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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/114

3:00 p.m., August 20, 1982

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

Executive Directors	Alternate Executive Directors
M. Abdollahi	
	C. Taylor
	E. Portas, Temporary
J. de Groote	
B. de Maulde	A. Le Lorier
R. D. Erb	
	T. Alhaimus
T. Hirao	T. Yamashita
J. C. Iarezza	
R. K. Joyce	
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	
S. Kiingi	F. Sangare
G. Laske	
G. Lovato	C. P. Caranicas
	A. B. Diao, Temporary
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	B. Legarda
	L. Vidvei
	Wang E., Temporary

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

African Department: A. C. Woodward. Asian Department: J. T. Boorman, J.-P. C. Golle, H. C. Kim. European Department: L. A. Whittome, Counsellor and Director; D. M. Ripley. Exchange and Trade Relations Department: C. D. Finch, Director; G. G. Johnson. External Relations Department: H. P. G. Handy. Fiscal Affairs Department: G. Blöndal, G. A. Mackenzie. Legal Department: Ph. Lachman, S. A. Silard. Middle Eastern Department: M. C. Niebling. Research Department: W. C. Hood, Economic Counsellor and Director; C. F. Schwartz, Associate Director and Director of Adjustment Studies; R. R. Rhomberg, Deputy Director; J. Artus, C. P. Blackwell, M. C. Deppler, S. J. A. Gorne, L. R. Kenward, M. D. Knight, A. K. M. Siddique, E. Y. P. Tung. Western Hemisphere Department: J. Ferrán. 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. El-Khouri, L. Ionescu, G. Jauregui, P. Kohnert, S.-W. Kwon, P. D. Péroz, F. Sarraf, F. Yeo T. Y. Assistants to Executive Directors: L. Barbone, L. E. J. Coene, T. A. Connors, R. J. J. Costa, I. Fridriksson, A. Halevi, Jiang H., M. J. Kooymans, W. Moerke, J. A. K. Munthali, J. R. Novaes de Almeida, Y. Okubo, G. W. K. Pickering, D. V. Pritchett, M. Z. M. Qureshi, P. S. Tjokronegoro, O. Üçer, A. A. Yousef.

1. WORLD ECONOMIC OUTLOOK - GENERAL SURVEY

The Executive Directors continued from the previous meeting (EBM/82/113, 8/20/82) their consideration of a General Survey paper on the World Economic Outlook (ID/82/2, 8/2/82). They also had before them a departmental memorandum on selected indicators of exchange rate changes and related variables (DM/82/52, 8/13/82).

Mr. de Groote recalled that, in his earlier remarks, he had stressed that Fund programs for developing countries should not give predominance to credit ceilings; he should perhaps have gone on to state in a more positive vein that importance should be given to price-corrective elements beyond the exchange rate. Also, a more institutional approach to the developing countries--analogous to the "institution building" of the World Bank in its structural loan agreements--could perhaps be devised in which a restoration of public financing was required within certain time limits rather than a simple observation of ceilings.

On another matter, Mr. de Groote said that he wished to correct the impression that, during the discussion of the Article IV consultation with the United States, he had expressed the view that the existing fiscal deficit could be lived with or even enlarged. On the contrary, he had indicated only that he saw no need to give priority to reducing the deficit, because the public would revise its inflationary expectations, producing a diminished deficit, increased investment possibilities, and potentially increased output. What he had intended to suggest was that public expenditure in the United States was not overlarge by comparison with that in other industrial countries, and that restraints on the deficit could be exercised through increased income rather than through a reduction of expenditures. In any event, he was in fundamental agreement with the position taken by Mr. Erb.

Mr. Polak noted that the staff had unfortunately been little more successful than national forecasters in predicting the timing of economic recovery in individual countries. While that lack of success might lead some to question the usefulness of such forecasts, he believed that the staff should persist in its efforts as a check against government forecasts, which appeared--even more than in the past--to be dominated by wishful thinking. He urged the staff not to be persuaded to show optimism that was not supported by evidence.

It was important to recognize the pervasive influence that uncertainty about the industrial countries imparted to the entire forecasting exercise, Mr. Polak continued. In various places in the staff report, there were slightly optimistic views on certain aspects of the performance of the developing countries--for example, with respect to higher prices or increased exports--but each of them was predicated on an upturn in the economies in the industrial countries, which remained uncertain. The interdependence of countries was obvious, but one had to be continually aware of the potential for error.

Remarking on the presentation of the World Economic Outlook paper, Mr. Polak wondered whether sufficient flexibility was being exercised, particularly with respect to certain subjects that deserved special attention. For example, he had found it surprising that, at a time when the newspapers were filled with items on the credit difficulties of a number of member countries and when there was considerable concern about the stability of the world banking system, the report said very little about either issue.

With respect to the country sections of the paper, Mr. Polak recalled that he had already made a number of comments in the course of his interventions on the recent Article IV consultations with both the United States and Germany. On France, he had failed to find in the paper any reference to monetary policy, an important variable. It had already been mentioned by Mr. Taylor that, in countries with floating exchange rates, the policy was to focus on the money supply. By the same token, in countries with fixed interest rates, it was important for the authorities--and for the Fund in describing policies--to concentrate on credit creation. One way of explaining France's payments difficulties might be to note that, by concentrating on the money supply, the French authorities were resupplying the money that was leaking out through the balance of payments.

Commenting on Section IV of ID/82/2, Mr. Polak agreed with the staff that there was no satisfactory alternative to the general strategy outlined. Nonetheless, he was somewhat uncomfortable with the tone of the presentation in Section IV, which seemed to have hardened by comparison with that in earlier World Economic Outlook papers. For example, on page 19, it was noted that the prevailing conditions in an unbalanced world economy had changed in recent years, "but not sufficiently to affect the fundamental character of adjustment policies consistently advocated by the Fund." Later, it was suggested that the adjustment "called for in the Fund approach is of a broad and fundamental character." On page 22, the staff had referred to the "comprehensiveness of the Fund's policy approach" and said that it "reflects the troubled state of most national economies." There appeared to be too much certainty about the wisdom of the Fund and perhaps a lack of modesty in preaching the Fund's "religion" of adjustment. There was some risk that the institution might be overstating not only its case--as perhaps had been done with respect to the advice given to the United States on monetary policy--but also its role in controlling the problems of the world economy. Indeed, the Fund occasionally failed to distinguish between what it could do and what it hoped would happen.

Mr. de Maulde remarked that France did in fact have a monetary policy, despite the lack of reference to it in the staff paper. Money supply targets and domestic expenditure targets had been adhered to in the first half of the year, and it was expected that they would be achieved in the second half as well.

Mr. Joyce agreed with Mr. Polak that the forecasting exercise by the staff, while a thankless task, provided an important broad outline of the future and should therefore be continued. His authorities accepted the staff analysis of the current world economic situation and of developments in the major industrial countries, and they shared the view that the growth outlook for the remainder of 1982 was considerably less bright than had earlier been anticipated. Indeed, up to very recent days, there had been only slight and hesitant signs of recovery.

The outlook seemed particularly pessimistic with respect to growth and unemployment, Mr. Joyce continued. Without quarreling with the forecasts themselves, his authorities felt that the time had come for a more fundamental reappraisal of the costs--in terms of output and employment--of pursuing present policies; they hoped that an effort could be made to reduce the costs without reviving inflation. Nonetheless, they shared the view of others that the overall stance of policy recommended by the Fund was generally appropriate.

He agreed with Mr. Laske that there had been some hopeful signs in a number of industrial countries in terms of a slowdown in inflation and a reduction in the rate of growth of the monetary aggregates and payments imbalances, Mr. Joyce remarked. The staff projections had understandably not incorporated some of the more recent estimates of the U.S. federal budget deficit, and it was not clear to what extent the recent declines in U.S. interest rates reflected greater private sector confidence in the Administration's ability to contain the deficit. They might, after all, be a reflection of the weaker than anticipated domestic demand pressures in the United States, or of the easing of policy by the U.S. Federal Reserve Board. In general, prospects for interest rates and for U.S. economic performance during 1983 remained somewhat uncertain, a situation that clearly had implications for the scope of policy maneuver in other countries. Still, he agreed with the staff that the United States and other industrial countries should continue in the direction of fiscal restraint without allowing a relaxation of monetary policy to jeopardize the ground that had already been gained against inflation. The overall conclusion seemed to be that the pace of adjustment must be maintained and, if necessary, intensified.

If Mr. Polak was correct in characterizing the Fund's approach as somewhat more "ecclesiastical" than it had been in the past, he hoped the institution would continue to adopt a fairly "catholic" approach in its policy advice to members, Mr. Joyce commented. The need to implement a balanced macroeconomic policy was clearly imperative if inflation was to be fought successfully and if excessively high interest rates--which had on occasion retarded economic recovery--were to be avoided. While the reduction in inflationary pressures was essential, the approach must be one that did not cause undue hardship or did not unnecessarily delay recovery.

He had been interested in the staff remark that, if one netted out cyclical influences, the fiscal impulse in the major industrial countries would be seen to have changed very little between 1979 and 1982, Mr. Joyce continued. The indication seemed to be that, at a minimum, there remained room for improvement. Although pressures for a more expansionary fiscal policy were currently strong, it was important for all countries to continue their efforts to control the size of the fiscal deficit, particularly in a medium-term perspective. Nevertheless, he could agree with those who felt it desirable also to look at other policy options. For example, monetary and fiscal policies in certain conditions could be usefully accompanied by incomes policies and, particularly in the medium term, by structural adjustment measures. He noted the staff's view that the initiatives already taken by authorities in the field of incomes policies were difficult to evaluate at the present early stage and he agreed that the effectiveness of such policies would vary according to the degree of support that they commanded at any particular moment.

In his own country, some moves had been taken to restrict the increases in prices and wages over which the Federal Government had direct control, Mr. Joyce observed. The idea was to encourage provincial governments and, ultimately, the private sector to follow the same path. In the past, his authorities had been opposed to the use of incomes policies, not as a matter of ideology but simply because they did not believe that such policies could work without widespread support among the public. At present, however, it appeared that the people were becoming increasingly convinced of the need for restraint, even if it had to be imposed upon them. Still, he remained uncertain about how effective some of the incomes policies would be that had been recently implemented in a number of countries, including Canada. To a great extent, the success in implementing such measures had been due to a general concern throughout the labor market that had resulted in union concessions in a number of industries not covered by the policies; and those concessions had helped governments to implement their policies of restraint. However, whether that support would continue once recovery got under way was debatable, particularly if the unions then attempted to recoup the concessions they had made over the previous few years.

On structural adjustment, Mr. Joyce noted the suggestion by the staff that a disproportionately large amount of the reduction in demand in recent years had taken the form of a shrinkage in economic activity rather than in lower inflation, and that the phenomenon was attributable to rigidities or structural imbalances in the economic systems of many countries. He agreed with the staff that neither the record to date nor the prospects for the future in dealing with structural adjustments were at all promising; indeed, he was concerned that the economic rigidities might even have become worse as a result of the depth of the current recession and might present a serious impediment to the ability of countries to reduce inflation and bring about sustained economic growth.

Clearly, recovery in member countries would to a great extent depend upon the timing and degree of recovery in the United States, Mr. Joyce considered. The danger was that, as private investment in the United States increased, the resulting demand for resources might compete with government borrowing, thereby pushing interest rates up once again. There was also the danger that the protracted nature of the recession and the resulting large number of bankruptcies might have damaged the industrial productive capacity of countries more severely than had been the case in past recessions. If so, bottlenecks could develop at a fairly early stage of the recovery, and the result might be a rather halting economic upswing, with inflationary embers fanned and reignited in certain sectors. Clearly, the prospects for such a development differed considerably from country to country, and he had some sympathy for the view expressed by Mr. de Maulde that it would be a mistake if the policy advice on restraint were not to take account of the different stages that individual countries had reached in reducing inflation and bringing about required budgetary adjustments. More fundamentally, policy advice should take account of the extent to which countries had succeeded in embarking successfully on the road to structural adjustment.

The problems of the developing countries were far more serious and difficult in some respects than those in the industrial countries, Mr. Joyce stated. Staff forecasts suggested that there would be a slight reduction in the accumulated current account deficits for the non-oil developing countries in 1982 and 1983, but it was obvious that even that small reduction would depend heavily on the pace and nature of recovery in the industrial countries. Because of the uncertainty surrounding such a recovery, the actual size of the deficits in the non-oil developing countries could vary greatly from the forecasts, particularly for those countries that were exporters of manufactured products and for middle-income exporters of primary products. The staff had expressed concern that the developing countries were being forced to walk a narrow path between increasing foreign indebtedness and overrapid domestic economic adjustment designed to forestall crises; while many Third World countries were of course already implementing adjustment measures--often at considerable costs in terms of their social and economic welfare--a number of them had not done so sufficiently. There was the danger that, as among the industrial countries, adjustment might not proceed as far or as fast as was necessary, and he agreed with Mr. Nimatallah that the Fund had a key role to play in helping countries both to fashion appropriate adjustment policies and to finance their balance of payments adjustment programs.

The need for Fund financing was growing, Mr. Joyce said, which was why he and some of his colleagues had been arguing for a large and rapid increase in the Fund's resources. Recent international events seemed to suggest that many developing countries would face increasing difficulties in obtaining private capital financing, particularly on terms they could afford; and he wondered whether the staff continued to regard the conclusion of the study on capital markets--namely, that the system could cope with the financing needs of the non-oil developing countries--as still valid in light of recent developments, or whether the world was heading for a situation in which increased caution on the part of lenders might have the potential for being self-reinforcing. Finally, he would take up questions regarding the outlook for Canada outside the meeting, but he did wish to note that his authorities' views on the character and appropriateness of the current Canadian deficit at the federal level did not completely coincide with those of the staff.

Mr. Erb, recalling the suggestion by Mr. Joyce that there was a danger in the United States that the fiscal deficit might crowd out private investment in the event of a recovery, agreed that such a danger existed, which was why the fiscal deficit had to be brought down over time. Mr. Joyce had also implicitly suggested that, if the recession were to be drawn out for a longer period than expected, there might be certain consequences in terms of a loss of capacity that would, in and of itself, strain future growth. However, he was uncertain what policy conclusions Mr. Joyce had drawn from his assumption.

Mr. Joyce replied that his own policy prescription was not very different from that of the staff. While investment might not play a leadership role in moving countries out of the current recession, it was essential for all countries to take whatever steps were necessary to ensure that investment occurred and that it was directed in such a way that, as countries moved out of recession, they would have an industrial plant that was more productive and responsive to the needs of the time. It seemed to him that, as an object for public expenditure, such a positive approach to investment made more sense in economic terms than devoting large sums of money to propping up ailing industries without ensuring that adjustment took place.

Mr. Prowse said that he could strongly support the statement by Mr. Hirao and that he could endorse the fundamental points made by Mr. Laske. On the staff paper itself, he considered that Section IV provided an admirable statement of problems and suggested appropriate policies to deal with them. There seemed little to argue about, even with respect to the comments on incomes policies, which reflected much of what had been agreed by Executive Directors in the past; however, he tended to support Mr. Taylor's well-informed comment on the matter of incomes policies, with which the United Kingdom had gained experience over the years. There had been plenty of time in which to assess such policies, and it seemed to be agreed that incomes policies did not work except in circumstances in which they were not really needed. Of course, there might be some scope for the kinds of modified policies mentioned by the staff. The staff had already noted the problem of rigidities and imbalances in the wage bargaining area; the great risk with incomes policies seemed to be that they introduced further rigidities and further structural difficulties rather than moderated them.

Unlike Mr. Polak and others, Mr. Prowse said, he had no difficulty with the overall tone of the staff analysis and presentation, and he could agree to the general approach, which appeared to be consistent with what the Fund had been saying for some time. There were some encouraging signs on the inflation front and in the control of money growth but there was also alarming uncertainty, so that he could see no case for adjusting the broad thrust of policy that the Fund had been recommending; indeed, the uncertainty of the situation seemed to strengthen the case for applying the Fund's prescriptions more carefully. The most urgent task for countries was to put things right domestically, particularly in the area of fiscal policy. The Fund's monetary policy prescription had been reasonably successful, and he continued to endorse the idea that control over inflation should remain a high priority for countries. However, the control of inflation should not be an end in itself; rather it should be considered an essential step toward re-establishing viable economic growth.

Some of his colleagues had questioned whether the objective of controlling inflation should not be refined somewhat, Mr. Prowse recalled, but he wondered how much refining was possible beyond specifying what a tolerable rate might be. There had been the suggestion by some that, since inflation had been cut to about 6-7 per cent in a number of countries, a risk could be taken toward expansion. He hoped that such an approach would not be taken, especially since, in present circumstances, any effort to define a tolerable rate of inflation could be counterproductive. He wished to reaffirm his support for the control of inflation as an overriding immediate objective; without such control, there would be no opportunity to work toward the other longer-term objectives.

Expanding on the issue of fiscal imbalances, Mr. Prowse noted that the statistical record and performance of the major industrial countries seemed to suggest that fiscal impulse by central governments had changed very little during the period 1979-82, so that the overall thrust of fiscal policy--after allowance for cyclical influences--had been neutral at a time when monetary policy had been shifting toward restraint. Moreover, the problem of the fiscal deficits was by no means confined to the major industrial countries. The evidence seemed to suggest that it was currently more urgent, rather than less urgent, to control the fiscal imbalance. He understood, of course, that there was some difference of view among his colleagues about how much emphasis should be given to the fiscal imbalance, and it would be a delicate matter for the Chairman to define the view of the Executive Board on that matter at the Annual Meetings. For his part, he did not believe that the moderate success achieved by one or two countries in controlling inflation provided a convincing case for any significant change in policy. Even the unhappy evidence of increased unemployment in many countries should not be used as an argument for change. Experience with the expansionary policies of the 1970s seemed to show that a shift toward expansion at present would be unwise. The fiscal situation was an immediate problem for the world, and it had to be emphasized that monetary growth could not be controlled without fiscal control, except with severe effects on interest rates and on the private sector. While all members of the Board were--as they should be--sympathetic toward the problems of the unemployed and other social difficulties of the time, the Fund as a whole should give no indication that there would be any early public reconsideration of policy on the basis of that sympathy.

Regarding the matter of balance of payments disequilibria and the closely related problem of external debt, Mr. Prowse recalled a specific suggestion by Mr. Laske that gave him cause for concern; the idea that the Fund should exercise some special surveillance over countries that were experiencing heavy external debt should not be publicly promoted, at least until its implications had been carefully reviewed by the Executive Board.

There were three aspects to the external debt situation that required action, Mr. Prowse continued. First, because external debt was a worrisome element in the broad picture of the world's problems, there should--at least initially--be no relaxation of adjustment policies, especially by those countries most affected. Second, any refusal to roll back domestic and agricultural protection could be disastrous for some of the smaller, less diversified countries experiencing heavy external debt. Finally, like others, he believed that the Fund would need to show strength and leadership in dealing with the matter of external debt and, for that purpose, would need to be financially strong enough to handle potential developments beyond those sketched out in Scenario A.

Mr. Iarezza, noting that the world economic outlook had changed little since the previous review, commented that Section III of the General Survey paper made it clear that the non-oil developing countries continued to face further deterioration in their terms of trade, which over the past few years had already fallen by 15 per cent for the group of net oil importers. A deterioration of that magnitude in such a short period of time had made it impossible for the economies of many non-oil developing countries to adjust immediately and completely, especially given their lack of diversification and their heavy dependence on price-elastic primary products. Also, the deterioration in the terms of trade had begun immediately following a boom in primary products, so that adjustment had been made all the more difficult in social and political terms because of the aspirations that had been brought about by the earlier boom. The financing that had been required to provide the necessary breathing space had led to growing external debt and increased debt service ratios in the context of very high nominal and real interest rates. Despite their problems, the developing countries had as a whole made important efforts to adjust, but those efforts had been overshadowed by the effects of increased oil imports and higher interest payments during the period 1978-81. Data suggested that, in the context of a worldwide recession, other components of the current account of the non-oil developing countries had in effect strengthened by $10 million during the period so that, even if it was agreed that the implicit adjustment efforts of those countries had been insufficient for whatever reason, it could not be denied that the effort had been made.

Like others, he agreed that further efforts toward adjustment were needed and that countries should be expected to adapt to external events of a nonreversible character, Mr. Iarezza continued. However, it was important to be careful in determining which events were nonreversible and in deciding on the time span within which adjustment could realistically be expected to take place. The recent important increase in oil prices, the fall in the prices of other primary products, the sluggish international markets faced by developing countries, and the vast increases in interest rates were among the factors that had adversely affected the developing countries. However, only two of them--the increase in oil prices and a portion of the increase in interest rates--could be considered nonreversible; the other elements, which could and should be reversed, explained a large part of the current worrisome situation in the less developed countries as a whole.

For adjustment to take place, sufficient financing was necessary, Mr. Iarezza noted, and it was important for private banks to develop a responsible approach to lending. Prudent and economic considerations were of paramount importance, and noneconomic and political factors should not be allowed to play a role in the lending decisions taken by banks. The level of indebtedness of many developing countries vis-à-vis private banks might have reached the point beyond which further growth was not recommendable, so that new financing for development purposes should come from other sources, mainly the multilateral development institutions. In that connection, it was difficult to comprehend the arguments of those who were pressing for a policy under which the middle-income countries--precisely those experiencing the greatest external indebtedness--should be "graduated" from the multilateral institutions and so placed in a position in which they had to increase their borrowing in foreign markets.

Some of the problems of the developing countries also fell within the purview of the International Monetary Fund, Mr. Iarezza considered. The Fund needed to be strengthened through quota increases and should not fail to explore all possible avenues--including future SDR allocations--to alleviate the plight of the developing countries. Interest rates were of course beginning to fall and a positive, although low, rate of output in the industrial countries was being forecast for 1983. At the same time, the overall current account deficit of the group of developing countries that were major exporters of manufactures was projected to fall by one third by 1983. He hoped that those projections, if realized, would last. Appropriate adjustment policies in both the developed and developing countries, a responsible attitude on the part of private banks, a strengthening of multilateral institutions, a stronger International Monetary Fund, and an increasing level of aid to the lowest income countries might then permit the process of international adjustment to develop smoothly and efficiently. Finally, although he had not touched on the issue of protectionism, he shared the view of Mr. Kafka and others that the reduction or elimination of protection would be crucial to any successful adjustment.

Mr. Jayawardena remarked that, as in the previous World Economic Outlook discussions, his chair continued to be more pessimistic than the staff. He had no quarrel with the staff's basic view that the need for economic adjustment was universal, involving control of inflation, improvement in productive efficiency, and the elimination of structural rigidities in order to correct the balance of payments and strengthen the base of the economy through sustainable growth. However, as pointed out in the paper, countries differed in their relative economic positions so that, in prescribing policies and economic priorities, the Fund should pay due regard to the political and economic compulsions facing each economy. For example, the non-oil developing countries--which had been severely affected by the situation in, and policies of, the industrial countries in recent times--needed to emphasize different economic priorities and instruments to meet the needs of their situation. Standard policies did not always work smoothly and effectively, and adjustment paths had to be designed so as not to halt growth in the economies in question. In particular, the time frame for adjustment needed to be longer, especially in a situation that was characterized as fundamentally unstable.

While the industrial countries faced difficulties in adjusting, the developing countries had even greater problems because there were fewer policy choices open to them, Mr. Jayawardena continued. Moreover, adjustment had to be tempered with adequate financing, properly applied. The virtual stagnation in the industrial countries had created a fertile climate for increasing protectionist tendencies, which had been reinforced by fluctuating exchange rates and high interest rates. Such an environment militated against the growth of developing countries' economies, which were currently faced with new "man-made" uncertainties.

In order to overcome stagflation in the industrial countries and so improve the economic performance in the developing countries, the Fund had placed primary emphasis on the reduction of inflation, Mr. Jayawardena observed. While the objective was a laudable one, the result of the globally restrictive stance had been a sharp downturn in economic activity; and generally high interest rates had served to delay a revival of investment, to weaken the corporate sector's profitability, and to increase the debt servicing burden of many countries forced to go to the private markets to finance their deficits. At the same time, uncertainties in the financial markets themselves meant that difficulties experienced in one financial center could have ripple effects on the entire system. Given the many dangers inherent in the current situation, the responsibility of the Fund in promoting an orderly financial system was considerable.

Inflation was corrosive and should be met headlong by appropriate policies, but monetary policy alone should not bear the brunt of adjustment, Mr. Jayawardena remarked; rather, there should be a better balance between fiscal and monetary policies. In many countries there was evidence of a decline in real terms in the monetary aggregates and even a perceptible decline in inflation. Even so, interest rates in real terms remained high and stood in the way of investment. The perception of the market appeared to be that the recent decline in inflation was only temporary, which was why most industrial countries had placed primary emphasis on monetary policy. Unfortunately, fiscal policies did not appear to be adequately supportive. As rightly noted in the World Economic Outlook paper, resolute adjustment in the fiscal stance of the industrial countries was called for in order permanently to eradicate the deep-rooted inflationary expectations. Continued and sizable deficits cast doubts on the corrective actions envisaged by the authorities in a number of countries. Of course, given the structural rigidities in industrial countries, he could appreciate the difficulty of fiscal adjustment; but that only served to highlight how much more difficult it was for the developing countries, where absolute poverty was increasing with each passing year.

The international setting in which adjustment had to take place was similar in many respects to the situation of the 1930s, Mr. Jayawardena considered; the uncertainties in the areas of exchange rates and in fiscal and monetary policies were reminiscent of the most difficult prewar days. However, economies at present were far more exposed to external influences, often beyond their control. The growth of GNP depended on the international trade of goods and services which, together with capital flows, had grown to unprecedented levels. Economic interdependence had become a fact of life, with each country thereby more vulnerable to inflation. In the circumstances, international adjustment had to be seen as a cooperative effort in which "beggar-thy-neighbor" policies were avoided. The elimination of OPEC surpluses was expected to result in counterpart surpluses for the large industrial countries, and he wondered--given current uncertainties--how those surpluses would be recycled in the emerging period. It was possible that they might be diverted back to the industrial countries, since capital markets--which were helping to recycle funds from surplus to deficit countries--were reducing their exposure with respect to the developing countries. The result was that a number of non-oil developing countries would be faced with the necessity for drastic adjustment at a time when adequate financing might not be available.

Many of the problems of the developing countries had arisen because of a severe deterioration in their terms of trade, Mr. Jayawardena continued. Payments projections for the medium term pointed to the need for massive adjustment and financing, and a number of developing countries that had earlier had easy access to private markets currently found themselves with little or no access to such markets; besides, the interest rate burden was substantial. The debt profiles of those countries had severely weakened, and they would thus require larger and larger amounts of concessional resources. If those were not forthcoming, economic difficulties and social unrest could only grow. It would be ironic if, in such a situation, the industrial countries were compelled in the end to return to the developing countries with military aid in order to help them sustain their governments against their own people. Such a possibility underscored the urgency of not curtailing concessional resources as part of the adjustment process in the industrial countries. High interest costs had adversely affected the developing countries, reducing their balance of payments positions to dangerous levels; and too restrictive an approach by the industrial countries to financing and conditionality could damage the chances of global revival. The implementation of gradual and moderate conditionality over an expanded time frame might be the only way to rescue the developing countries from the dismal abyss described in the staff paper.

The International Monetary Fund was itself at an important crossroad in current circumstances, Mr. Jayawardena remarked. The institution had a responsibility to rise to the occasion and appropriately channel the adjustment efforts of all countries. As guardian of the international monetary system, it must exercise surveillance over both developed and developing countries in order to bring about a growing understanding among members and encourage a greater convergence of economic policies--particularly in the industrial countries--in order to reduce inflation and promote higher growth and employment. In that context, the recent Versailles summit--the undertakings of which had yet to be spelled out--perhaps held some hope, but a close review by the Fund of the macroeconomic policies of the major industrial countries was nonetheless clearly called for. In that regard, he had noted with interest Mr. Hirao's suggestion that the structural adjustment problems of the industrial countries deserved special attention by the Fund.

In the context of international cooperation, there had been, for the first time in several years, a decrease in global reserves and a substantial increase in the indebtedness of non-oil developing countries, Mr. Jayawardena observed. The appreciation of the U.S. dollar had reduced the dollar unit value of world purchases and increased dollar indebtedness. Taking reserves and international liquidity overall, the global liquidity situation had deteriorated, and the single most important factor prompting such a development had probably been the high level of interest rates that had resulted in a net inflow of capital into the United States. Looking at the reserve needs of the non-oil developing countries and the requirement of a proper balance between conditional and unconditional liquidity, his authorities felt that the time was appropriate for a resumption of SDR allocations and a large quota increase that would enable the Fund to play its proper role in the current hour of challenge.

Mr. Abdollahi remarked that he too was pessimistic about prospects for the world economic outlook. Despite the progress that had been made in certain areas, the global recession was continuing, even in the face of the second consecutive year of a stagnation or decrease in the price of oil. Unemployment had reached unprecedented proportions, and inflation, while somewhat under control, still posed a threat. Growth in the volume of world trade had ceased in 1981, commodity prices in real terms were at their lowest levels in 30 years, and interest rates and exchange rates remained unbearably high; hence, it was difficult to share even the guarded optimism expressed by the staff for 1983 and beyond.

The measures adopted by the industrial countries had placed undue emphasis on monetary policy and had created disincentives that had far-reaching social and economic consequences, Mr. Abdollahi noted. The outlook for growth in economic activity in the major industrial countries was not clear; at most, a moderate recovery for the United States in 1983 was presumed by the staff in certain specific conditions that could easily fail to materialize. Economic conditions and policies in the industrial countries had already sent shock waves throughout the rest of the world and had adversely affected the world trade and payments system and prices of raw materials and primary commodities, while at the same time giving rise to protectionism. Those developments were having adverse effects, particularly on the developing countries. As noted by the staff, the recession and slack demand in the industrial countries were likely to mean no increase in the economic growth rates of the non-oil developing countries for 1982, and a 2.5-3.0 per cent real growth rate clearly fell short of that necessary to sustain such economies, even at their current unsatisfactory level. Moreover, for most of them, per capita incomes would fall in both 1982 and 1983.

He was grateful to the staff for having focused in the 1982 Annual Report and the World Economic Outlook paper on the serious problems in the primary commodities markets, Mr. Abdollahi said. As mentioned on page 14 of ID/82/2, the current situation in the markets for raw materials was almost unprecedented: prices of non-oil primary products were projected to decline by 7 per cent in 1982, following a 15 per cent decline in 1981, while real purchasing power had fallen substantially because of the continuing deterioration in the terms of trade. Given the bleak outlook for economic growth, any hope of containing inflation within manageable levels would be illusory, and exogenous factors would be too severe to allow the developing countries to pursue sound policies. The combined current account deficits of the non-oil developing countries had increased steadily to more than $100 billion in 1981, and deficits of a similar magnitude were expected for 1982 and 1983.

For the subgroup of low-income developing countries, the deterioration would be even more severe, Mr. Abdollahi continued, although it could not be blamed on excessive imports, which had declined in real terms. The weakness in the terms of trade and the sluggish export performance in the face of worldwide recession would prove a major stumbling block for those countries. Moreover, high interest rates in the capital markets had naturally led to higher rates being charged by the multilateral institutions; and that phenomenon, coupled with the lack of access to private capital markets by many developing countries, had made it more difficult for them to find appropriate solutions to their problems. Traditionally, the major proportion of all loans from the private market had gone to a few developing countries; however, high interest rates in the recent past had created unprecedented debt servicing problems even for those traditionally fortunate borrowers, and the outlook was for more such problems to emerge.

The total external indebtedness of the developing countries had reached more than $500 billion in 1982 for long-term debt, Mr. Abdollahi noted. According to one estimate, short-term debt would amount to over $100 billion, and debt servicing payments would rise to $52 billion, or more than half the expected external deficit for 1982. Unfortunately, despite the recent easing of interest rates, it was expected that the debt problem would remain severe throughout 1982 and 1983.

It might be worthwhile for the Fund to take a new look at the problems of the oil producing and oil exporting countries, whose situations at present were somewhat different from what they had been in recent years, Mr. Abdollahi considered. The weakening of the global demand for oil, the emergence of new oil exporting countries, the flooding of oil markets by some members of the oil exporting group, and the decline in the real price of oil over the previous two years could signal large deficits in the balance of payments of many of the oil exporting countries. Short-term current account surpluses had almost been eliminated for 1982 and--according to some estimates--for 1983 as well, so that those countries would have to rely exclusively on reserves to finance their potential deficits. Moreover, after years of expansionary policies, the oil producing and exporting countries would, like others, have to adjust their economies. As noted by the staff, they had already had to adjust to changing prospects by restricting or curtailing expenditures as a way of avoiding current account deficits, which could have adverse repercussions on imports and on the recovery of the oil trade.

He was in broad agreement with the staff's conclusions in the section of the paper concerning the policies of adjustment, Mr. Abdollahi stated. The need for substantial economic adjustment was almost universal; and, because the adjustment efforts should be mainly structural in nature, they would require both patience and courage. He could accept the staff view that it was necessary to adopt monetary restraint and fiscal discipline in an appropriate balance in both the industrial and the developing countries. However, it was difficult to accept the idea that almost complete reliance on monetary restraint should be continued, particularly in those economies where the fight against inflation had been relatively successful. For the developing countries, while substantial adjustment efforts had already been undertaken, more needed to be done, although the scope for maneuverability by those countries was far more limited than in the industrial economies. In that respect, he had been somewhat disappointed to note the acknowledgment by the staff that "the pursuit of adjustment policies in many industrial countries is subject to mounting political and social pressures," while no mention whatsoever had been made of the obvious social and political pressures in the developing countries and their limiting effects on the choice and extent of adjustment measures.

Notwithstanding the necessity of further substantial adjustment efforts in the developing countries, the greater burden of responsibility for dealing with current problems fell on the industrial countries, particularly the major ones, Mr. Abdollahi considered. Protective barriers should be reduced and mounting protectionist tendencies should be resisted, official aid and transfers should be increased in real terms, and all policies should be looked at closely with a view to their effects on others. He also agreed with the staff that the real performance of the world economy could be strengthened if the industrial countries were better able to cooperate in order to achieve mutually consistent policies that promoted economic adjustment.

With respect to the Fund's role in dealing with current problems, Mr. Abdollahi supported the view that the medium-term adjustments prescribed by the Fund should be designed to correct balance of payments disequilibria while at the same time strengthening the productive bases of members in order to create an environment that was conducive to sustained growth. Unfortunately, those two objectives occasionally proved contradictory, particularly in the short run. In his view, adjustment policies that gave priority to creating an environment for growth and development would prove far more beneficial in the long run. His chair believed strongly that, in light of the unprecedented economic problems facing members of the Fund--particularly those from the developing world--a great responsibility fell on the institution. Traditional financial intermediaries did not appear able to meet all the needs of countries, and it was thus necessary for the Fund, through quota increases, substantially to increase its financial resources. Two large developing countries had approached the Fund for resources in the past 12 months, and there was the possibility that a number of others might follow suit in the near future. In the circumstances, staff estimates on the size of the Fund for the 1980s might be out of date and in need of further revision.

Mr. Alhaimus observed that the most important conclusion to be drawn from the updated survey prepared by the staff was that prospects were worsening for practically all groups of members, thus indicating a further deepening of the recession. The prospects for industrial countries seemed to be somewhat worse, with a projected negligible growth rate for output, and widespread unemployment. Given the importance to the rest of the world of developments in the industrial countries, he would appreciate further clarification of certain aspects of the staff's estimates. The working assumptions included certain policy adaptations or changes that seemed likely to occur, even though they had not yet been announced by national authorities. For example, there seemed to be no indication that the recent U.S. fiscal measures had been among the unannounced policies taken into account by the projections. The staff paper had indicated that the projected pickup in real GNP in the industrial countries was centered on consumption expenditure that partly reflected, in the case of the United States, the midyear tax cuts. It would be interesting in the circumstances to have some assessment, however tentative, of the likely impact of the new U.S. fiscal stance, particularly with respect to the expected pickup of activity.

Another important feature of the staff estimates was the idea that the current recesssion was adversely affecting practically all subdivisions of the group of developing countries, Mr. Alhaimus continued. Worsening prospects for output faced all major exporters of manufactures, the oil exporting countries, and others. The continuation of such a trend was likely to increase the number of members that could expect to face critical situations in future, and the Fund should be alert to the prospects of a wider spectrum of members in which developments might affect the overall economic and financial picture.

In response to current problems, the developing countries had taken painful adjustment measures that had often kept growth rates at low levels, Mr. Alhaimus observed. Moreover, as noted in the staff paper, certain adjustments and adaptations had often been forced upon those countries by circumstances abroad. The 1982 World Development Report of the World Bank had gone so far as to state that most developing countries had adjusted better than the industrial countries in the period 1974-81 and that they had generally performed better in both recessions of the previous decade and in the intervening period. The deepening of the current recession, as evidenced by the staff projections, was bound to render the adjustment efforts and sacrifices of the developing countries increasingly unsustainable, given the social and political pressures imposed on them and the further narrowing of policy choices. Moreover, some of the favorable factors that had facilitated adjustment by the developing countries in the past might not be as effective in the future. External assistance and access to capital markets were being reduced, and arrangements such as the oil facility were no longer available. It would be difficult for the developing countries to carry out their adjustment efforts in the face of such increasingly adverse developments, particularly when protectionist measures in the industrial countries were on the rise. In such unmistakably grave circumstances, he would expect the Fund to take up its responsibilities in a more effective manner. Prevailing difficulties could not always be addressed through a rigid application of conditionality and a tightening of access; and, as circumstances worsened, more members might face crisis situations unless the Fund was able to act in a more effective and imaginative way. Indeed, restrictions on trade and investment might become even more widespread if members were unable to find alternative solutions to their desperate circumstances.

Mr. Wang observed that the non-oil developing countries had, since the mid-1970s, been forced to take measures to adjust the structure of their internal economies to permanent changes in international prices. By their nature, structural adjustments took somewhat longer than other economic changes and often required an increase in investment. In many instances in the past, the process of such adjustment had been facilitated by international capital flows and official development assistance; however, since 1979, the developing countries as a whole had had to face adverse external changes resulting from the recession in the industrial countries. For the non-oil developing countries, current account deficits had grown rapidly, owing to a large deterioration in their terms of trade and rising interest rates. Even some oil exporting developing countries had been faced with increasing deficits on current account in recent months because of declines in the volume and price of oil exports. In such adverse external circumstances, most developing countries had been compelled to institute policies of retrenchment and short-term adjustment, which had implied drastic changes in the rate of expansion and a postponement of investment, even though expansion and investment were both essential for structural adjustment over the medium to longer run.

A potential conflict had developed between the two forms of adjustment, a conflict that had been evident in recent country item discussions in the Executive Board, Mr. Wang continued. As revealed in those cases, the measures adopted for structural adjustment had contributed to expanding the supply and volume of exports, which had increased at significantly higher rates than the volume of imports. However, the recent deterioration of the terms of trade as a result of the deepening world recession had, together with rising interest rates, brought about large changes in the financial positions of countries, forcing them to introduce short-term adjustments of a different nature. Imports and investment had been restricted, which had resulted in a slowdown of domestic growth, so that the short-term adjustments adopted by many developing countries implied--in present circumstances--an abandonment or revision of the policies that had been introduced for structural adjustment.

Experience showed that a conflict between short-term and long-term objectives of adjustment could, to a great extent, be eased if the volume of flows of international capital to countries could be enlarged, Mr. Wang remarked. It was thus important to expand access to balance of payments financing on terms that took account of the structural adjustment problems of countries. Extended arrangements through the Fund and increases in official development assistance could certainly help to resolve the conflict between the need to reduce balance of payments deficits and the need to sustain investment for longer-run adjustment. But a greater contribution to the resolution of the conflict should come from the recovery of demand by industrial countries for developing countries' exports, with a consequent improvement in their terms of trade. Unfortunately, the immediate prospects for such an occurrence were not bright; indeed, the overall economic situation appeared to be deteriorating further.

Mr. Erb said that he was broadly in agreement with the conclusions of the World Economic Outlook for the medium term. He supported the idea that it was important to maintain the objective of achieving price stability and stable economic growth. In that connection, he recalled that Mr. Lovato had asked whether the United States had a "target rate" of inflation in mind. It was difficult for the U.S. authorities to conceive of a positive rate of inflation that was somehow stable and sustainable over the long term; the medium-term price objective of the United States was to achieve price stability to the extent possible. If there was to be a convergence of macroeconomic policies internationally, the implication of the U.S. objective was that there would need to be a convergence of relative rates of inflation toward price stability, which would be an important determinant over the short to medium run of exchange rate stability, especially among the three major reserve currencies. If, over the next one or two years, there was a divergence in the rates of inflation, there would also be a further significant instability in the exchange rate; hence, he agreed with the staff that a primary objective of monetary policy should be gradually to reduce money growth in order to lay the basis for price stability.

He could also support the idea that further fiscal adjustment would be necessary, Mr. Erb remarked. In the past two days, expenditure reductions and tax increases had been agreed in the United States. As he had noted during the 1982 Article IV consultation with the United States, such moves were unusual; indeed, in a historical context, it would be difficult to find any previous recession in which the course of fiscal policy had been set to reduce the deficit. While in the very short run the consequence of such a move could be to prolong the recession and further increase unemployment, reductions in the fiscal deficit would nonetheless be the key to laying the basis for longer-term economic growth. Unless the Government reduced fiscal borrowing as recovery progressed, investment--which would be necessary as the economy approached capacity--would be crowded out. Reductions in the fiscal deficit could not be fine-tuned; however, as much emphasis should be placed on medium-term reductions as on those in the near term.

The issue that would have to be faced continually over time was the importance of bringing under control the relative size of government expenditure in various economies, Mr. Erb noted; that was an issue that was perhaps related to the question of convergence of macroeconomic policies among countries. Also to be faced was the question of the composition of spending; Mr. de Maulde and others had pointed out that, for economies with different structures, the appropriate level of expenditure would depend importantly on the direction of that expenditure. Clearly if it was allocated to productive investment, the implications would be far different from those that would arise when expenditure was concentrated on transfers and consumption.

In order to reduce the deficit and borrowing by governments, it was necessary to bring revenues into line with the socially acceptable or desirable expenditure level in each country, Mr. Erb observed. In that respect, it was important to continue to take into account the impact of the structure of taxes on savings, investment, and consumption. There were of course differences in savings rates among countries; for example, where rates were relatively low, the tax structure should be modified to encourage savings and investment while still generating an appropriate level of revenue.

On the structural side, Mr. Erb considered that recent trade measures taken in some countries needed to be reversed and, generally speaking, there should be a recommitment to reducing trade barriers. That objective should be pursued not only by the industrial countries but by the developing countries as well, particularly those that were more advanced and had relatively large and diversified manufacturing bases. All countries also had a responsibility to open their savings markets, a move that would allow them to enjoy the benefits of additional competition; and there should be continued liberalization of national capital markets in both developed and developing countries alike.

On the role of the International Monetary Fund in the adjustment process, Mr. Erb remarked that it was of course important to take a pragmatic approach to adjustment programs in connection with the use of Fund resources, and adjustment measures should be geared to the particular problems causing the balance of payments difficulties in each country. Surveillance should be exercised over both industrial and developing countries, and he agreed with Mr. Laske that more attention should be paid in Article IV consultations to the debt servicing position of major borrowing countries and that particular attention should be paid to the maturity structure of that borrowing. It might be helpful to add to the tables provided in the World Economic Outlook papers some estimates of the short-term debt of members. One might use cumulative current account deficits and subtract all other financial outflows as a rough approximation of that debt or of changes in it. The issue of the financial size of the Fund was obviously related to questions on the financial role and structure of the Fund, both of which would be discussed by the Executive Board at a later date.

On another matter, Mr. Erb said that he had had some difficulty understanding Mr. Vidvei's chiding of the United States for not being as cooperative in international economic relations as it had once been. That point had been echoed by others in the discussion for the Article IV consultation with the United States, and Executive Directors apparently were perceiving the United States as insensitive to the concerns and problems of other countries. It was obvious that there were many ways in which developments in the United States could have a detrimental impact on other countries, in the same way that developments in other countries could have an effect on the United States. In looking back over the previous 18 months, he found that he had no apologies to make concerning the level of cooperation by the United States or the degree of concern within the U.S. Government regarding the impact of U.S. economic development on other countries. In fact, he could argue that the record of the United States during the period had been quite good in that connection.

In the past, Mr. Erb recalled, emphasis had been placed on the economic problems that the United States had been creating for other countries because of its inflation, and it was for that reason that the Government had focused its efforts on the achievement of price stability. Success in that area would be the best way for the U.S. Government to contribute to international stability, especially given the reserve currency role of the U.S. dollar. During the 1981 Article IV consultation with the United States, the staff and the Executive Board had advised the U.S. Government to stay on a monetary policy course that would gradually reduce monetary growth. That course had been adhered to. It had also been pointed out that the United States had serious fiscal problems and that steps should be taken sooner rather than later to deal with what had been projected to be continued high deficits. As discussed in the most recent Article IV consultation, the employment and growth responses to the shift in tax regulations had clearly been disappointing to many in the Administration who had felt that the tax measures should have had a fairly immediate impact on economic growth. He felt that there had been perhaps too much optimism in expecting a quick turnaround in output; however, the focus on some of the tax measures had certainly been correct, since many of them at the time had discouraged investment and savings.

During 1982, some significant steps had been taken to reduce expenditure growth and to raise revenues through other tax measures that had clearly been recommended by the Executive Board in 1981, Mr. Erb continued. The main advice of the staff during the 1981 consultation had been not to reverse policies in the face of unemployment and excess capacity, and the U.S. Government had followed that advice. It should be remembered that, while the pursuit of such policies might be painful to others, it also hurt people in the United States itself. In the view of the staff, a period of unemployment and excess capacity was a burden that had to be borne if price stability and stable economic growth in future were to be achieved. Hence, with respect to the course of macroeconomic policy, the United States had been forthcoming in a way that was consistent with its international responsibilities.

In other areas, the United States had played a positive role during the recent summit meeting in pressing for a forum in which there could be multilateral consultations among major countries, the long-term effects of which should prove to be positive, Mr. Erb went on. The United States had also agreed to engage in an intervention study, and he hoped that other governments would do so as well. After eight or nine years of floating exchange rates, few governments had systematically examined their experience with exchange market intervention, and the views of governments with respect to the desirable level of intervention and the conditions in which it should be undertaken were not homogeneous among the major currency countries. The purpose of the study in the United States was to examine the consequences of intervention in the past and so create a guide to future intervention policy. He hoped that the points he had mentioned would serve to dispel the sense of dissatisfaction among some of his colleagues about the degree to which the United States had been cooperative in dealing with economic problems both at home and abroad.

Mr. Polak inquired whether Mr. Erb had suggested that convergence between inflation rates in the United States, Japan, and Germany would produce greater exchange rate stability.

Mr. Erb replied that such convergence was a necessary condition for further exchange rate stability. Put another way, if inflation rates were to begin to diverge, it was likely that greater exchange rate instability would occur in future. Inflation rates were beginning to converge, although the transition period was having an impact on exchange rate stability in the short run. For the medium to longer term, a convergence of inflation rates was required for exchange rate stability.

Mr. Kharmawan stated that the members of his constituency had supported the anti-inflationary policies of the developed countries because they were convinced that inflation needed to be reduced before the revival of the world economy could take place on a sustainable basis. They had also supported the staff's advice about the importance of a balance between monetary policy and fiscal policy, and they had done so for a number of years. Unfortunately, the hoped-for results seemed to be slow in coming, and he wondered whether, in the view of the staff, any real progress had been made by the industrial countries in strengthening fiscal policy to support monetary policy.

The staff had suggested that recent declines in interest rates were mainly a result of the deepening recession and the consequent reduced demand for money, Mr. Kharmawan continued. Was the implication that monetary policy had failed to achieve some of its objectives? It seemed to him that the monetary policy followed thus far had indeed resulted in a reduction in the money supply, so that business enterprises had been squeezed of their resources to expand, and it was for that reason that the demand for money had been declining. He would appreciate some clarification from the staff about whether monetary policy had worked, and about what the relationship was between monetary policy and the recession. He also wished to know what progress had been made in applying advice on fiscal policy so as to reduce the deficits in a way that would allow inflation and interest rates to fall. In particular, he inquired whether the recently adopted tax measures in the United States were expected to have an impact on interest rates. Generally speaking, since all countries--both developed and developing alike--were involved in a deep recession with rising unemployment, he was interested in clarification of the causal relationships between policies. It was clear that inflation and interest rates had fallen somewhat and that certain measures to reduce the deficit had been taken in the United States. It would be helpful if the staff could provide some estimate about when a change in policy could be undertaken in order to arrest the recession so that the countries in his part of the world could begin to resume the sort of economic development that had been placed in jeopardy in recent years.

Another matter of concern to his authorities was the fact that the World Economic Outlook paper did not comment in any detail on structural rigidities and changes, Mr. Kharmawan said. Much attention had been devoted to financial measures, but only an allusion to the need for structural changes in the industrial countries had been made. He wondered what progress those countries had achieved in reducing structural rigidities in order to increase the efficiency of production, especially since such progress was an important element in the effort to arrest the recession.

It seemed to be agreed by all that protectionism should be reduced, Mr. Kharmawan observed. For a number of years, the developing countries had been suffering from protectionism in the industrial countries and had been forced to deplete their reserves and increase their level of borrowing in order to combat the balance of payments pressures imposed upon them by that protectionism. However, there was a limit to what could be done, particularly in the poorer countries for which official development assistance was on the wane. Without further improvement in inflation and a reduction in interest rates that would allow changes in the policies of the industrial countries in the near future, the situation of the developing countries would continue to be weak indeed.

Mr. Diao, noting that the adjustment process would take time and courage on the part of national authorities, remarked that it was important to know how to achieve a proper balance in designing adjustment programs, and to decide whether the individual country or the Fund should determine the critical point beyond which an adjustment program might be disrupted. His authorities had always believed that the adjustment efforts required of the developing countries must be viewed in a framework of global economic growth and development. Adjustment should be undertaken in a way that guaranteed a minimum rate of economic growth, at least equal to the growth rate of the population. The success of the adjustment effort would depend essentially on the adequacy and effectiveness of domestic policies as well as on the performance of the world economy and the volume of external capital flows. Recovery in the world economy was itself dependent on the effectiveness of policies in the industrial countries, and that effectiveness hinged on the willingness of those countries to adopt greater fiscal restraint and a more balanced policy mix.

On the matter of financing, Mr. Diao observed that the problems facing the non-oil exporting developing countries were severe, particularly for the poorest among them. What was needed in the circumstances was a massive transfer of resources on concessional terms in a spirit of international cooperation. Despite difficult times and budgetary cutbacks in the major providers of aid, there remained scope for mobilizing additional resources to the poorest developing countries, especially since their financing requirements were not particularly substantial. For its part, the Fund should provide advice to member countries in difficulty and encourage them to undertake the required adjustment at an early stage and, for that purpose, it was essential that an adequate volume of resources be made available to support the adjustment efforts. A substantial increase in the quotas of member countries was thus crucial. The heavy external borrowing by developing countries--particularly the non-oil exporting developing countries--was alarming, and was another good reason for a substantial quota increase in the Fund. While he could see the Fund playing an active role in the area of external debt by closely monitoring the evolution of the debt profile of developing countries--a suggestion made by Mr. Laske--the controls should be directed more toward the private banks, with a view to encouraging them to follow more responsible lending policies. In that way, the Fund could play an impartial and objective role in promoting effective and positive adjustment.

Mr. Kiingi observed that the picture provided by the staff in its World Economic Outlook paper seemed to be even bleaker than it had been at the time of the previous discussion in April. The recession was deepening, with growth figures revised downward and unemployment levels on the rise. Excess capacity seemed the order of the day, and hope for recovery remained elusive. Some successes had of course been achieved. For example, while still generally high, inflation was being brought under control in some of the major industrial countries, monetary expansion was slowing, and noticeable economies had been taking place in the energy field. Unfortunately, those successes had given rise to little optimism on the part of the developing countries, where growth remained low, balance of payments positions were in deficit, inflation continued to be a serious problem, and debt profiles were worrisome.

He could certainly agree with those who felt that adjustment in the industrial countries continued to be necessary, Mr. Kiingi said. While factors beyond the control of the authorities undoubtedly contributed to the problems of the industrial countries, there was scope for further adjustment on the fiscal and monetary fronts. On a related matter, he recalled that the developing countries had been advised by Mr. de Groote to look toward "institution building" as a solution to some of their problems, and he was not clear what exactly had been meant by that suggestion.

The developing countries were of course grateful for aid in whatever form, Mr. Kiingi remarked, but many of them were beginning to question whether some of the so-called aid was not in fact adding to their debt and affecting future earnings. He agreed with those who felt that the Fund should monitor loans to developing countries, including aid, to ensure that such loans were in fact helpful. There were situations in which loans to assist the stockpiling of some agricultural products had ended up depressing agricultural performance. The developing countries were willing to work toward some semblance of order in their economies, but they would need proper help if they were to achieve a measure of success. The time for emphasizing aid in traditional forms had passed; in many cases, it had become a distorting factor. Indeed, national authorities had often redirected resources that should have been used for development because they were secure in their belief that the ever-present benefactor could be expected to provide aid if it was needed. It was important that developing countries be given the sort of aid that would help them rid themselves of problems rather than aid that served only as a temporary, "band-aid" approach to those problems. It was of course impossible for any country to provide the sort of aid necessary, for example, to feed all the people in northern Uganda for the next 50 years; in the circumstances, there was no point in feeding them only for the next six months. The creation of new tastes and habits--which only had to be changed again when the aid was withdrawn--was a destabilizing factor that could affect economic performance.

Mr. de Groote remarked that, when he had used the term "institution building" in his earlier intervention, he had not had in mind the creation of new institutions but rather the better functioning of existing mechanisms, such as the collection of taxes and the operation of central banks.

The Director of Adjustment Studies observed, first, that little had been said, in the course of the discussion, about long-term interest rates in the United States. Those rates had declined by only 3 percentage points from their peaks in 1981, corresponding to the decline in the inflation rate over the same period. Hence, real long-term interest rates remained as high at present as they had been in 1981, at about 6.5 per cent for long-term treasury bonds with a maturity of 15-20 years and 9 per cent for AAA utilities.

A question had been raised by Mr. de Maulde about how the deficits of the non-oil developing countries would be financed in future, the Director recalled. Table 10 of the staff paper set forth estimates suggesting that it would be possible to finance the deficits, but it should be emphasized that those estimates had been built up on a country-by-country basis, in a process by which the consistency of the current account and financing projections was evaluated in a complete balance of payments framework. Despite all the uncertainties involved, the estimates reflected a detailed effort to make full use of the available data, while drawing on the expertise of the area departments.

With respect to Mr. Vidvei's question about the potential for Japan to stimulate domestic demand and thus help to stimulate world economic growth, the Director observed that the Japanese authorities were allowing the automatic stabilizers to work, a welcome development. The staff had pointed out that, if the recovery of domestic demand was accorded high priority in Japan, caution would be appropriate in withdrawing fiscal stimulus. The fiscal deficit should of course be reduced over time, but the staff had felt that the Japanese authorities could allow some flexibility in fiscal policy in the short term.

The point had been made by Mr. Vidvei that, given the decline in non-oil primary commodity prices in 1982, the staff's projection of a 13.5 per cent increase for 1983 seemed on the high side, the Director noted. The

13.5 per cent figure had been derived within the framework of the overall estimating and projecting process, with all the assumptions that process involved. Non-oil primary commodity prices were very difficult to forecast, and the projections were subject to a substantial margin of error. However, as could be noted from Table 6 on page 45 of ID/82/2, there had been a decrease in those prices in 1978, increases in 1979 and 1980, and a sharp plunge in 1981 followed by another fall in 1982. Hence, even if the 13.5 per cent increase were realized in 1983, it would not be particularly high; indeed, it would produce a level for non-oil primary commodity prices considerably lower in both nominal and real terms than that in 1980.

Turning to Mr. Polak's comments on the staff projections, the Director said that the results of the Fund's short-term forecasting exercise--or any other such exercise--should not be taken too literally. As in the latest published report on the World Economic Outlook, the staff had often pointed out a number of caveats to be taken into account in the projections, noting that attention should mainly be focused on the directions and patterns of indicated change. In that way, the forecasting exercise could be helpful in depicting the global economic picture and in providing a basis for analyzing and deciding upon the policies required to deal with both domestic and external problems. As to whether the forecasts were too optimistic, it might be noted that, although the projections of real GNP had been revised downward somewhat in the paper, the staff's projections during the past year or so had been similar to those of the OECD Secretariat and less optimistic than those of national officials and private forecasters in several of the major industrial countries, particularly the United States.

On the question posed by Mr. Polak concerning the scope for including different subjects in the World Economic Outlook, the Director observed that the staff had far more flexibility in handling subject matter in the annual published report than in the sort of short paper currently before Executive Directors. The latest published report, for example, had a greatly expanded section of appendices in which the research that had been done during the course of the year on a number of issues had been set forth. Special presentations had been made on fiscal, monetary, and exchange rate developments in the industrial countries, as well as on the link between growth and inflation in the non-oil developing countries and on several other subjects. Certainly, in its published reports, the staff would be attentive to the necessity for covering new subjects and making certain that it was sufficiently current in its approach; however, in the short General Survey paper, the effort to be concise was paramount, and the subject matter chosen for discussion was very much affected by the scheduling of other Board discussions and documents. For example, little had been said about protectionism in ID/82/2, not only because it had been covered in other World Economic Outlook documents, but also because it had been recognized that there would be an Executive Board discussion on trade policy at some time in the near future. Also, with respect to the comment by Mr. Polak on the world banking situation, he recalled that the Board had recently discussed the issue of international capital markets. In light of that discussion, the staff had said less on the matter in ID/82/2 than it might otherwise have said. Still, much of what the staff had been thinking about financing, within the confines of its statistical and working assumptions, had been conveyed in the estimates of current account deficits and financing.

Attention had been drawn by Mr. Polak to the staff suggestion on page 20 (ID/82/2) that doubt should be resolved on the side of steadfastness in restraining the rates of expansion of money and credit, the Director recalled. A quite lively discussion about monetary policy and the complications and problems surrounding it had already been held in connection with the drafting of the 1982 Annual Report. It appeared that there had been some concern by a number of Directors that, whatever problems might be involved in avoiding excessive variability in interest rates while endeavoring to establish the credibility of efforts to achieve and maintain lower rates of monetary expansion, national authorities should not allow the target rate of monetary expansion to get off track, at least beyond the upper limits. That matter had been thoroughly discussed, and the statement in ID/82/2 had been only an effort to summarize the institution's point of view as already presented in the Annual Report.

Several Directors had wondered whether the results of recent actions on the tax bill in the United States had been reflected in the staff projections, the Director observed. In fact, the tax changes assumed in making the staff projections were approximately the same as those embodied in the tax bill itself, even though they had not yet been announced by the authorities.

In commenting on the fiscal position of industrial countries, several Directors had remarked that there remained room for improvement in the fiscal area, the Director noted. On pages 20 and 21 of its paper, the staff had stated that, after adjustment for certain influences, fiscal policy in the seven major industrial countries as a group had been approximately neutral between 1976 and 1979 and again in the more recent period. As pointed out by Mr. Hirao, the implication was that the fiscal stimulus had not been withdrawn and that there was in fact room for improvement in the fiscal area, especially since, with the working of the automatic stabilizers at a time of slow growth or recession, actual deficits had increased substantially since 1979.

On Mr. Joyce's question whether the conclusions of the study on capital markets continued to prevail, the Director stated that he was not pessimistic regarding the ability of the international banking system to supply credit flows of a general magnitude needed to finance in aggregate the deficits projected for 1982 and 1983, provided that the world economy moved roughly along the projected path of modest recovery. The aggregate of the deficits would be appreciably lower in relation to trade flows than in 1981, although that was not to deny that individual countries--particularly those not perceived to be making appropriate steps toward adjustment--would have difficulty in maintaining their access to external bank credit.

It had been mentioned by Mr. Abdollahi that the staff had made little effort to comment on unemployment in the less developed countries, the Director recalled. The staff was certainly aware of the difficult situation with respect to unemployment in those countries, but it had tended to focus on the problem in terms of the industrial countries because of their importance in the global economy, as well as the ready availability of statistics.

On the suggestion by Mr. Erb that the staff might have concentrated more on the maturity structure of the debt of the non-oil developing countries, particularly short-term debt, the Director commented that the World Bank's Debtor Reporting Service provided information on public and publicly guaranteed debt of a medium-term and long-term nature, and the staff could reproduce more of the work from that source in its papers. However, the information on nonguaranteed long-term debt was poor, and it was unlikely that much could be done on the maturity structure in that regard. With respect to short-term debt, reporting was very incomplete in balance of payments statistics, even in countries with relatively good statistical bases. The United States, for example, had an "errors and omissions" item in the balance of payments running to tens of billions of dollars in a single year, and much of those amounts must have been in the area of short-term capital flows. For the less developed countries, the errors and omissions problem was at least equally difficult; only by making heroic assumptions about errors and omissions and cumulating estimated flows could the staff estimate the outstanding amounts of short-term debt. Hence, without intending to be negative with respect to Mr. Erb's proposal, he did wish to note that that area was extremely difficult to deal with statistically.

Commenting on the difficult questions raised by Mr. Kharmawan, the Director noted that monetary policy had not failed where it had been applied. The trouble was that monetary policy had often not received adequate fiscal support, so that there had been an imbalance between monetary and fiscal policies that had created enormous difficulties in some countries. There were a number of rigidities or structural imbalances--including rigidities in wages and prices arising from indexation and rigidities in government expenditures and the public sector generally--in which there was a good deal more room for initiative in some countries. The staff had for some time been stressing the importance of tackling rigidities and structural imbalances, although it was very difficult to gather systematic information about them on a country-by-country basis and set it down in an overall quantitative framework. Also, the record of industrial countries in the area of official development assistance was unfortunately quite poor, and much more needed to be done to reduce or eliminate protectionism. All such problems made it clear that there was a need for better policies in the industrial countries--and those had certainly been recommended by the staff--but there was no way of knowing how long it would take for progress of the sort desired by Mr. Kharmawan to be achieved. The staff had attempted to provide a framework for discussion of the matter through its scenarios. If the assumptions underlying Scenario A, for example, were carried out, and countries pursued appropriate adjustment policies, one could expect a marked improvement in the situation of the industrial countries--with a distinct impact on the developing countries--in the next few years, thus paving the way for a better performance of the world economy in the second half of the decade. Such a timetable was far from ideal, but it was much better than the one that would result in all probability if prematurely expansionary fiscal and monetary policies were substituted for the policies currently being recommended by the staff.

It was clear that the non-oil developing countries were in a difficult situation and had been facing a troublesome external environment for the better part of the past ten years, the Director of Adjustment Studies concluded. In the circumstances, it was important for the developing countries themselves to pursue or strengthen adjustment measures and to establish creditworthiness, so that adequate financing for their adjustment efforts would be forthcoming.

Mr. Erb remarked that he was having some difficulty understanding the framework within which the staff had made its judgments about fiscal policies. Japan was at the moment being encouraged not to reduce its budget deficit, while the United States was being advised that its deficit should be reduced. It would be interesting to hear from the staff about when the United States would reach a position at which it would no longer be advised to reduce its deficit and when Japan would reach a point at which it should reduce its deficit.

The Director of Adjustment Studies commented, first, that the Japanese authorities were looking toward a reduction in the public sector deficit over the longer run, and the staff was in agreement with that objective. However, with very low inflation and weak domestic demand in Japan, the staff had come to the view that, if the authorities were to place any priority on domestic demand expansion, they should not withdraw the fiscal stimulus rapidly in order to reach their medium-term objective because that would not be good for domestic demand in Japan or for the world economy. Because the circumstances in Japan were quite different from those in the United States, the policy advice could be different as well.

Mr. Erb observed that demand in the United States was also flat; indeed, in some European countries it was negative.

The Chairman noted that the inflation rate in Japan was at only 2 per cent, which was a good bit lower than the 6-7 per cent basic rate in the United States, where more caution should perhaps be exercised to avoid fostering further inflation. If the inflation rate in the United States were at 2 per cent, the Fund would perhaps not be insisting so much on reducing the fiscal deficit, but it was unlikely--given the size of the current deficit in the United States--that a 2 per cent inflation rate could be reached soon. Also, the household savings ratio in Japan was very much higher than that in the United States, so that Japan could have higher fiscal deficits without a crowding out effect. It was for that reason that the staff had felt that Japan was in a better position to ease up on efforts to reduce the fiscal deficit, at least in the short run.

Mr. Hirao added that there was also some difference between Japan and the United States in terms of capital utilization. In Japan, domestic production was running at more than 85 per cent of capacity, while it was at less than 70 per cent of capacity in the United States. A textbook theory would suggest that greater stimulus was needed in the United States rather than in Japan.

The Director of Adjustment Studies remarked that, in the case of Japan, the fiscal advice being offered by the staff was not hard-hitting; it was actually conservative.

The Chairman added that the Fund was not playing the "locomotive" game. It was being cautious, and was not urging Japan to pump money into the fiscal circuit. It was simply saying that, in the present complex juncture of events, the Japanese authorities could be a little more at ease about achieving their fiscal objectives in terms of timing.

Mr. Erb stated that he was not so much questioning the advice itself as the apparent inconsistency in the criteria employed to make such advice. With a current account moving in the direction of a deficit in the United States and with a very strong dollar, the indication was that the fiscal deficit was too large and should therefore be brought down. For Japan, however, he would look at things somewhat differently. With a weakened yen and a high deficit, a case could be made for borrowing and spending by the Government relative to investment abroad. He could make a case for a higher fiscal deficit in Japan but he would do it from the point of view of relative exchange rates and external positions, rather than from the internal criteria that appeared to be used by the staff.

The Chairman remarked that it was also worth looking at the interest rate situation and the depressing effect of the interest rate differential on the yen. One way of reducing interest rates in the United States so as to place the yen in a better relationship vis-à-vis the dollar was to reduce the fiscal deficit in the United States.

Mr. Hirao observed that, for the previous six-ten months, the external market had been dominated by the interest rate differential. More recently there had been some easing in that differential, but the yen remained weak. At the same time, there was a growing perception in the market that the Japanese economy itself was weak by comparison with that of the United States because of the very large fiscal deficit in terms of GDP, and there was indeed some room for worry on that score.

Mr. de Maulde, speaking on another matter, noted that the staff had perhaps misunderstood a point he had made in his earlier intervention. When he had indicated that he could not imagine how the deficit of the non-oil developing countries would be financed in 1982 and 1983, he had not at all been hinting at any inconsistency in Tables 10 and 11 of the staff paper. He had only been suggesting that, with growing debt and greater skepticism by the private market about the creditworthiness of certain borrowers, there might be more difficulty than in the past in producing the required financing. If the financing was not forthcoming, the debts would fall but greater adjustment would be required with fewer imports, slower growth, and a generally gloomier picture for the non-oil developing countries than had been provided in the staff appraisal.

Mr. Prowse, recalling earlier remarks by the Chairman on the question of the theoretical operation of the budget, wondered whether it was fair to state that the Chairman endorsed the countercyclical operation of the budget deficit. He also wondered whether, over time, the staff saw countercyclical policy as operating around a neutral, long-term trend such that, other things being equal, the surpluses at some stage would offset the deficits. Finally, it would be interesting to hear whether the staff viewed money supply as being operated similarly in a countercyclical fashion.

The Chairman responded that there should indeed be a neutral path over the longer term, with cyclical swings both upward and downward in the fiscal position of the budget. In fact, the staff was making an effort to advise the renewal of a more even path in terms of fiscal positions. He would have to reflect somewhat before answering whether or not the argument could apply to money growth as well.

Returning to the issue of the difference in advice given to Japan and the United States, the Chairman noted that Mr. Erb and Mr. Hirao had made some interesting points. Pushing the argument to the extreme, the suggestion would seem to be that, if the yen was weak, it would be important to restrict demand locally and to be certain that imports would not be too buoyant in Japan. However, in view of the very sluggish domestic position, such a prescription would be somewhat awkward.

The staff representative from the Research Department remarked that what was really needed was a judgment about how fast the private sector would be able to absorb a sudden change in the public sector deficit. If the deficit were reduced in the United States over the next two or three years, it might not be much of a problem for the private sector to offset that reduction through an increase in private investment. In the case of Japan, however, a large reduction in the public sector deficit over the next two or three years would probably not be offset by an increase in private sector investment. There would in fact need to be a doubling in the rate of growth of potential output in Japan, and he did not see such an increase as likely. In the circumstances, the authorities should be careful about how quickly they reduced the public sector deficit. Of course, it would have to be reduced in the longer run, but not so quickly that its effects could not be absorbed by the private sector. If there was a large reduction in the public sector deficit that was not absorbed through an increase in private investment or through a reduction in the saving propensity of the private sectors, it would have to be absorbed through a decline in economic activity that would reduce the flow of savings and increase the current account surplus. That in turn could lead to a large increase in the exchange rate.

The Chairman noted that the yen appeared to have depreciated in spite of the strong movement in the current account.

The staff representative from the Research Department observed that data on the 1970s suggested that the yen did not begin to appreciate immediately with an increase in the Japanese current account surplus; it had appreciated only with a delay of one or two years.

The Chairman said that the exchange of views that had been brought about by Mr. Erb's questions was certainly interesting and should perhaps be pursued outside the meeting. In summing up the discussion on the World Economic Outlook, he observed that Executive Directors had noted that the output forecasts had been revised downward by the staff since the previous discussion. They had stressed that unemployment in the industrial countries--which had reached unprecedented peaks since 1945--had become most worrisome.

Directors had also observed that the forecasts contained in the staff papers were clouded by a number of uncertainties and pointed to only a moderate recovery in activity, the Chairman continued. Indeed, there seemed to be no signs of a strong pickup in investment, given the current state of low utilization of capacity and of weak profitability of enterprises in most of the industrial countries. A revival in private consumption and in productive investment would depend heavily on a durable decline in interest rates and a fall in inflationary expectations.

In discussing the industrial countries in particular, Executive Directors had noted that several countries had made notable progress in the fight against inflation, the Chairman remarked. The Japanese and German economies had been especially commended for their performance in that regard; progress by the United Kingdom had been encouraging, and the reduction in inflation in the United States had been sharp and impressive. Still, the battle had not been won, and the present general level of price increases remained unacceptably high, with uneven progress among the industrial countries. Executive Directors had suggested that the good performers on the inflation front should continue in their determined fight against inflation and that further decisive progress must be made by those countries where inflation was still quite high if lower rates of interest, a revival of growth, a better convergence in inflation rates, and greater stability in the exchange markets among the major currencies were to be achieved.

The balance of payments situation of the industrial countries reflected a diversity of individual situations, the Chairman noted. There had been a global positive shift of more than $50 billion during 1981 and 1982 in the current account of the balance of payments of the industrial countries. However, that shift had been concentrated mainly in the two countries--Japan and Germany--that had achieved the best results in the fight against inflation. The deficits of a number of industrial countries were quite high, reflecting insufficient convergence among the major industrial countries in term of their economic policies. Those deficits were also a factor in exchange rate instability.

The policy indications suggested by the discussion were clear, the Chairman said. First, in the area of monetary policy, restraint had been one of the major elements in the anti-inflationary progress accomplished during 1981 and 1982. In general, it could be said that monetary targets had been observed, although it was difficult to judge the degree of monetary restraint in a period of transition. The problem was that monetary policy had not always been sufficiently supported by fiscal policy. The danger of growing budget deficits had been impressively analyzed by Mr. Hirao, whose observations a large number of Directors had endorsed. Generally speaking, fiscal positions had not been corrected as they should have been, following the considerable stimulus that had been injected into the industrial economies after 1975. The level of present fiscal imbalances and the growing rate of public debt that was the reflection of several years of destabilizing fiscal positions had had a severe impact on the flexibility of the budget as a policy regulator, on public confidence in the determination of the authorities to preserve an anti-inflationary stance, and on the medium-term availability of resources for the financing of investment. The fiscal position of the United States was in that respect of great importance to the rest of the world. Recent measures adopted by the U.S. Congress had been welcomed as a helpful step toward a more acceptable fiscal position in the United States; nevertheless, it had been remarked that the present and foreseeable level of budget deficits was high, and that the welcome downturn in interest rates that had recently been observed could be sustained and lead to a revival of confidence and product investment in the medium run only if improvements in the fiscal position were continued. Of course, the prescription of fiscal rehabilitation had not been limited to the United States; indeed, it was considered worthwhile advice for other industrial countries and for developing countries.

With respect to supply-oriented or structural measures, Executive Directors had noted that economic rigidities had become worse over time, representing one of the most difficult obstacles to the reduction of inflation, the Chairman commented. A number of Directors had made interesting comments on the need flexibly to adjust the economic behavior of countries and to take account of shifts in technology, terms of trade, and income distribution that industrial countries had been facing for a number of years. Given the need for structural correction of fiscal rigidities and the ingrained tendency toward more social transfers through the budget, it appeared that a major policy rehabilitation needed to be undertaken in a number of industrial countries.

Also needed was a moderation of wage increases to help restore better profit margins and incentives for investments, the Chairman continued. Directors had suggested that wages needed to develop with moderation, although there remained sharp differences of view on the advisability of resorting to incomes policy to achieve the objective. The preponderance of view seemed to be that a rigid position should not be taken on the matter of incomes policy, but three points had been made clear. First, incomes policies or practices should always begin with wage restraint in the public sector itself, which should set an example for the rest of the economy. Second, incomes policies should never be a substitute for proper demand management policies. Finally, incomes policies could be a useful device for individual countries if they were seen by the authorities and the social partners as being effective in reducing the rigidities in wage bargaining. There were some countries with experience in the area of incomes policies that had seen an increase in wage bargaining rigidities. Still, it had been interesting to note the indication by some Executive Directors that there was an increasing willingness among the public to accept some moderation or restraint in wage development and some revision in social security devices.

With respect to the necessary shift toward more productive activities, Directors had stressed the dangers of artificially financing unprofitable or uncompetitive activities through the public budget, and they had noted the related dangers of protectionism in promoting anti-inflationary and antirigidity policies, the Chairman said. One point on which all Directors agreed was that none of the aforementioned supply or structural and incomes-oriented policies could be a substitute for proper demand management policies. Despite some differences of view, a large majority of the Executive Board considered that the Fund should maintain its general policy stance and not advocate a relaxation of demand management policies, which could only make inflation more difficult to control and would not be likely to bring about any substantial reduction of unemployment.

Executive Directors were unanimously concerned about the problems of the developing countries in the current situation, the Chairman observed. Lower rates of growth were worrisome; indeed, it was noted that more and more countries were facing negative per capita rates of growth as a result of the protracted recession, the prolonged deterioration in the terms of trade, and the high interest rates in international markets. Also, the adverse external influences had in many cases been accompanied by unduly expansionary domestic policies, with results that had also contributed to sharply increased balance of payments deficits on current account and rapid growth of external debt. A number of Directors had questioned the prospects for financing the current account imbalances that the staff had forecast, and two points had been stressed by Executive Directors in that regard. There was unanimous agreement on the need for adjustment; no one had objected to the necessity for developing countries to improve the management of their fiscal and monetary instruments, and he had been interested to hear the reflections of some Directors on the active utilization of pricing policies and exchange rate policies in Fund programs in that regard. On the other hand, some Directors had emphasized the dangers of import cuts, which could be damaging not only for international trade but also for the future development of the developing countries. They had stressed the need for time for adjustment to take place in an orderly fashion and had underscored the importance of a strong International Monetary Fund and for long-term capital movements to be directed toward productive activities in the developing countries.

On the matter of international cooperation, the Chairman noted the emphasis by a number of Directors on the dangers of protectionism and on liberalization of capital markets, which was an essential part of the open system. In that respect, interesting comments had been made on the role of the Fund in the matter of convergence of economic policies. Some Directors had stressed the importance of surveillance over industrial countries in order to promote a better convergence of economic policies toward a sounder path of growth and stability, and he had heard with interest the remarks on the potential role of the Fund in participating in a multilateral approach to convergence along the lines that had been agreed by the countries involved in the summit meeting at Versailles. The point had also been made that the Fund should perhaps incorporate in its surveillance activities the matter of the debt position of countries, and he had heard several reflections on how better to grasp the debt maturity structure and short-term aspects of external debt that were at present perhaps not sufficiently covered in staff reports. Also raised in the course of the discussion were several ideas on adjustment policies as encompassed in Fund programs and the point that the International Monetary Fund needed to be sufficiently strong to cope with the financial problems that would be facing members in the months and years ahead.

The Executive Board then concluded its consideration of the World Economic Outlook.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/113 (8/20/82) and EBM/82/114 (8/20/82).

2. MAURITANIA - EXCHANGE SYSTEM

The approval of Mauritania's exchange restrictions under Decision No. 7079-(82/64), adopted March 19, 1982, is extended until January 31, 1983 or the completion of the next Article IV consultation with Mauritania, whichever is the earlier. (EBD/82/203, 8/17/82)

Decision No. 7187-(82/114), adopted
August 20, 1982

3. SAUDI ARABIAN MONETARY AGENCY - BORROWING AGREEMENT - CHANGE IN CONVERSION ARRANGEMENTS

The Managing Director is authorized to communicate to the Saudi Arabian Monetary Agency the Fund's willingness to accept deutsche mark, French francs, pounds sterling, U.S. dollars, and Japanese yen when an exchange is required of Saudi Arabian riyals borrowed under the agreement authorized in Decision No. 6843-(81/75), adopted May 6, 1981; provided that the members issuing those currencies concur to the use of their currencies held by the Fund for the purposes of investments resulting from such acceptance of their currencies, and provided further that the Fund's depositories in their territories agree to open and maintain "Borrowed Resources Suspense Accounts - Cash Accounts" for these purposes. (EBS/82/145, 8/13/82)

Decision No. 7188-(82/114), adopted
August 20, 1982

APPROVED: February 17, 1983

LEO VAN HOUTVEN
Secretary