."

Mr. Buira remarked that he appreciated the effort by the staff to make a more flexible presentation in its set of papers. He could agree, as stated in the proposed decision, that the provisions of the extended Fund facility remained appropriate, and that there should be a review no later than when the Eighth General Review of Quotas became effective.

The first thing to note about the problem of adjustment, Mr. Buira said, was that to a large extent the nature of imbalances was not what it used to be. Traditionally, the primary goal of Fund-supported adjustment programs had been to correct external disequilibria, with the secondary objective of reducing inflation, usually arising from excess demand. Programs could be reduced to three basic objectives: balancing government or public sector budgets, reducing the growth of the money supply, and establishing a realistic exchange rate. There was considerable merit to that approach, since in many countries rising fiscal deficits had become an important source of pressure on prices and the balance of payments. Large and sustained fiscal deficits financed through excessive monetary expansion or external borrowing eventually damaged the economy by giving rise to inflation, external imbalances, misallocation of resources, and low rates of growth and increasing unemployment.

However, that traditional policy was not the best one for all cases, Mr. Buira observed. Over the previous few years, the problem of adjustment had become one of attempting to restructure economies in order to adjust to higher costs of energy, which had dominated most other economic issues. For an oil importing country, the rising cost of energy imports could be offset either by increased exports or by a reduction in imports. In industrial countries, oil demand had been reduced substantially through the adoption of deflationary policies, which had slowed growth, and through conservation measures, which had reduced the ratio between the consumption of energy and the growth of GNP. The process had been a costly one in terms of unemployment and output forgone. However, it had been greatly assisted in the industrial countries by the OPEC countries' rapid absorption of imports. At present, the central adjustment problem was that relative prices of raw materials and manufactures, interest rates, levels of international trade, and the demand for exports meant that a number of developing country economies that had been marginally viable appeared no longer to be viable, and others had become only marginally viable.

For the non-oil developing countries, the problem was made more difficult because they did not have a flexible productive structure, nor did they have the high technology to produce the sophisticated industrial goods required by the OPEC and OECD countries, Mr. Buira remarked. The few that had relatively flexible economies--the middle-income countries, or the newly industrialized ones--had been able to borrow in capital markets. Those countries had followed a strategy based on borrowing aimed at export expansion. However, the sustainability of that strategy was questionable when world trade was stagnating or barely expanding. Certainly, some developing countries might have successfully oriented their productive structure toward exports and then turned the export sector into an engine of growth. The question, however, was whether the exports of all non-oil developing countries as a group to the OECD countries could grow more rapidly than the market as a whole. The answer, he believed, was that the greater the number of countries entering into the NIC club, the more difficult it was for them to sustain high rates of export growth, and the more difficult it became for other countries left behind to join that club. Of course, the situation of the poorer countries, those whose exports were essentially basic raw materials, was much more difficult. They faced rising import prices and declining or stagnating export volumes as a result of depressed prices of export crops and a decline in demand in the economies of their major trading partners.

He had described the nature of the problem faced by most countries with arrangements, Mr. Buira declared. The staff, in its paper, recognized that "in over two thirds of the programs the original balance of payments difficulties were associated with adverse terms of trade, and in particular import price movements.... Between 1977 and 1979 the deterioration in the ratio of the current account to GNP in countries with Fund-supported programs in 1980 amounted to an average of slightly under two percentage points of GNP each year." That meant almost 6 per cent of GNP in three years. The staff then commented that "the export and import price effects alone were over three quarters of the total." Those statements set out clearly the nature of the problem faced by non-oil developing countries, and it was worth noting that all arrangements involved those countries. To those factors should be added the effect of rising interest payments on external public debt, which had had an important impact on the current account of many developing countries.

To make a small point on causality, Mr. Buira remarked, an important factor behind the worsening of the fiscal position and the current account of the balance of payments observed in many countries was not that the authorities had adopted a more expansionary stance, but simply that with the same policy stance the decline in export prices and export proceeds was reducing government revenue to a significant extent, thus affecting both the fiscal outcome and the balance of payments outcome.

The question was therefore one of finding the best approach for correcting imbalances largely induced by exogenous factors, Mr. Buira stated, and the best way to bring about a viable balance of payments position in such circumstances. Clearly, there was an important difference between strengthening the balance of payments as a result of a slowdown in growth and economic activity, and achieving a sustainable solution compatible with growth. It was stated in EBS/82/97 that "...the strategy for attaining medium-term balance of payments viability ranged along a spectrum from an almost exclusive focus on the restriction of aggregate demand to reliance on measures aimed at adjusting the economic structure." However, the evidence was not entirely reassuring.

There were essentially five types of policies in Fund programs, Mr. Buira observed. First, policies aimed at reducing the overall deficit of the government or the public sector; there were few exceptions to the intention of seeking lower deficits, and, moreover, in three quarters of the cases, the program included measures to restrain expenditure. Second, virtually all programs included credit ceilings, although in a number of cases, the targets for public sector credit represented a greater rate of deceleration than those of total domestic credit, reflecting the aim of freeing credit for the private sector. Third, a frequently specified policy was general wage restraint, which was seen to have beneficial effects on inflation, often in support of exchange rate measures. Fourth, higher real rates of interest were planned to promote savings, and to rationalize and improve the capital account of the balance of payments. Fifth, policies with respect to the exchange rate were specified in a number of cases, usually requiring frequent adjustments in response to domestic inflation. It might well be concluded, as in the staff paper, that "the policy content of the programs under review was not very different from that of programs in earlier years. Certainly similar fiscal, monetary, and external debt policies were specified in almost all countries."

That programs had not changed substantially compared to past programs, Mr. Buira noted, suggested that they might not be adapted to the new circumstances prevailing in the world economy. From their content, it was apparent that they continued to be aimed essentially at demand imbalances. Like Mr. Finaish, he detected a bias--or preference--in favor of reducing the role of government to allow more scope for private sector operations. That was indicated by the emphasis on reducing public expenditure rather than on increasing public revenue, and by the limitations on credit to the public sector in order to allow more credit for the private sector; it was also borne out by the emphasis on liberalizing the prices of goods and services, particularly in the so-called structurally oriented programs. The presumption, although of course it was not stated, was that there was too much government, that the public sector was too large, and that the private sector could perform the necessary tasks better. Tackling the adjustment problem would require a substantial restructuring of the economies in question. How could that be done? Was the private sector the key to the process?

Energy provided a good case example of a structural problem, Mr. Buira stated. The adjustment to higher costs of imported energy would certainly require both immediate and structural responses. Among the former would be such measures as passing on the higher prices to the consumer, obtaining additional capital inflows to finance the increased energy costs, and reducing the growth rate of GNP. However, those immediate responses were not by themselves sufficient to complete the adjustment of the economy to the new relative prices, because any attempt to return to a higher rate of growth could result in an unsustainable balance of payments position. Adjustment to higher energy prices would be incomplete as long as the structure of the economy was not adapted through the development of domestic energy sources and the more efficient use of energy. In many cases, coal, hydroelectric power, and other energy sources were abundant, but, until domestic energy resources were developed, economic activity would have to remain below potential. The development of energy resources would require considerable investments in mining, processing, transport, and coal-using equipment, or alternatively in hydroelectric power-generating plant and transmission grids. Was the private sector always better placed to carry out those tasks? What was required was a shift not only in demand but also in supply, in response to the new prices. The question would be how best to accelerate structural change in such a way that the costs of the resulting disruption would be reduced. It would also be important to find out how best to cushion the effects of changed relative prices so that the cost to the poor countries was limited. The present structure of conditionality would at times delay, rather than assist, the necessary structural adjustments.

While the case of energy was perhaps the most striking example of changes in relative prices, it was not the only one, Mr. Buira stated. The prospects of slow growth in world trade suggested that many developing countries would need to develop their own energy sources or change the structure of their economies, moving away from one or two export products, if they were to combine a viable external position with an acceptable rate of economic growth. Where energy potential was limited, the response would require adjustment in patterns of trade through the development of export or import substitutes in order to pay for the higher cost of oil.

Often the adjustment would require substantial investments in infrastructure and a certain lead time; thus, unless undertaken by the a national government, there was little chance that they would be made. That requirement had important implications for the adjustment path envisaged in a program for the public sector deficit and the balance of payments.

The problem had been posed in the staff paper in terms of whether a gradual stabilization approach was more effective than "shock treatment," Mr. Buira commented. In developing countries, it was not simply that there were sound arguments for believing that a gradual adjustment process with appropriate emphasis on supply might be both more effective and less disruptive than a demand management program concentrated in a short period of time. It was normally impossible to achieve the required structural adjustment through shock treatment. However, a change in the character of Fund conditionality to take into account the structural nature of the imbalances faced by many countries would imply a significant increase in the Fund's financial resources. There was no reason why the Fund should not permit drawings beyond 450 per cent of currently inadequate quotas, to the extent that it could obtain resources. Alternatively, reluctance to provide the Fund with adequate resources could be translated into a further hardening of conditionality, preventing the Fund from performing its proper role.

In the past, Mr. Buira recalled, conditionality had changed in response to objective factors such as changes in the liquidity of the Fund and subjective factors such as changing political circumstances and perceptions in major countries. That might be unavoidable, but it was undesirable to vary conditionality for exogenous reasons that did not relate to countries' needs. Most non-oil developing countries were unable to borrow substantial amounts on commercial terms, faced restrictions on multilateral development bank credits, and a decline of OECD assistance measured as a proportion of the GNP of industrial countries. Thus, financing the necessary adjustment was increasingly difficult for non-oil developing countries. Yet it was hard to devise solutions to structural problems that did not involve increased lending over a lengthy period. At present, there was a need for the Fund to play a greater role in recycling and adjustment through appropriate conditionality that would not rely essentially on demand management, but would give as much importance as possible to encouraging investment and production responses from both the public sector and the private sector so as to facilitate the required structural transformations, without unnecessary damage to economic growth and social equity. What was needed was a pattern of adjustment more akin to the solution of long-term structural problems, and larger, sustainable international capital flows, not to mention greater equity in the distribution of growth.

Referring to other points raised by the staff papers, Mr. Buira noted, first, the question of how to promote structural change and stimulate supply. The staff's treatment of supply problems appeared to be based on a theory that could be put into the words: "increased supply is largely a question of appropriate pricing." While he had no quarrel with the pricing policies advocated in the staff paper, it seemed to be an oversimplification of the issue to reduce the concept of supply-oriented policies largely to a question of pricing. It should not be forgotten that the Fund was dealing with developing countries, often with the poorer ones. There it was evident that a number of important policy actions could be taken to enhance agricultural production that had little to do with pricing. In developing countries, the agricultural sector might often be characterized by primitive techniques, land tenure systems that were hostile to improvements, imperfect labor markets, monopolistic distribution channels allowing middlemen to retain profits, low savings and inadequate credit facilities, arbitrary legal administration and uncertain enforcement of contracts, and corrupt and inefficient administrative systems. The labor force might be illiterate, unskilled, suffering from malnutrition and poor hygienic conditions that in turn made workers apathetic, lacking in ambition, and unwilling to innovate and take risks. In those conditions, the promotion of agricultural output was not simply a matter of incentives or pricing policy.

Appropriate pricing policies might be a necessary condition, but they were certainly not a sufficient one, Mr. Buira stated. The measures necessary to enhance agricultural production ranged from technical assistance and extension services to greater availability of credit and improved marketing systems, and to public investments in infrastructure, such as roads and railway lines that would reduce the cost of access to markets and permit new lands to be opened up, not to mention the provision of irrigation, fertilizers, and improved seed. Therefore, it would seem foolish to approach supply problems by neglecting all nonprice considerations. To his mind, the essence of adjustment through supply-oriented policies was the promotion of adjustment through growth and investment, particularly in certain sectors, which would result in a gradual transformation of the structure of the economy in order to adapt it better to current and future conditions.

Much was made in the staff paper of a distinction between demand restraint and structurally oriented programs, Mr. Buira noted. While he would not claim that the distinction was meaningless, he believed that in most programs it was less meaningful than suggested by the staff. That contention was borne out by the almost exclusive emphasis on prices as the key to structural policies, and by the nature of performance criteria. With a few honorable exceptions, such as the Indian program and a few others, the so-called structurally oriented programs were little more than a combination of demand restraint plus price liberalization, and were thus largely insufficient to ensure a viable balance of payments position over the medium term. Moreover, Fund programs did not seem to command a strong commitment at the highest political level. That lack of commitment--one of the causes of the low rate of compliance with programs--might be due to the emphasis placed on fiscal and other measures of restraint that would often be perceived as largely irrelevant to the needed structural adjustment. Concern over the high rate of failure of programs suggested the need for a closer look at their content.

He was concerned about what he regarded as an undesirable trend toward stand-by arrangements that were less suited to dealing with structural problems, and away from extended arrangements, Mr. Buira observed. The design of extended arrangements might still pose problems, since the Fund had not yet developed the performance criteria to make them operationally different from stand-by arrangements. In fact, many extended arrangements tended to be a succession of traditional stand-bys. The programming framework generally treated output as independent of monetary factors, and had been rationalized on the grounds that, with a typical program for the short term, it could be assumed that the domestic supply of resources was fixed. That assumption could not be relied upon with the extension of programs to the medium term in which the growth problem would have to be faced directly. However, the Fund's current programming framework did not help it to do that. The solution was not in moving away from the extended Fund facility and from the recognition of structural problems, but to improve the facility, and its policy mix, in order to give operational content to the idea of structural adjustment.

It was of course wrong to compare, as the staff did in its paper, the results achieved by stand-by and extended programs over the very short term, Mr. Buira said. By definition, an extended arrangement would aim at structural changes that took longer to be realized. Obviously, in the short run, structural adjustment might require an increase in balance of payments deficits while certain investments were under way, whereas arrangements based on demand restraint would result in a short-run improvement, which did not of course indicate that a slowdown in economic growth was a sustainable solution. It was quite clear that programs that were fundamentally demand-oriented would not work if the problems were structural. That did not mean that there was no room in Fund programs for demand management policies, but rather that emphasis should be placed on solving the structural problems of the economy.

Many current programs might have become inoperative mainly because of their concentration on traditional demand-management policies, Mr. Buira mentioned. On the other hand, success could be found in supply-oriented programs that were designed specifically to respond to the member's needs and problems and were accompanied by sufficient financing. A case in point was Turkey, the value of whose total exports had at the outset of the program been less than that of oil imports. Clearly, sole reliance on demand management policies would not have solved Turkey's external difficulties, because even the depressed level of economic activity generated a level of demand that clearly outstripped that of supply. Only through flexible supply-oriented policies and considerable financial support could redressment be attained, even though it had implied a larger current account deficit at the beginning of the program. Though endowed with a more diversified economy than most developing countries, Turkey's success was a good example of how a flexible approach based on a combination of demand and supply-oriented policies and adjustments in a medium-term context, coupled with sufficient financing to bridge the initially increased external gap, could effectively contribute to a country's external viability and to the international adjustment process.

Finally, Mr. Buira stated that while he had supported the proposed decision, his support did not extend to the emphasis on preconditions or to the other conclusions in EBS/82/97. In fact, most of the recommendations in Section VII of that paper seemed to represent a continuation of the shift in Fund policies from structural adjustment toward shorter-term programs. That was a move in the wrong direction and one that was neither necessary for the preservation of the revolving character of the Fund's resources nor suited to the nature of the problems faced by member countries or by the world economy at present.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/91 (6/30/82) and EBM/82/92 (7/7/82).

3. EL SALVADOR - 1981 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5395-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the Article IV consultation with El Salvador until not later than July 16, 1982.

Decision No. 7152-(82/92), adopted
June 30, 1982

4. THE GAMBIA - EXCHANGE SYSTEM

The approval of The Gambia's restriction arising from arrears on external payments under Decision No. 6872-(81/84) is extended until September 30, 1982 or completion of the mid-term review of the 1982 stand-by arrangement with the Fund, whichever is earlier.

Decision No. 7153-(82/92), adopted
July 2, 1982

5. GREECE - EXCHANGE SYSTEM

The approval under Decision No. 6961-(81/129) of Greece's exchange restrictions and multiple currency practices with the changes as described in EBD/82/164, is extended until December 31, 1982 or the completion of the next Article IV consultation with Greece, whichever is earlier.

Decision No. 7154-(82/92), adopted
July 2, 1982

6. SUDAN - EXCHANGE SYSTEM

The approval of Sudan's multiple currency practice under Decision No. 7055-(82/19), adopted February 18, 1982, is extended until September 30, 1982 or the completion of the 1982 Article IV consultation, whichever is earlier.

Decision No. 7155-(82/92), adopted
July 2, 1982

7. UGANDA - EXCHANGE SYSTEM

The approval under paragraph 5 of Decision No. 7090-(82/48), adopted April 15, 1982, for the retention by Uganda of an exchange restriction relating to external payments arrears is extended until consideration by the Executive Board of Uganda's request for a stand-by arrangement, or August 31, 1982, whichever is earlier.

Decision No. 7156-(82/92), adopted
July 2, 1982

8. EAST CARIBBEAN CURRENCY AUTHORITY (ECCA) - TECHNICAL ASSISTANCE

In response to a request from the East Caribbean Currency Authority for technical assistance, the Executive Board approves the proposal set forth in EBD/82/168 (6/30/82).

Adopted July 2, 1982

9. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 82/15 through 82/19 are approved. (EBD/82/162, 6/29/82)

Adopted July 6, 1982

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, their Advisors, and an Assistant as set forth in EBAP/82/229 (6/29/82), EBAP/82/231 (6/30/82), EBAP/82/233 (7/2/82), and EBAP/82/234 (7/2/82) is approved.

11. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/82/232 (6/30/82) is approved.

APPROVED: December 15, 1982

LEO VAN HOUTVEN
Secretary