NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/52

10:00 a.m., April 21, 1982

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

Executive Directors	Alternate Executive Directors
	A. Yasseri, Temporary
	C. Taylor
A. Buira	
	H. G. Schneider
	P. D. Peroz, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. C. Iarezza	R. T. Salazar
R. K. Joyce	
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
S. Kiingi	F. Sangare
G. Laske	G. Winkelmann
G. Lovato	
	C. Bouchard, Temporary
	A. S. Jayawardena
Y. A. Nimatallah	S. El-Khouri
J. J. Polak	T. de Vries
A. R. G. Prowse	
J. Sigurdsson	
	Tai Q.

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

Also Present
African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; S. N. Kimaro. Asian Department: J. T. Boorman, W. G. L. Evers, S. Shah. European Department: L. A. Whittome, Counsellor and Director; L. E. De Milner, D. M. Ripley. Exchange and Trade Relations Department: C. D. Finch, Director; S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; A. Abisourour, M. Guitian, G. G. Johnson. External Relations Department: A. F. Mohammed, Director; N. K. Humphreys. Fiscal Affairs Department: O. J. Evans, R. D. Kibuka. Legal Department: G. P. Nicoletopoulos, Director. Middle Eastern Department: A. D. Crockett, M. C. Niebling, S. von Post. Research Department: C. F. Schwartz, Associate Director and Director of Adjustment Studies; R. R. Rhomberg, Deputy Director; C. P. Blackwell, M. C. Deppler, S. J. A. Gorne, L. R. Kenward, M. D. Knight, A. K. McGuirk, A. K. M. Siddique, G. H. Spencer, E. Y. P. Tung, P. Wickham. Treasurer's Department: H. Flinch. Western Hemisphere Department: C. E. Sansón, Director; J. Ferrán, E. Hernandez-Cata. Bureau of Statistics: C. A. Patel. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. J. Batliwalla, M. A. Janjua, K. V. Jännäri, G. Jauregui, F. Yeo T. Y. Assistants to Executive Directors: M. J. Callaghan, L. E. J. Coene, T. A. Connors, R. J. J. Costa, M. K. Diallo, J. M. Jones, P. Kohnert, V. K. S. Nair, Y. Okubo, D. V. Pritchett, M. Z. M. Qureshi, J. Reddy, J. Schuijer, D. I. S. Shaw, H. Suzuki, J. F. Williams.

1. WORLD ECONOMIC OUTLOOK - MAIN ISSUES

The Executive Directors resumed from the previous meeting (EBM/82/51, 4/19/82) their consideration of a staff paper dealing with the main issues of the World Economic Outlook (ID/82/1, 3/29/82; and Cor. 1, 4/1/82). They also had before them a draft report on the World Economic Outlook, which was intended for publication; a Departmental Memorandum on selected indicators of exchange rate changes and related variables (DM/82/25, 4/15/82); and a revised draft of an Occasional Paper on recent experience relating to the implications of sluggish industrial-country growth for economic growth in the non-oil developing countries (3/15/82).

Mr. Kafka observed, first, that world trade, which was dominated by the industrial countries, was expected by the staff to recover from the zero volume growth registered in 1981. The recovery seemed to depend heavily on the forecast of a sharp swing from falling to rising imports, other than oil, in the industrial countries. Even leaving aside the dangers of protectionism, the forecast was not easily reconciled with the projected decline in the growth rate of GNP in those countries; it must, therefore, rely on an expectation of a reversal of the inventory liquidation of the previous year, which was certainly not made more likely by the expectation that interest rates would continue to be high. He was aware that, as had been shown in the draft Occasional Paper on the implications of sluggish industrial-country growth, there was no precise correspondence between GNP growth in industrial countries and the growth of their imports. But it was worrisome to note that the GNP growth rate for the industrial countries was expected to fall at the same time that non-oil imports were expected to rise.

For the developing countries, Mr. Kafka continued, the staff foresaw a decline of the purchasing power of exports for major oil exporters and flat export purchasing power for the smaller oil exporting countries. But for the net oil importing countries, the forecast of a recovery was based on an improvement in the volume of exports and roughly stable terms of trade. Under the circumstances, one could at best hope that the forecasts would prove correct. Even if they did, considering the high cost of financing current account deficits and, in some cases, problems of access to foreign credit, it was not surprising that the growth rates of the non-oil importing countries, which were at best equal to the rate of population growth in 1981, would be only slightly above it in 1982. On the other hand, the growth rates of the major oil exporters, which had been negative in the past two years, would be flat in 1982, and those of the smaller oil exporting countries would continue to fall. That an increase in per capita income was necessary to provide employment for rapidly increasing populations made the profound social and political impact of those rather disappointing growth prospects obvious; and it was only partly alleviated by the fact that some progress on inflation was expected among all groups of developing countries, and industrial countries as well.

A redistribution of current account balances among the industrial countries was also foreseen by the staff, Mr. Kafka noted, as the group would swing into surplus from a small collective deficit in 1981. But that collective swing would be more than offset by the sharp decline in the collective surplus of the major oil exporting countries together with the increase in the collective deficit of the smaller oil exporting countries. The net oil importing countries were expected to have a slightly smaller nominal deficit on current account, most of the fall being due to the comparatively substantial improvement expected in the situation of the major exporters among them. Obviously, those nominal improvements hid considerably larger ones in real terms, and in relation both to GDP and to exports. A large part of the improvement of the situation of the net oil importing countries and of the industrial countries had to be ascribed to their efforts to conserve and to find substitutes for energy, and to the expectation of unchanged or even falling oil import prices. However, the projections of current account developments were made embarrassingly uncertain by the large and growing size of the residual item. That item appeared to hide service receipts of various kinds; but it might also suggest that the non-oil developing countries would be unable or would not be willing to sustain the predicted growth rates of GDP and of imports.

In addition to high interest rates, which had been discussed at great length at the previous meeting, Mr. Kafka recalled, the recent period had been characterized by fluctuating interest rates, and consequently by considerable fluctuations among the exchange rates of industrial countries. Major problems had thereby been created for the less developed countries, because the currencies in which they borrowed and those in which they traded were not always the same.

However many difficulties they might face, and despite being battered by a succession of oil and interest rate shocks, the developing countries, particularly the non-oil developing countries, would have to persist in their efforts to bring absorption and output into better balance, Mr. Kafka commented. That would be exceptionally difficult in the present general setting of the world economy. But what was particularly important was the pursuit not only of restrictive demand policies but of investment aimed at export promotion and import substitution, the latter particularly in the energy field.

No general financing problems for non-oil developing countries were foreseen by the staff for 1982, Mr. Kafka remarked. He hoped that that was true, despite the uncertain outlook for current account balances. That uncertainty placed all the capital flow forecasts in doubt, a fact to be the more regretted as they were on the whole rather encouraging. Thus, flows of long-term capital were expected to increase somewhat for all categories of non-oil developing countries and nondebt creating flows for almost all, the preoccupying exception being the low-income countries. Private long-term capital flows were expected to increase for the small net oil exporters, but the major exporters of manufactures among the net oil importers whose current account deficits would decline most strongly would have a consequent reduction in private capital inflows. There would also be an overall fall in short-term finance, including reserve-related finance.

For many of the smaller developing countries, and perhaps for some industrial countries, the future policies of the International Monetary Fund might be important, Mr. Kafka considered. Until recently, the Fund had moved toward a degree of liberalization in the volume of resources that it made available to countries appealing for its assistance and for the length of time for which it made them available. It had done so without prejudice to its appropriate conditionality. It had also taken important steps with respect to the policy design that it was prepared to consider in adjustment programs. Thus, until lately, it had been accepted that it might be appropriate for the Fund to finance a program for a low-income country that would help to bring about adjustment in the context of an increase in investment rather than simply or mainly by demand restraint. That had seemed a reasonable approach because the sacrifices imposed on consumers in low-income countries had often been such that programs had failed, even though they had been designed to lead to rapid adjustment.

Fund policy in general, however, had come under attack, Mr. Kafka continued, with respect not only to the design of policy but also to the requirement that an approach to the Fund would not be welcome unless countries at least appealed simultaneously to international capital markets whenever they had access to them. In other words, an attempt was being made to apply a principle of graduation in the Fund, as well as in the World Bank; he had already stated his conviction that the idea made even less sense for the Fund than for the IBRD. Another cause for concern was the apparently increasing tendency for the Fund to demand that preconditions be met before it concluded a lending agreement. He was less concerned about the preconditions as such; under certain circumstances, it might actually be easier for a country to enter into a Fund program after taking certain steps on its own rather than under what could be publicized domestically as Fund pressure. The problem was that preconditions could lead to a delay in the conclusion of stand-by and extended arrangements that could be extremely bothersome in the present condition of the world economy. It was for that reason that he had on several occasions suggested the establishment of a short-term bridging credit facility in the Fund. Another desirable aspect of cooperation at the present time would be an appropriate SDR allocation that would relieve developing countries, which for the most part had to borrow reserves, from having to maintain borrowing on the scale required to keep their reserves in an appropriate relationship with imports and total payments.

Apart from the general setting of the world economy, Mr. Kafka added, the dangers of protectionism were of particular concern to the developing countries. A careful analysis of the problem had been made in the draft report on the World Economic Outlook. Although many countries had resisted pressures for increased protectionism, the situation was still extremely worrisome and would become more so the longer the stagnation of the world economy lasted. The staff had drawn attention to the dangers and had emphasized correctly how, for example, the Multifiber Arrangement increasingly discriminated against developing countries. But protectionism in its various forms affected not only industry but also agriculture.

In commenting on the extraordinary volatility in the exchange rates of major currencies in the past two years, Mr. Kafka observed, the staff had stated that the relative stability obtained with some difficulty among the countries participating in the European Monetary System should not yet be extended to other industrial countries. The difficulties of running a par value type of monetary system were generally ascribed to extreme differences in rates of inflation; the staff might wish to comment on whether or not the dispersion of inflation rates between the EMS and other industrial countries was in fact noticeably wider than those prevailing among the EMS countries.

Looking further ahead, the staff had presented somewhat disappointing projections for the medium term, Mr. Kafka noted. In Scenario A--the central scenario--growth in the industrial countries would increase only slightly above the depressed growth rate of the late 1970s, whereas the growth rate of net oil importing developing countries would be below or only marginally above that of the late 1970s. The results in Scenario B were more depressing still. Even Scenario C, the most optimistic one, was not much better than Scenario A. A major effort might have to be made, so that Scenario A could be achieved at least in the medium term.

Mr. Sigurdsson commented first that he agreed with the staff that smaller industrial countries were, generally speaking, facing substantial adjustment problems. It was important to recognize clearly that the small open economies were heavily dependent on developments in the major countries. A precondition for the success of the adjustment efforts of such countries was that major countries in a strong balance of payments position would make room for the needed adjustment by adopting a more expansionary economic policy. That precondition did not of course reduce the need for domestic adjustment in the smaller industrial countries, particularly in the area of fiscal policy.

The prospects for developing countries were, of course, even more heavily dependent upon resumption of growth in the industrial world, Mr. Sigurdsson added. The balance of payments outlook for the developing countries over the medium term looked somewhat better in 1981, and on the whole the staff's view that the financing of their deficits should not cause serious problems seemed plausible. But the situation could become precarious for individual low-income developing countries and even for some middle-income primary producers. Meanwhile, many uncertain factors affecting the balance of payments outlook of the developing countries could altogether too easily lead to a less favorable outturn than the staff was forecasting.

The balance of payments and debt situation of the developing countries demonstrated the need for measures to expand world trade, Mr. Sigurdsson stated. It was also of great importance for industrial and oil exporting countries to maintain a high level of official development assistance, which was sorely needed by low-income developing countries. Inflation was plaguing many developing countries, which would certainly be helped in redressing their balance of payments and adjustment problems if they were able to bring their rates of inflation down to more controllable levels.

On the general features of the world economy, Mr. Sigurdsson referred first to certain points arising from the statistical tables appended to ID/82/1. Table 6 showed clearly how much the slow process of deflation had affected commodity prices. If it was borne out, the staff forecast in that table would make 1982 the fifth year in a row in which non-oil developing countries had had deteriorating terms of trade. The prices of primary commodities--except for gold and oil--were lower in terms of manufactured goods in 1981 than at any time in the previous 35 years, and the implications were that the 1982 figures might be lower still. He wondered whether the staff foresaw an improvement in the terms of trade for primary producers in the course of 1982 and into 1983; Section 9 of Appendix A to the draft report on the World Economic Outlook did not seem to say so. On a more technical level, it would be interesting to know whether the staff had tried to make a systematic comparative assessment of commodity-by-commodity movements in the terms of trade with the country-by-country studies that presumably lay behind the terms of trade figures in Table 6. Needless to say, the terms of trade picture was of great importance for the financial operations of the Fund, affecting directly as it did the demand for resources from the compensatory financing facility--and possibly from the buffer stock facility--and indirectly the general demand for Fund credit.

There were two interesting figures in Table 7, Mr. Sigurdsson noted. The staff had forecast a $25 billion surplus for the oil exporting countries in 1982, a sharp decline from 1981. At the same time, the deficits of other developing countries would hardly diminish at all. Could the staff say whether the most recent movements in the oil market were likely to bring about a further reduction in the oil countries' surplus in 1982 and 1983, or whether the emerging pattern of payments imbalances would make the task of deficit financing even more difficult than before?

He had also been concerned, like Mr. Kafka, by the bottom line of Table 7 in ID/82/1 reflecting errors, omissions, and asymmetries, plus balances with nonmembers, Mr. Sigurdsson added. It showed a highly interesting development: the negative residual had increased rapidly over the previous few years and had reached $61 billion in 1982, a figure particularly puzzling since the centrally planned economies included in that item probably had a sizable deficit on current account. Perhaps the staff would care to speculate on the reasons why the residual had become so large that it was detracting from the credibility of the balance of payments forecasts.

The analysis of the world economic outlook in general and the U.S. economy in particular had recently been heavy with monetary considerations, Mr. Sigurdsson remarked. Much of that analysis had centered on the detailed techniques of monetary controls, sometimes without asking the prior question of whether or not there was a sound theoretical basis for the monetary approach, in particular when considering its international ramifications. Simply put, the most effective monetary strategy for countering inflation and achieving stable growth, under a system of floating exchange rates, was said to be for each country to fix its own rate of monetary growth as if demands for national currencies were stable and independent of one another. Recent experience had led many economists--even confirmed monetarists--to question the validity of that approach, some of them on the basis of international considerations. Professor McKinnon had put forth the view, in a Departmental Memorandum (DM/81/61, 8/17/81), that the--admittedly casual--empirical evidence suggested: "that the national (convertible) monies of an inner group of industrial countries are highly substitutable in response to expected exchange rate movements. This international currency substitution destabilizes the demand for individual national monies so that one can not make much sense out of year-to-year changes in purely national monetary aggregates in explaining cycles in national rates of price inflation." That was an interesting statement, considering the attention devoted to studying the minutiae of the weekly changes in money supply in some major countries. It would be interesting if the staff would comment on that view and its implications for the role of international cooperation in general and the Fund in particular. To his mind, it was yet another argument in favor of strengthening the Fund's surveillance of the economic policies of members with the aim of making them internationally cooperative, and lessening exchange rate instability between the key currencies.

It was also important to recognize clearly the need for a balanced approach to economic policy, Mr. Sigurdsson stated. The Managing Director had recently highlighted the need to restore fiscal discipline as a vital element of a policy of economic recovery. The assertion was certainly true, and he would quote from the Managing Director's address to the American Enterprise Institute on March 16, 1982: "The measures that are needed to address the fiscal problems facing so many countries today depend, of course, upon the particular circumstances and situation in each individual country. Different countries would want to follow different policies toward economic recovery but, to be effective and successful, they must have at least one element in common: policies pursued at the national level must be internationally cooperative. In essence, this means taking the interests of other countries into account and contributing to the working of the international adjustment process."

As had been stated during the previous meeting, Mr. Sigurdsson recalled, not too much should be expected from economic policy. The best that could be hoped for was to move policy in the right direction in an economic situation that was always fluid and changeable. It was precisely for that reason that it was necessary to support even the best of monetary and fiscal policies with a well-coordinated incomes policy. The formation of incomes rarely took care of itself in economic systems. Any economic policy was in a sense an incomes policy. Whatever policy was followed could not succeed in containing inflation unless it influenced wage negotiations and the rate of wage increases. The staff was therefore right to stress, as it did in the general survey in the draft report on the World Economic Outlook, the importance of flexible or informal incomes policies as useful adjuncts to fiscal and monetary policy. Nevertheless, he joined Mr. Polak in his comments at the previous meeting on the discussion of wage contracts; the categorical statements in the last paragraph on page 38 of the draft report on the World Economic Outlook could easily be taken to mean that the Fund considered any and all kinds of wage contracts as being detrimental to sound economic policy. That could hardly have been the intention of the staff, whose comments on the point he would welcome.

Finally, Mr. Sigurdsson said that he agreed with the staff comment that international cooperation was of vital significance in the current state of the world economy. The role of the Fund in that cooperation should be strengthened, not only its financing role, through an increase in its resource base following an early completion of the quota review, but also its role as a forum for surveillance.

Mr. Lovato said that the discussion at the previous meeting had set the stage for a review of the prospects of developing countries. Besides the draft report on the World Economic Outlook, the draft Occasional Paper on the implications of sluggish growth in industrial countries for developing countries' growth was informative and thought-provoking; the conclusion to be reached was said to be that, while growth in industrial countries was not the only, or even the overwhelming, determinant of growth in developing countries, it nevertheless remained a major factor because it set the framework in which internal policies could be developed.

There had been few signs of improvement in the position of developing countries since 1981, Mr. Lovato continued. The size of their external imbalances on current account had reached the unprecedented figure of $100 billion, with little prospect of a quick reversal, particularly in nominal terms. At the same time, the rate of growth of output had fallen to about 2 per cent, implying a negative growth rate in per capita terms. Although the rate of inflation had eased somewhat, it remained at an unacceptable level in many countries, forcing continued adjustments in exchange rates or losses of competitiveness that would compound present problems.

There seemed to be no easy way out of that rather bleak scenario, Mr. Lovato commented. As had been mentioned during the discussion at the meeting on policies in the major industrial countries, there was little room left for the relaxation of either fiscal or monetary policies. There was even less room for relaxation in developing countries, given their weaker financial structure and greater vulnerability to external shocks. The staff had stressed that excessive internal stimulus, which had resulted in higher and growing fiscal deficits, had been a contributing factor in bringing about the current situation. Painful as the measures needed to reverse the situation could be, they would have to be undertaken because there was no feasible alternative. Nobody wanted to promote restraint for its own sake; wherever possible, adjustment policies should be coupled with an increased development effort so that structural problems could be solved while excessive demand pressures were eliminated. However, it was also apparent that the resources available to finance the process were limited, and that many countries, particularly those that had not developed a manufacturing sector, would have to undertake a serious adjustment effort before embarking on successful development programs.

As he had mentioned during the first part of the discussion, Mr. Lovato recalled, the attitude of the major industrial countries was also an important factor in determining the way in which the recession would be overcome, and in creating an environment in which developments could gain new momentum. It went without saying that the tendency toward protectionism should be opposed. What was more important, however, in the short term was the current high level of interest rates, which was severely limiting the scope for recovery among developed countries and posing an additional and direct burden on developing countries in the form of interest payments on debt. The disarray caused by the present situation added strength to the argument for a change in policy mix, in the spirit of international cooperation, a topic on which he had elaborated at the previous meeting. The medium-term scenarios that the staff had presented were not encouraging. He wondered whether it would be possible to imagine an in-between scenario, with a different policy mix than the one under Scenario A but without the all-out relaxation of policies depicted under Scenario B. Such a scenario might be feasible, and an effort should be made to achieve it.

In any event, Mr. Lovato commented, the present difficult situation indicated the undesirability of a decrease in external assistance. His authorities had stepped up their attempts to increase overseas development assistance, and developed countries should be encouraged at least not to reduce assistance from the present levels.

Finally, referring briefly to the role of the Fund, Mr. Lovato reiterated that the Fund should continue to play a central role in the adjustment process and that it should be adequately endowed with resources to do so properly. The discussions of the World Economic Outlook were certainly useful; they provided the opportunity to explore ways of increasing international cooperation and improving world economic conditions.

Mr. Finaish observed that the world economy continued to be characterized by high inflation, low rates of growth of output and world trade, growing unemployment, and large external imbalances. However, developments over the previous year or so had some positive features; most notably, a significant fall in the rate of inflation in some major industrial countries was forecast for 1982. Nonetheless, inflation remained a serious problem in those countries, as the present inflation rates were still high by the standards of the 1960s and early 1970s, and inflationary expectations remained sticky. Furthermore, progress on the anti-inflation front had been accompanied by a further deepening of recessionary tendencies in the industrial countries, leading to still lower rates of growth of output and world trade and higher rates of unemployment.

The discussion in the general survey of the draft report on the World Economic Outlook echoed the main strands of the argument in the 1981 report, Mr. Finaish continued. Four broad conclusions could be drawn about the nature and scope of economic adjustment needed in present circumstances. The first was that the need for undertaking substantial adjustment measures was not limited to any single group of countries or to any small number of countries; rather, it appeared to be widespread, among both industrial and developing countries. Of course, from the standpoint of the global economy, successful adjustment in major industrial economies was of much greater importance.

Second, Mr. Finaish went on, the type of adjustment needed required an appropriate mix of demand management policies supplemented by structural adjustment measures, in many cases covering a wide range of activities. The causes of the present stagflation were complex; many had developed over a long period and had engendered deep-rooted structural distortions, rigidities, and deficiencies. The alleviation of those problems, making it possible to improve the conditions for enhanced economic efficiency and the growth of productive capacity, was an important prerequisite for the lasting containment of inflation and a return to higher sustainable growth rates.

The third conclusion to be drawn, Mr. Finaish noted, was that because of the deep-rooted structural aspects of present problems, they could be dealt with effectively only in a medium-term framework. Thus, an appropriately balanced package of policies would have to be implemented consistently and steadfastly over several years in order to effect a gradual, but durable, improvement.

Fourth, Mr. Finaish commented, in the current global economic setting, it had to be recognized that the relative situations of countries could differ considerably. The composition of the required policy package would therefore have to differ in order to take account of the respective special circumstances and characteristics of various countries. However, the greatly increased level of economic interdependence in the present world would require a measure of mutual consistency in the broad thrust of policies pursued by major countries and groups of countries if there was to be successful adjustment at the international level. The conclusion was clearly a need for greater international economic cooperation, a consideration that had been correctly stressed in forceful terms in the staff paper on the World Economic Outlook.

Referring first to the situation in non-oil developing countries, Mr. Finaish said that, while a clear picture of recent and prospective growth rates, balance of payments positions, and the magnitude of adjustment and financing required could emerge only from a disaggregated analysis, the non-oil developing countries had many problems in common. Generally, their growth rates continued to be low and they had in many cases fallen even lower over the previous year, while their external deficits had grown still larger, and the financing of those deficits remained difficult. Their problems had been aggravated significantly by the adverse developments in the world economic environment in recent years, although with varying degrees of intensity. In particular, the non-oil developing countries had suffered from depressed demand for their exports, sharply higher import prices, a deterioration in their terms of trade, and an increase in their debt servicing burden as a result of large increases in interest rates in international financial markets. Besides, the greater variability of interest rates and exchange rates over the previous two years in some major industrial countries had further complicated the task of economic and financial management in the developing countries. The rise in interest rates had occasioned an outflow of capital from some developing countries.

For those reasons, Mr. Finaish noted, the prospects of an improvement in the economic situation of non-oil developing countries in the near future were linked to improvements in the economic situation in the industrial countries. While the severity of the problems currently being faced by the developing countries would be eased considerably by a less harsh external economic environment, the major part of the improvement in their situation would clearly come from their own efforts. But the adjustment effort required of those countries in present circumstances would indeed be formidable; most would agree with the staff that many of them needed comprehensive adjustment programs. In addition to measures aimed at achieving the needed degree of demand restraint, such programs would include policies designed to deal with the structural deficiencies underlying the balance of payments problems. The need of those countries for supply-oriented adjustment policies was substantial, given the limitations on their productive base; in fact, structural measures on the supply side would constitute an integral part of any program for achieving a meaningful and sustained improvement in their domestic and external financial positions. As those measures took time to produce the desired results and called for a greater volume of resources, the need was for medium-term adjustment programs of commensurate size.

Obviously, adjustment had to be financed, and the scale of required financing increased with the scale of the desired adjustment, Mr. Finaish went on. Thus, if the required adjustment in developing countries was to take place without undue hardship, international assistance in the financing of the adjustment efforts would continue to be needed on a substantial scale. While no major financing difficulties were envisaged at present by the staff for the larger countries among the LDCs, some of them, particularly of the low-income countries, might well experience such difficulties. Not only had they been affected most seriously by the strains of recent developments in the world economy, but they were also the countries experiencing the greatest difficulty in raising funds in international capital markets. The low level of income and the pressure on the resources of those countries meant that they would be hard pressed to put up with the further slowdown of growth that the required economic adjustment might entail unless the process of adjustment was facilitated by an increase in official external financial assistance, on which many low-income countries primarily depended.

To turn to the oil exporting countries, Mr. Finaish welcomed the greater attention given in the draft report on the World Economic Outlook for 1982 to what might be called the domestic dimension of the problems of that group of countries, and he trusted that further improvements would continue to be made in that direction. The oil exporting countries shared many of the circumstances and problems of other developing countries, but they also faced rather different policy issues. The major thrust of economic policies in recent years, especially in the countries that were more heavily dependent on oil exports, had been to use the enlarged financial resources that they derived to strengthen and broaden their productive base with a view to fostering sustained and diversified growth in the future. In pursuit of those objectives, oil exporting countries faced difficult policy questions of how to optimize the extraction rates for oil--an exhaustible resource--and make efficient use of oil revenues in the tasks of economic development and diversification.

The broad character of the domestic economic policies of oil exporting countries had remained largely unchanged over the previous two years, Mr. Finaish commented. Financial policies had been relatively restrained, being designed to foster development while avoiding the re-emergence of major supply bottlenecks and severe inflationary pressures of the type experienced in the mid-1970s, which had resulted partly from the highly expansionary financial policies pursued in the wake of the first round of oil price adjustments. The recent weakening of the oil market and the consequent decline in export receipts was expected to contribute to further restraint in domestic financial policies in 1982. However, greater financial restraint was in many cases not expected to be dictated chiefly by any serious financial stringencies stemming from the currently weakened world oil market since, as the staff had noted, a large part of the projected fall in oil receipts was expected to be accounted for by major oil exporters with relatively strong payments and reserve positions. It was more likely to reflect the adoption of a generally more cautious approach based on an increase in perceived uncertainties about the future course of the oil market and a heightened realization of the desirability of making efficient use of available financial resources. Although, as he had noted, financial policies over the previous two years had been restrained compared with the mid-1970s, in absolute terms, they had ranged from moderately to fairly expansionary. As a reflection of those policies, the rate of inflation and the real rates of growth in the non-oil sectors and in imports had remained at fairly high levels, although appreciably lower ones than experienced in the mid-1970s. Thus, it would seem possible for many of those countries to make a further significant reduction in the rate of growth of domestic absorption without jeopardizing major development objectives.

Some might even see certain positive aspects for the oil exporting countries in the recent softening of the oil market and the consequent reduction of oil production, Mr. Finaish noted. For instance, there would be less depletion of oil reserves, at least in some cases. Also, the reduction in oil receipts might signal the need for greater discipline in expenditure policies and a firmer set of investment priorities, serving in turn to reduce the temptation to overspend and to expand certain sectors that were not very productive. Thus, the current oil market situation might be used as an occasion to pause and review existing expenditure schemes to work toward more careful planning of the utilization of oil revenues in the future.

The section in the Appendix to the report on the World Economic Outlook on the world oil situation was informative and useful, Mr. Finaish considered. However, it would have been even more so if the thorough description had been supported by deeper analysis. For instance, the factors behind the recent weakening of the world oil market could have been analyzed at greater length, and a distinction made between those that could be considered relatively temporary in character and thereby reversible over the short term, such as fluctuations in inventories or a cyclical fall in demand, and those that could be considered relatively more fundamental and have an influence on the market for a much longer period, such as structural changes leading to greater energy conservation and the development of alternative energy sources. Furthermore, the significance of the latter factors could have been assessed relative to that of other factors bearing on the longer-term balance between oil supply and demand, such as the gradual but inexorable depletion of the world's low-cost energy reserves or the expected significant growth in the future of the energy requirements of developing countries, which at present accounted for a relatively small proportion of the total consumption of commercial energy in the world. It was in the context of such an analysis that a reasonable assessment could be attempted as to whether or not the recent softening of the oil market represented just a temporary slack or the beginning of a longer-lasting change in the global balance between the supply of oil and the demand for oil.

It would not be an easy task, Mr. Finaish recognized. A variety of views were being expressed about the current world oil market situation and the prospects for coming years. Although it was difficult to come to any definite conclusion, certain factors and recent developments in the oil market ought to be kept in view in assessing the present situation.

First, Mr. Finaish stated, a significant fall in world demand for oil had taken place. It was generally known that the fall reflected in part the present recession in major consuming countries and in part the success achieved in conserving oil and in substituting fuels. However, it was not yet known what proportion of the fall in demand was attributable to those factors, information that would be important for an assessment of the future course of the demand for oil. If the fall in demand had stemmed mainly from the recession, a large part of it could be shortlived; indeed, the staff had noted that demand was expected to increase again in 1983 with the onset of recovery in some major industrial countries. On the other hand, the fall in demand would clearly be more durable if it stemmed chiefly from conservation and interfuel substitution. However, it should be noted that the strength of the effect on demand of the latter factor would also diminish to the extent that efforts directed at those goals were relaxed in response to the softening of the oil market brought about in part by the initial fall in demand. The staff had noted indications that that might already be happening to some extent.

Second, Mr. Finaish observed, many oil buyers had been drawing down their inventories over the previous several months. While no firm figures were yet available, by most accounts, the drawdown had been substantial.

A huge buildup of oil stocks had taken place over the previous years, especially during 1979 and 1980, in the wake of the crisis in Iran and the expectation of a further tightening of the oil market. The announcement by OPEC in October 1981 of its intention to freeze oil prices in nominal terms through the end of 1982 had provided holders of oil stocks with the incentive to destock because it signaled that the real price of oil would be allowed to fall, or perhaps that even the nominal price would in fact fall. That incentive had been further strengthened by a substantial increase in the costs of carrying stocks due to the rise in interest rates. The large drawdown of stocks had meant that the demand to buy oil from OPEC countries had fallen by more than the fall in overall demand by consumers. However, the picture with respect to inventory changes could clearly alter sharply over a relatively short period in response to changes in perceptions about the security of supply, expectations about the future price of oil, and the costs of carrying inventories. Although recently a cause for downward pressure on oil prices, inventory changes might later be a cause for upward pressure. It was also useful to remember that inventories were exhaustible: by some accounts, oil inventories would have been reduced substantially by the end of the summer of 1982.

Third, another factor acting to reduce the demand for oil from OPEC countries had been the increase in oil production by non-OPEC exporters, most notably the United Kingdom and Mexico, Mr. Finaish observed. Indeed, the largest oil producer among the developing countries, after Saudia Arabia, was apparently not an OPEC country but Mexico, which was nevertheless still classified by the Fund as a non-oil developing country. The non-OPEC oil exporters had sought to increase and consolidate their share of internationally traded oil. Thus they had been more concerned with volume than prices and had tended to lower official sales prices quite promptly in response to spot market signals, thereby shifting most of the reduction in world oil demand to OPEC countries. Whether that factor would continue to influence the oil market as much in the period ahead would, of course, depend on whether non-OPEC producers would increase their oil production significantly further. From a longer-term perspective, it was useful to bear in mind that the oil reserves of those countries were only a fraction of those of their OPEC counterparts.

Fourth, Mr. Finaish commented, another effect of the large inventories accumulated over preceding years and of the increase in oil production by non-OPEC countries--ones that had also been following the spot market signals more closely--had been to strengthen the bargaining position of the purchasing oil companies. Those companies had been permitted to reduce the lifting of oil from OPEC countries in order to obtain better terms under new contracts.

Fifth, the U.S. oil market, on being freed from price and import regulations, had become integrated into the world petroleum market, Mr. Finaish observed. Changes in prices in the United States tended to be transmitted back to the world market, a significant development. Deregulated prices enabled domestic producers to increase supplies even when the market was depressed, the resulting slack being transmitted--through a reduction in imports--to the world market and ultimately to OPEC.

Sixth, the dominance of the world oil market by a handful of large companies had been reduced, Mr. Finaish stated. There was at present a much larger number of buyers, including governments as well as small and big companies. That change had been conducive to the development of the spot market in crude oil: the scale of operations on that market had been increasing.

Finally, Mr. Finaish mentioned the change in the structure of the oil supplied by OPEC. Until 1979, OPEC had consisted of two large producers (Saudi Arabia and Iran), four middle-sized ones whose output often reached or exceeded 2 million barrels a day (Iraq, Kuwait, Nigeria, and Venezuela), and seven smaller producers. At present there was only one large producer--Saudi Arabia--and none of the four middle-sized producers was reaching the 2 million barrels per day mark. The important implication was that most of any adjustment in output that was made at present would have to be borne by one major producer, not by four or six, as had been the case previously. In fact, in 1975 an informal agreement had been reached on the adjustment of output, the burden having been shared by several producers.

Perhaps he should add, Mr. Finaish remarked, that he was not trying to take a position on whether or not the recent situation in the world oil market represented a short-term phenomenon or a longer-lasting tendency. As he had said earlier, his purpose had been only to point out some of the factors that needed to be taken into account for a fuller and balanced assessment of the current situation. To come to any firm conclusion on the future course of the oil market would require much greater information than was currently available on the respective orders of magnitude of those factors and their relative impact on the market. Nonetheless, even the mere recognition of the presence of several factors--some possibly rather temporary, others more enduring--behind the present oil market situation could help to guard against premature or facile conclusions about future oil market developments.

Greater international cooperation was needed, Mr. Finaish agreed with the staff, in order to deal more effectively with the present set of global economic problems. These were four aspects of international economic cooperation that were particularly relevant in the present setting. First, there was a need for a broad coordination of actions among major industrial countries in order to achieve a more consistent broad thrust of policies in major areas, a topic that had been discussed at the previous meetings.

Second, Mr. Finaish added, an extremely important form of international economic cooperation was a reduction in barriers to international trade. The present recessionary tendencies in industrial countries, and the attendant increase in unemployment, had given rise to increased pressures for additional protectionist measures. The need to firmly resist such pressures and also to reduce existing barriers could hardly be overemphasized. Trade barriers constituted an important obstacle to the structural adjustments currently needed in many industrial countries. By impeding the adjustment in the allocation of resources in response to changes in cost/price relationships and the pattern of comparative advantage, those barriers perpetuated rigidities and low productivity, which were among the major causes of the present economic problems of the industrial countries. In addition, protectionist barriers in industrial countries had a particularly damaging effect on developing countries, which depended upon increased access to foreign markets to improve their growth prospects. An important goal of the adjustment efforts expected of developing countries was greater efficiency in the allocation of resources and increased exports: high trade barriers in industrial countries militated strongly against that goal. For instance, it was reported in the section on developments in trade policy in the Appendix to the draft report on the World Economic Outlook that many developing countries considered the Multifiber Arrangement, covering textiles and clothing, to be the single most important barrier to the growth of their exports.

A third important area of international cooperation was aid to developing countries, Mr. Finaish stated. Recent trends in the volume of official aid flows from industrial countries, as well as its distribution, gave cause for concern. The ratio of official development assistance to GDP of those countries had been very low in recent years, much below even the modest UN target. As official development assistance was a small component of the budgets of most industrial donor countries, the volume could be raised significantly even under present circumstances. He hoped that countries whose official development assistance had stagnated or declined in recent years would take timely steps to restore it to more satisfactory levels.

Fourth, Mr. Finaish considered that international financial institutions like the Fund could play an important role in fostering greater international economic cooperation. Adequate support from member countries for the activities of such institutions and a balanced regard in their policies for the interests of the membership would serve to enhance the role of international institutions as agents of international economic cooperation.

Mr. Buira said that he wished to associate himself with the request of Mr. Finaish that the staff should make an attempt to clarify which of the factors affecting the current oil situation were temporary and which were more permanent.

Mexico had been producing oil since the turn of the century, Mr. Buira remarked, and it had been the largest oil exporter in the 1930s. It had ceased to export oil in significant amounts following the nationalization of 1938, when Mexico had been subjected to a commercial and financial blockade by the countries whose oil companies had been operating in the country. Having had a long-established national oil industry, Mexico had not felt the need to join OPEC, but it did have a production policy, subjecting exports to an upper limit, together with a number of other ceilings, including one that prohibited exports of more than half of Mexican oil to any one importer and another that prevented Mexico from supplying more than 50 per cent of the requirements of any one importer.

On the issue of classification, Mr. Buira added, presumably the staff had applied uniform criteria, taking into account oil revenues as a proportion of a country's exports of goods and services. Moreover, he recalled that when the classification of oil exporting countries had been introduced on the occasion of the Sixth Quota Review, the quotas of countries classified as oil producers, which did not include Mexico, had been doubled.

Mr. Finaish responded that he had referred to Mexico's position as an oil exporter, on the basis of the figures given in Table A-24 attached to Section 7 in the Appendix to the draft report on the World Economic Outlook, as opposed to the description in the text of the report itself of Mexico as a non-oil producing country. The general reader might not be aware of the Fund's manner of classifying its member countries.

The Chairman commented that the statistical criteria underlying the country classification had been applied in an even-handed way. The staff could perhaps comment at the end of the discussion.

Mr. Yasseri recalled that the emphasis in the informative debate on the economies of the industrial countries at the previous meetings had been mainly on substantive policy issues rather than on detailed staff projections of key economic variables of the industrial countries. The staff had quite rightly recalled that, owing to uncertainties relating to some of the projections, attention should be focused on the directions and patterns of indicated changes rather than on the actual figures. Nevertheless, he wondered how far it was possible to go in concluding that there was no significant divergence between Fund projections for 1982 and 1983 and those forecast by the industrial countries.

Continuing, Mr. Yasseri noted that the extensive chapters in the draft report on the World Economic Outlook on oil exporting and non-oil developing countries were highly informative and well documented, even if up-to-date figures and statistics were not always available for such countries. He was therefore in full agreement with the general theme and the main conclusions drawn by the staff, although he had some observations of form and substance to make and comments on certain projections relating to oil exporting countries.

A number of disparate features were dealt with in the sections of the report on oil exporting countries, Mr. Yasseri stated. As the staff had noted on page 10 of the draft of Chapter IV on oil exporting developing countries, it was difficult to generalize about the individual policy actions or trends in those countries because their domestic economic conditions and policies differed widely. A more meaningful analysis might perhaps be possible if one or two subgroups were formed, within the category of oil exporting countries, each having more or less similar features. Alternatively, perhaps on the same basis as for the industrial countries, a few of the oil exporting countries possessing representative features could be singled out for special analysis. In addition, the section on oil exporting countries did not seem clear in giving individual policy advice; the reason of course was related to the absence of coherent groupings and subdivisions and the resulting hazy pattern of individual policy trends. The staff had appropriately mentioned that oil exporting developing countries were currently reviewing their development strategies in the light of lower volumes and real prices of oil exports. But on page 59 of Chapter II of the draft report on the World Economic Outlook, the staff also mentioned that "therefore, the policy problem now confronting some of them relates more to a choice between reducing the rate of government spending, and thus experiencing a slower growth of their non-oil economies, or permitting budgetary and external payments positions to weaken significantly." The issue was how clearly those two alternatives presented viable policy choices.

For oil exporting developing countries, Mr. Yasseri continued, the average rate of growth of government expenditure had slowed down, and economic growth had been of the same order in 1981 as in 1980. Naturally, because of the important role that oil exports played in the economies of such countries, any dramatic upheaval in the world oil situation led to a change in their economic prospects. Such an upheaval had occurred, and the staff had pointed in its analysis to the fragile and highly sensitive nature of the economies of oil exporters to changes in oil prices. In fact, such countries had from the very beginning recognized the vulnerability of their economies and had taken steps aimed at relative diversification. The development of agriculture, light industry, and petroleum-associated industries had been undertaken initially to further those aims. But such efforts necessarily took time, and problems had been confronted in implementing programs, such as those relating to the inefficiency of public sector investments, the redistribution of labor away from agriculture, and other difficulties to which the staff had drawn attention on page 8 of Chapter IV of the draft report. Apart from those problems, however, the immediate obstacle was the prospect of having to curtail development programs and new projects. Policies would therefore become more restrictive in 1982, with an adverse effect on economic growth rates in non-oil sectors in 1982 and 1983. Allowing for the deepening decline in oil production, and taking into account the expected worsening of the terms of trade of oil exporting countries in 1982, the real national income of those countries was expected to decline.

The staff projections also pointed to a decline in the current account surplus of oil exporting countries to about $25 billion in 1982, Mr. Yasseri went on. There were other projections, however, of a smaller figure of $15 billion, assuming on a 10 per cent decrease in the value of exports and a 15 per cent--compared with the staff's estimate in Table 12 of Appendix B of 10 per cent--increase in import value, and a negative balance on net invisibles of $55 billion. Taken together, those projections generally meant that the weakening of the external payments position of oil exporters would necessitate further adjustments in their policies. Thus, the choice of policies mentioned in the General Survey--between reducing the rate of government spending and permitting budgetary positions to weaken--might not be as clearcut as it seemed and would in fact in some instances pose a dilemma. Because development investment normally covered a considerable time span, which necessarily implied that the particular investment had been budgeted and planned well in advance, it was difficult to interrupt projects at a later phase. On the other hand, experience with deficit financing, the rapid pace of development, and the resulting inflation, supply and infrastructure bottlenecks--and, above all, the present volatile but tight conditions in the world money and exchange markets--cautioned against permitting an excessive weakening of budgetary and external positions. In fact the lessons of 1975 to 1979 had led to a tendency toward moderation in development expenditures, and the latest gloomy prospect was bound to adversely affect the fortunes of many oil exporting developing countries.

The developing world had had a hard year in 1981, Mr. Yasseri commented. The economic conditions of non-oil developing countries had been aggravated, among other things, by high international interest rates, an increasing debt burden, the gradual drawing down of foreign exchange reserves, greater resort to private capital markets, and, perhaps most important, recession in the industrial world. He agreed with the staff's argument on page 47 of the draft General Survey that some of those aggravations and the subsequent inability of countries to adjust were the result of external factors such as geographic location and international commodity prices. However, in Chapter V on the non-oil developing countries, the staff had clearly mentioned that undue expansionary fiscal and monetary policies, which had generated excessive demand and hence excessive imports, had led to rapid inflation and, in the absence of an adequate exchange rate adjustment, given an artificial advantage to imported goods.

During the Executive Board's recent seminar on interest and exchange rates in developing countries, one view that had been echoed by several Executive Directors was, first, that there was a limit to which such expansionary policies could be pursued, and, second, that due regard should be given to the particular characteristics of each country because a unique, uniform prescription embracing all cases would perhaps not be easy to find, Mr. Yasseri recalled. He realized, of course, that expansionary monetary and fiscal policies had created problems in some non-oil developing countries, but he wondered to how many that criticism had applied during the past three years. In fact, such countries had introduced policies of demand restraint in 1981 to adjust their external accounts, with consequent severe negative impacts on domestic growth. Recession in the industrial countries had also adversely affected the external sectors of non-oil developing countries. The prospects for 1982 and 1983 for the current account and terms of trade were not encouraging. Those gloomy prospects, moreover, were forecast despite a decline in real oil prices in 1982 and the stationary real oil price envisaged for 1983.

As for the more serious picture relating to the debt service payments of non-oil developing countries on their long-term external debt, Mr. Yasseri noted, those payments had risen by nearly 30 per cent in 1981 and would increase substantially in 1982. Moreover, in 1986, even under the most optimistic scenarios, there would be no substantial improvement. In fact, there had been a steady decline in nondebt creating flows and official net long-term capital over the past several years, as was evident from Table 27 of Appendix B. Instead, there had been a steady increase in private capital flows with higher interest rates and stiffer conditions; yet even such credits were not easily forthcoming for many of the smaller LDCs. The slowing down of economic activity and import demand in industrial countries had had severe effects, so much so that the expansion of the export volume of developing countries had dropped from 10 per cent in 1979 to 3 per cent in 1981; that slowdown had also somehow aggravated their terms of trade. It was the hope of his chair that a much higher level of outside financial help would be forthcoming to alleviate some of those hardships.

Finally, on the role of the Fund, Mr. Yasseri observed that in principle there was of course additional scope for member countries requiring Fund support to draw on its resources to a greater extent. In practice, however, that possibility was limited to those members making a vigorous effort to correct their payments imbalances. How strong an effort had to be undertaken varied according to circumstances. Experience had shown that some members had not been able to complete their programs. While recognizing that such programs constituted a necessary part of any worthwhile effort toward real adjustment, for developing and developed countries alike, a comprehensive study of the causes of so many inoperative programs was called for. He believed that it would be possible, without abandoning the basic tenets of adjustment, to lessen the unfavorable impact of some aspects of the adjustment packages and to improve the implementation of programs. The improvements could include, inter alia, more extensive use of technical assistance and more frequent monitoring of economic performance. Yet, if programs were to be made available on a larger scale, the Fund's financial resources would have to increase appreciably, as evidence of the potential needs of member countries during the next few years would show. Therefore, to prevent further declines in the real value of quotas, a substantial upward quota adjustment was called for.

As an international financial institution, the Fund was in a unique position to recycle financial flows with a view to making the international monetary system function smoothly and eliminating any emerging imbalance, Mr. Yasseri concluded. His chair had repeatedly argued for a financially stronger Fund that could confidently stand at the center of the international financial system; it also believed that some of the recycling tasks of commercial banking could eventually be taken up by the Fund. Perhaps in the not-too-distant future the Fund would be assigned a reserve accepting role, with at least some part of members' foreign exchange reserves being deposited in the Fund, a function similar to that carried out by the Bank for International Settlements.

Mr. Iarezza recalled that, as the Executive Board had had the opportunity to find out at the previous meetings, the world economic situation might continue to be characterized by a low level of economic activity and a falling but still high rate of inflation. The outlook for the remainder of 1982 and 1983 was not promising, and, even with a certain uneven resumption of economic growth and lower inflation in 1983, there were still no clear reasons for satisfaction.

Even though he agreed with the staff that, in some or in many non-oil developing countries, internal policies had been too accommodating, Mr. Iarezza asked Executive Directors to bear in mind how badly those countries had been hit by external events. First, the change in relative prices, especially the price of oil, had severely affected their terms of trade. Second, as international inflation had increased owing to the lack of appropriate and timely adjustment policies in the major industrial countries, nominal interest rates had increased, affecting the debt service payments of all capital importing countries and the creditworthiness of several of them. Finally, as developed countries--with delay and a certain lack of consistency--had started to apply adjustment policies, those non-oil LDCs had been struck once more by sluggish economic activity and a drop in the prices of main primary products. Those developments had affected their trade account and the service component of their balance of payments, because of the high level of real interest rates, especially if nominal interest rates were deflated against the international prices of primary products.

The medium-term scenarios developed by the staff gave no grounds for believing in a quick turnaround of the gloomy situation, Mr. Iarezza remarked. Scenario C was clearly too optimistic to discuss at length. Scenario A was the one expected to materialize. But Scenario B could not be ruled out completely because of the risk that a lack of success for some industrial countries' fiscal policies would lead to the undue continuation of high inflationary expectations and even higher adjustment costs or, even worse, to the abandonment of their adjustment efforts altogether.

The main conclusion to be drawn, therefore, Mr. Iarezza continued, was that the balance of payments imbalances of non-oil LDCs would unfortunately, remain at high levels in the foreseeable future unless a clear and coordinated strategy was followed, incorporating three elements. First, the non-oil LDCs themselves should apply consistent adjustment policies, based on an appropriate balance between demand and supply policies. Second, there should be a clear commitment from the main industrial countries to free trade and financial flows, or at least a commitment to pursue a more favorable policy with respect to the products produced by and financial flows oriented toward developing countries. Third, an active role should be played by the Fund in promoting adjustment, by the multinational development institutions in providing long-term development financing, and by official development institutions in providing the needed concessional aid for the lowest-income countries.

The first and the third elements of that strategy had been reviewed several times during Executive Board discussions on surveillance, SDR allocations, and the size of the Fund, Mr. Iarezza recalled. Therefore, he would concentrate his remarks on the need for a clear commitment to free trade. On that point, he agreed with the staff that the problems of international recession and mounting unemployment had led in recent years to trade friction and to renewed pressures in favor of protectionist policies. He viewed with great concern the growing trend toward bilateralism in trade negotiations among developing countries because it might discriminate against countries not directly involved in the negotiations and hinder the access of developing countries to foreign markets.

He also noted with great concern the lack of willingness to address the issue of protection against the import of labor-intensive manufactures and primary products in general, and agricultural products in particular, Mr. Iarezza added. The argument that internal political pressures in the affected sectors stood in the way of trade liberalization was completely unconvincing. Those who listened in the Executive Board to arguments against protection by developing countries of their industrial sectors, and in favor of convincing the domestic industrial groups of developing countries of the advantage of free trade for an optimal allocation of resources, might have some hope that the policymakers in developed countries would apply the same devotion to convincing internal political groups in their own countries. To cite only the Multifiber Arrangement, covering textiles and clothing, its discriminatory effect against low-cost developing country exporters unduly prolonged the adjustment of underlying structural disequilibrium in the protected markets themselves.

Referring to primary products and specifically to agricultural products, Mr. Iarezza said that he had been puzzled by the opening paragraph of Section 2(d) of Section 8 of Appendix A. It was mentioned that "the multilateral trading framework, as embodied in the GATT, has always recognized that protection of the farm sector is an important social objective of government policy. This notion is as widely accepted today as when the GATT was established." He wondered who did widely accept that policy. The crisis at the Havana Conference in 1947-48 at the beginning of the GATT's existence, the Kennedy Round discussions in the early 1960s, and the proliferation of special panels within the GATT to consider agricultural protectionist policies, suggested that the GATT's attitude to agricultural protection was not widely accepted at all.

His chair had strongly supported the idea that the Fund, in its role of promoting international adjustment, should become more active in encouraging members to ease trade restrictions, Mr. Iarezza stated. He welcomed the attempt of the staff to follow trade developments more closely in regular Article IV consultations, and believed that progress in that direction had been made since the World Economic Outlook had been discussed in June 1981. The Fund could and should also continue to play a useful role in supplementing the efforts of the GATT to handle both persistent and emerging trade problems. The importance for internal and international adjustment of avoiding trade restrictions should not be downplayed.

As could be seen from the staff's reports, Mr. Iarezza continued, those among the oil importing countries most exposed to international markets had been the hardest hit by world recession. In contrast, the relatively more closed economies and the smaller ones, less exposed to world market conditions, had experienced a more moderate slowdown in GDP growth. If the world recession lasted longer than expected and had more serious consequences for export-oriented activities in general, and if the maintenance of traditional protectionist policies and the appearance of new ones aggravated those problems, might not a reversal of the pattern of growth be induced in many developing countries? Would governments not feel tempted to reallocate resources toward the import-substitution sector and other activities as an alternative to export-oriented growth? The bleak prospects for international trade--reinforced by growing protectionist pressures in many industrial countries--might have lasting effects on the allocation of resources in the developing world and induce an anti-export bias in many countries. There was a growing risk that non-oil developing countries might approach the problem of achieving external balance not with the standard methods recommended by the Fund but rather by an increase in barriers to trade and by a gradual closing of their economies. He would welcome the opinion of the staff on the extent to which present and prospective trends in the world economy might affect the direction of growth in developing countries.

Mr. Erb noted that, as spelled out in the staff paper, the economic problem of the smaller, more open industrial countries was a difficult one. As the discussion of many individual cases in the Executive Board had shown, those countries confronted problems relating to monetary management, the role of exchange rates, and external trade developments, which had a direct and large impact on their economies. It was obviously important for the major industrial countries to achieve the objectives of price stability and of stable growth, and also to maintain more open markets. At the same time, as indicated in the supplementary notes in Appendix A of the draft report on the World Economic Outlook, the same policy mistakes had been made not only in the major industrial countries but in the smaller ones as well. He would cite specifically the rapid growth in government expenditures in most of the smaller industrial countries and the widening of fiscal deficits, which had in many cases had a direct impact on the current account and thus led to the need for external borrowing. The same broad policy advice on fiscal expenditure would therefore also be appropriate for the semi-industrialized countries.

As for the issues affecting developing countries, Mr. Erb continued, the draft Occasional Paper on the implications for them of sluggish industrial country growth was a useful supplement to the sections in the draft report on the World Economic Outlook covering developing countries. Again, the experience of those countries was diverse, and it was hard to make specific policy recommendations; however, some observations could certainly be made with respect to inflation. In the past, external developments had exacerbated the inflationary problems of developing countries, including higher rates of inflation in the industrial countries as well as the oil price increase. But, as had been pointed out in the draft Occasional Paper, similar problems with inflation also stemmed from a lack of control over domestic expenditure and monetary policies.

In a world of sharply fluctuating exchange rates, especially among the major currency countries, the exchange rate policies of developing countries were certainly complicated, Mr. Erb noted. That was why he believed that the objective of price stability was so critical for those countries. He had of course to admit that more than a few cases had been discussed in the Executive Board during the previous year of developing countries' having maintained rigid effective exchange rates, which had reduced the competitiveness of their exports and also of their internal markets vis-à-vis imports. On the other hand, countries following a more flexible exchange rate policy had been faced with the problem of deciding how flexible their rates should be.

As for trade, it was indeed necessary to keep pressure on the industrial countries to maintain and to increase the openness of their trading markets, Mr. Erb said. Yet developing countries also needed to be more aggressive in opening up their own markets, not only to imports from the industrial countries but also to imports from one another. Studies had indicated that there were significant potential gains to be had from more open trading relationships among the developing countries.

On debt management, Mr. Erb continued, high real interest rates were of course hurting developing countries, especially those with large external debts and that had borrowed in the past at commercial rates. The current high level of real interest rates was however a transitory development; rates would be falling, but the negative real interest rates of the middle and later 1970s were not likely to return, a factor that developing countries would have to take into account in their debt management policies during the 1980s.

Without going into the details of specific forecasts, Mr. Erb remarked that the view of his authorities on real economic growth over the coming year was more optimistic than that of the staff. The U.S. forecast of the OPEC current account position was significantly different from that of the Fund, being closer to one of balance compared with the Fund's forecast of a surplus of $25 billion. The outcome remained to be seen, but the likelihood was that OPEC countries would have a much smaller current account surplus. As to the large total of the residual in Table 7 of ID/82/1, which was forecast to reach $61 billion in 1982, his authorities estimated that, if account was taken of the normal deficits of nonmember countries, the figure would be as much as $71 million. It was not so much the level but the significant increase of that residual in the past two years that raised questions about the underlying forecasts. Perhaps the statistical methods used understated surpluses for some countries or overstated deficits for others because of unrecorded transactions.

Returning to the points that had been raised during the discussion on the World Economic Outlook in the previous meetings, Mr. Erb said that, in looking to the summing up that would be made of the entire discussion, he had been trying to arrive at something that would be useful for his own authorities. So far, there was clearly a general consensus that on fiscal policy--and most people in the U.S. Administration and Congress would agree--the United States needed to control its expenditure growth and, if need be, to bring revenues in line with expenditures, thus reducing the fiscal deficit. As he had already stated, it was important to concentrate on the longer-term fiscal deficit and not on the one for the current year or even for the year ahead.

On monetary policies, a number of issues had been raised that it was difficult to go into in any depth, Mr. Erb considered. He agreed with those who had said that, given the importance of the policy of controlling monetary aggregates, not only in the United States but in other countries, there was a need continually to decide whether or not a policy was working and was appropriate. Some concern had been expressed that the demand for money might be more volatile than it was thought to be, or that it might shift. Obviously, such developments had to be taken into account. In an open world, even in one where there were clearly extensive financial linkages between the United States and other countries, those who had worked on money demand functions would argue that there had not been significant increases in the volatility of those functions. There had been shifts over time, but they had been gradual. As he had indicated at the previous meetings, in setting monetary targets over the coming year or two, the Federal Reserve would have to be aware of possible shifts in the demand for money. He agreed with Mr. Sigurdsson that the analysis in DM/81/61 deserved further consideration, but, in raising the issue with economists on the Fund staff, he had found that line of approach to be less attractive than he would personally have thought.

As for the points that had been made about the fluctuations in U.S. monetary policy and the excessive preoccupation with what had been termed during the discussion "short-term movements in money aggregates," Mr. Erb considered that the best way to deal with the issue in future would be for those who were concerned to raise it in the Executive Board. As he looked back over the previous year, the markets had reacted most noticeably to weekly movements in the money aggregates during periods when the growth of money had been off the target path for some time. They had done so particularly toward the end of the summer of 1981 when there had been more than three months of no growth in the monetary aggregates, and they had done so again in late December and in January 1982, two months of extraordinarily sharp growth in the money aggregates. Yet the huge increase in the money supply on Friday, April 23, 1982 of almost $7 billion had passed almost unnoticed by the markets; if it had occurred after two months of rapid monetary growth, attention would obviously have been paid to it. Indeed, there was a strong case for paying attention, as the Federal Reserve had in the summer of 1981, to the departure of monetary growth from the target path.

Similarly, steps had been taken in February to bring the growth of the money supply down from a level significantly above the target range, Mr. Erb commented. If he had understood them correctly, the implication of some comments made during the discussion at the previous meeting had been that the Federal Reserve should have allowed the growth of monetary aggregates to continue at that time. But the U.S. authorities would then have been faced with a severe credibility gap; even nonmonetarists would have seen severe implications if the strong rate of growth of money aggregates experienced in the early part of 1982 had been allowed to continue.

As it was, the Federal Reserve had taken a historic decision, with the economy in a state of recession, to reduce the chances of repeating the experience of late 1980 and early 1981. At that time, the perception had been that the economy was in a deep recession and that a strong rise in the growth of money had been accepted for too long, thereby feeding inflationary expectations, and probably also the more rapid growth in the U.S. economy, leading to the sharp rise and oscillations in interest rates.

As for incomes policies, Mr. Erb said that he could agree with those who had mentioned at EBM/82/51 that it might be useful to focus on possible steps to remove the inflationary factors built into price-setting and wage-setting procedures, mainly in the form of automatic indexing schemes, whether related to wages, social security, or other variables. More generally, attempts to apply wage and price controls could inhibit the kind of structural adjustment that was in fact taking place and needed to take place, not only for the industrial countries themselves but, perhaps even more important, for the developing countries in need of more open markets.

The Fund had a critical role to play in policy direction and cooperation, Mr. Erb commented. It had a long way to go in building on the surveillance and Article IV consultation process and the World Economic Outlook exercise, to lay a better basis for economic cooperation. At a minimum, an improved understanding of the views and policy interactions among the major currency countries was called for. For example, he was not sure what advice was being given specifically on intervention policy and on monetary policy during the previous two meetings, when different views had been expressed about the primary focus of policy or about appropriate policy shifts in the United States.

Taking up the financing role of the Fund, Mr. Erb remarked that the Fund had traditionally played an important role in the system as a source of temporary balance of payments financing for individual countries and thereby for the system as a whole. There had been periods in which the Fund's lending activities had increased significantly in response to large balance of payments shifts; there had also been periods in which lending activities had ebbed as abnormal imbalances had receded. Over the previous two years, the need for Fund financing had been large, given the balance of payments adjustments that had to take place, and the need might continue to be so for the coming year or two. Even though his authorities were more optimistic about the current account positions of countries, including OPEC and developed country members, the decline in the OPEC surplus might itself lead to adjustment requirements to which the Fund would need to remain alert and responsive. It was after all in accordance with his authorities' concept of the financial role of the Fund for the institution to be most active in helping countries to adjust during sudden periods of rapid increases or declines in the balance of payments surpluses and deficits of large groups of members.

Referring specifically to the sections of Chapter 2 of the General Survey on the role of the Fund, Mr. Erb stated that he would prefer to see a significant revision of pages 81-83, or even a shortening of the section. He felt that some important issues that would have to be discussed further and resolved in the context of the Eighth Quota Review had been prejudged in those pages.

Finally, it seemed to him, Mr. Erb added, that the section on Fund surveillance was misleading in noting that there was an asymmetry between the Fund's surveillance process and its lending process, and suggesting that there should be more symmetry of treatment of members subject to surveillance and members using the Fund's resources. The surveillance process involved, and should involve, all member countries, industrialized or developing. The Fund's surveillance responsibility was in many ways quite distinct from its role as a source of balance of payments financing. Clearly, any country borrowing from the Fund--an industrial country or a developing country--would be subject to Fund conditionality. It would feed a misconception to suggest that the surveillance process should be made symmetrical in the sense that somehow the conditions applying to use of the Fund's resources would be applicable under the surveillance process.

Mr. Buira commented that the world economic situation had not improved since it had last been discussed in the Executive Board. The three major problems that dominated the world economy continued to be inflation, stagnation of economic growth, and large imbalances on current account, although there had been some shift in their relative importance. Furthermore, several other problems had become more acute, such as those related to the stagnation of world trade, high and rising rates of unemployment, increased protectionist tendencies, the high level of interest rates, and the volatility of interest and exchange rates.

Because Executive Directors in general had touched on those problems in the previous meetings, Mr. Buira recalled, there was no need for him to dwell on developments in 1981 and expected developments for 1982 and 1983. While inflation had abated in the industrial countries and was expected to abate slightly in 1982, the growth of output had continued to fall, and the decline had become the predominant problem for both the present and for the next few years. Indeed, real GNP growth in 1982 would fall below the depressed rates of the previous two years in the industrial countries, while it would only recover slightly from the also depressed rates of the previous year in the non-oil developing countries. That situation had strained national economic situations and complicated economic management, and had brought hardship to a large number of member countries, especially those belonging to the non-oil developing group.

In the external sector, Mr. Buira continued, the situation was somewhat more ambiguous. Whereas the major industrial countries had showed a marked improvement in current account balances during 1981, and the oil exporting countries a concomitant reduction in their surpluses, the non-oil developing countries, as a group, had recorded no improvement. The combined deficit of the latter was expected to remain at about $100 billion in 1982 and 1983, compared to a deficit of about $40 billion in 1978. Of course, the large residual factor gave rise to further questions as to whether or not there had actually been a deterioration.

The picture of the world economy was obviously worrisome, Mr. Buira added, especially for the developing countries. For them, the situation was particularly serious, and the medium-term scenarios presented by the staff did not afford significant cause for encouragement. Even in the best of circumstances, the largest group of countries in the world was seen to be suffering from a protracted period of depressed economic activity in the medium term, with only slight improvements from one year to the next. For all countries, the scenarios--even under the best of circumstances--showed no marked improvement that would restore in the relatively short term the rates of economic growth experienced on average over the previous decade.

To a great extent, the current and prospective situation of oil importing developing countries was a consequence of the unfavorable external environment that had accompanied the increasingly restrictive financial policies adopted by the major industrial countries, Mr. Buira observed. That was clearly brought out in the staff's statement in the General Survey that "for nearly ten years now, non-oil developing countries have faced an unfavorable external environment. This environment was particularly unfavorable in 1980 and 1981, as a result of the 1979-80 increase in oil prices, the recession in the industrial world, and the increase in nominal and real interest rates." The position was worsened by protectionism against both labor-intensive manufactured goods--the Multifiber Arrangement being a definite example--and imports of agricultural products.

But the statement in the General Survey should not be interpreted as an assertion that internal domestic policies were in no need of corrective adjustment in all or most non-oil developing countries, Mr. Buira continued. Clearly, inappropriate policies were being followed in many countries. It was equally clear, however, that the external environment was playing a major, if not the most important, role in the deterioration of the oil importing countries' overall economic situation, and especially in the deterioration of their external sectors. In any event, those countries had undergone a significant adjustment in the past two years, albeit one that had virtually been forced on some of them by economic realities and limitations on their access to financing. Imports in real terms had declined significantly. The rates of monetary expansion, although still somewhat high, had decelerated. Credit to governments had tended to hold steady in nominal terms, and the growth rate in general had declined. Against that background, the terms of trade had deteriorated. Export markets had contracted. Foreign debt had increased markedly, particularly short-term debt, while reserves had either not increased or been drawn down. External debt service had increased noticeably, in face of higher interest rates and shorter maturities, and access to capital markets in general had become more constrained. At the same time, the volatility of interest and exchange rates had made the formulation of economic policy on a consistent basis more difficult.

It should be obvious that economic management in such an environment became difficult and that the scope for national authorities in the formulation of their policies was narrow, Mr. Buira added. Even granting the need for some corrective adjustment in policies, there could be no measurable improvement in the situation of non-oil developing countries, especially oil importing countries, while the present international environment endured and while restrictive policies remained in place in major industrial countries. The need for an improved policy mix in a number of countries had been discussed in the previous meetings, and the situation of the developing countries made such a change particularly urgent.

It had become evident, in the present difficult circumstances, that international economic cooperation had an important role to play, Mr. Buira declared. That meant that each country should not only take into account the impact on others of its economic policies but also seek to avoid such measures as might make for greater difficulties for others. A case in point was the issue of high interest rates, which had been discussed at the previous meetings; the issue of protectionism would fall under the same heading. There were also a number of other problems, such as the inflation and recession afflicting the world economy, the requirements of the adjustment process in a situation of structural disequilibria, and the various matters relating to recycling and the external indebtedness of LDCs, as well as the issues of liquidity creation and the transfer of resources. The solution of all those problems, among others, called for an increased degree of cooperation, a conclusion that, despite the complexity of the problems, seemed to have emerged clearly in the course of the discussions.

In the past, Mr. Buira recalled, monetary cooperation had made great strides when not only the developing countries but also the industrial countries had been experiencing acute problems. Outstanding examples were the decision to create the special drawing right and to develop it into the principal reserve asset, the establishment of the oil facility, and the creation at the Jamaica meeting of a Trust Fund for the lower-income developing countries hardest hit by oil prices. Indeed, it had been suggested that monetary cooperation flourished only when the major currencies were under pressure. The re-establishment of the health of the international economy and the restoration of growth and hope to much of the developing world could not be accomplished without the collaboration of all. Although national efforts had been primarily responsible for the economic progress achieved over the previous 35 years or so, much of that unprecedented progress would not have been possible without the increase in cooperation that had taken place among nations. Unfortunately, as a result of a number of factors--some economic, others political--the will to cooperate seemed to have diminished at precisely the time when the need for it had grown. Although all countries were facing serious difficulties, for which there were neither easy nor in some cases apparent solutions, there was a danger of weakening and eroding the machinery for economic cooperation that had been laboriously constructed over the previous decade.

Since the mid-1970s, Mr. Buira pointed out, most efforts at international economic cooperation had largely proved to be failures. He recalled the disappointment felt after long days, and occasional nights, spent fruitlessly at the Conference on International Economic Cooperation in Paris; the dismay at the virtual dismissal of a number of eminently sensible recommendations and proposals made by both the Brandt Commission and the Group of Twenty-Four; the fruitless protracted procedural discussions on North-South issues within the United Nations and UNCTAD; and the limbo to which unique efforts such as the Cancun Summit had been condemned.

It was apparent from the figures on the flow of resources on concessional terms, Mr. Buira stated, that after two decades of lip service, the industrial countries were no more than half way to meeting the UN target of 0.7 per cent of GNP for official development assistance. The regional banks and the World Bank were finding it increasingly difficult to sustain the level of their operations at programmed levels. The International Development Association had had to reduce its commitment authority for 1982 by 37 per cent and face a further reduction in commitment authority for FY 1983.

The role of the Fund itself was being increasingly questioned, Mr. Buira remarked. The hardening of conditionality threatened to make much of its current lending inactive in practice; the desire to limit the Fund's size, both by limiting quota subscriptions and by refusing to allow the institution to borrow more resources, threatened to diminish its future role. In addition, there was the apparent abandonment by several large countries of the SDR and its role as the principal reserve asset.

It all added up to a grim picture, Mr. Buira considered. He would feel a considerable loss if some existing institutions, imperfect as they might be, were further emaciated at a time when circumstances would give them a larger role to play. That should not be allowed. It was in the interests of all to approach international economic relations on a footing of reason that favored the necessary adjustments and adaptations without unnecessary hardship, without compounding the social strains to which most countries were currently subject, and without adding to the recessionary forces at large in the world economy.

Mr. Laske noted that he had already touched explicitly or implicitly on some of the issues being discussed at the present meeting. He would add, first, that he was in full agreement with the staff that Scenario A was the most realistic and desirable one. Under that scenario, the world economy would conquer in due course both inflation and underemployment, and that victory would in turn promise an early return to more satisfactory rates of growth as well as to reduced imbalances in the international payments pattern. It was the scenario that would also allow the Fund to perform its traditional role as a monetary institution providing temporary financial assistance to member countries that found themselves in balance of payments difficulties.

Nevertheless, Mr. Laske mentioned, he had had considerable difficulties with the description of the role of the Fund in Chapter 2 of the draft report on the World Economic Outlook. He recalled that when the Committee of the Whole had discussed the size of the Fund on April 9, 1982, he had explained how his authorities perceived the future functions of the Fund, a perception that differed from the presentation on pages 82 and 83 of the draft General Survey. The discussion of the Eighth Quota Review, which was in full progress and on which Ministers could be expected to make substantive observations at the Helsinki meeting of the Interim Committee, should not be dealt with at such length and in such depth in the report on the World Economic Outlook. Therefore, he would join Mr. Erb in proposing that the text from page 81 to the top of page 83 be redrafted in such a way that it did not prejudge what the Board of Governors might eventually resolve with respect to the Eighth Review of Quotas and the future role of the Fund.

Returning to the scenarios presented in the draft report, Mr. Laske remarked that unfortunately the world economy had not yet fully turned the corner onto the road of Scenario A. There was still a danger that, under the impression of widespread underutilization of capacity, authorities would no longer be able to resist the pressures or the temptation to resort to premature stimulatory measures, which might even be implemented in such a way that the gains made in adjustment over the previous 12 to 18 months were given away. There was a continuing and urgent need for countries to maintain their resolve to pursue cautious demand management policies, to further contain inflationary pressures, to establish realistic exchange and interest rates, and to remove structural rigidities that had built up over the previous two decades. Such a course of action was a necessity for both industrialized and developing countries, including not only the major industrial but also the smaller industrial countries. He strongly endorsed the staff's statement that "policies did matter" and that the developing countries could contribute significantly to the success of their adjustment process by following appropriate policies in the areas that he had mentioned.

The staff projections showed that the deficits of the non-oil developing countries would continue to be rather large, Mr. Laske continued. Such a view was not altogether surprising, since the task of adjusting their economies to significantly changed circumstances could not be accomplished in the very short term. It was however of some comfort to note that the non-oil developing countries would also benefit from the rapid decline in the huge surpluses that the oil producing countries had registered over the previous two to three years, which in itself was an indication that the global adjustment process was working, although may be not at the desired speed. Particularly noteworthy was the increased potential for self-propelled growth that the exporters of manufactures among the developing countries had gained with the diversification of their economies. It seemed clear that adjustment efforts of the right sort could improve the situation of developing countries. But for a large number of countries in the developing world, especially for those producing primary products, cyclical developments in industrial countries continued to be highly important. Developing country producers of manufactures, as well as of primary products, depended heavily on the maintenance of free trade.

His authorities fully supported the Fund's commitment to a free trading environment, Mr. Laske concluded. The intensification of protection would be a serious obstacle to a revival of the world economy; its global disadvantages would far outweigh the partial gains for certain industries or for certain countries. It went without saying that his authorities also supported the notion of close international cooperation, which should stretch beyond the provision of financial assistance, and beyond the transfer of real resources, to center on the convergence and coordination of economic policies, with the objective of regaining growth and of restoring and maintaining financial stability in the world.

Mr. Taylor remarked that priority should continue to be given to combating inflation not only in the industrial countries but also in the developing and oil exporting countries. The dangers of relaxing a firm commitment to counterinflationary policies at the present stage were well illustrated in the staff's medium-term scenario analysis. Even allowing for the inevitable imprecision and the arbitrariness of scenario projections, Scenario B gave a fair illustration of the disturbing consequences--especially for GNP growth and unemployment--of failing to reduce inflationary expectations rapidly enough. But it had to be recognized that the fight against inflation was not an end in itself. A deceleration in inflation on a global basis was an essential foundation for sustained growth, and there was no real distinction between industrialized and developing countries; indeed, they had a strong mutuality of interest. Although counterinflationary policies should be applied with as much sensitivity as possible, especially in the poorer countries whose citizens were least able to absorb the costs of adjustment, a reduction in inflation and inflationary expectations was necessary for all countries if a firm basis for sustainable growth was to be established.

On the situation of the developing countries, Mr. Taylor continued, his authorities were in broad agreement with the staff's reassessment of the outlook for them in the light of the recent major weakening of oil prices. Perhaps the most notable feature to emerge from the staff's projections was the large fall in the current account surplus of the oil exporting countries, combined with the broadly unchanged deficit for the non-oil developing countries. He wondered whether or not the staff had given any specific consideration to the likely implications of that shift on the composition of capital flows and the role of international bank lending and recycling. As the United Kingdom had become a fairly substantial oil exporter--somewhat on the same scale as Mexico--he had noted with great interest Mr. Finaish's perceptive thoughts on the reasons for the softening of the world oil market. Recent developments in that market might not be as temporary a phenomenon as had been thought, and it might be worth looking into the matter in a separate study. For example, Iran and Iraq would presumably once again become major oil exporters. It would be interesting to see a simulation of the consequences of different assumptions for oil prices, if the exercise was technically feasible. The medium-term projections were surely based to some extent on an econometric apparatus, and he had therefore wondered whether the staff could run such an alternative projection.

Reverting to the puzzling question of the residual item in the balance of payments, Mr. Taylor mentioned that the figure of $61 billion for 1982 was no doubt largely a forecast, rather than a product of the statistics that were already emerging. For that reason, he asked whether the figure was in fact not so much a reflection of statistical discrepancies as of a major inconsistency in the forecast itself.

The reduction and possible eventual disappearance of the aggregate current account surplus of the oil exporting countries, Mr. Taylor went on, would bring the task of adjustment to the forefront. Corrective action might prove especially difficult after so many years of oil surpluses. But to delay adjustment, should it prove necessary, would intensify and deepen economic imbalances still further. However, as Mr. Yasseri had observed, where corrective measures were needed, they should be oriented so as not to interfere with the needed development and diversification efforts taking place in oil exporting countries.

On a related point, Mr. Taylor noted, the energy situation could tighten considerably in the later 1980s, according to the staff, as energy demand picked up in the developing countries and as economic growth was revived in the industrial countries and elsewhere. Consequently, despite the severe weakening in the oil market, domestic energy prices should continue to reflect underlying trends to ensure that consumers and investors were given the correct signals about the true cost of the resources that they were using. It would also be important to prevent a reversal of the progress made toward the conservation of energy and greater efficiency in the use of energy. The time might be right for countries that had hitherto held back from passing on the full price of petroleum products to consumers, for fear of the inflationary effects, to correct troublesome fiscal deficits while offsetting weaker prices in the energy sphere.

The divergencies in the experience and prospects for non-oil developing countries, as they emerged in Chapter V of the draft report, were quite striking, Mr. Taylor commented. In passing, he wondered whether the system of classifying developing countries had become a little outdated. Reference had been made to that point with respect to oil producing developing countries that were not major oil exporters; in the interests of clearer exposition, at least some net oil exporters might be included with the major oil exporters. In addition, it seemed possible that the experience of the relatively important manufacturing exporters among developing countries might be aligning them more with industrializing countries than with primary producers. He recognized that there was a lot to be said for maintaining a consistent categorization over time for comparative purposes, but equally there was a danger of obscuring important trends. The general issue of the classification of individual countries for statistical purposes might be reviewed.

The staff had rightly drawn attention to the severe structural and financing difficulties faced by the non-oil developing countries, Mr. Taylor said, and their prospects certainly did give serious cause for concern. They had faced an unfavorable external environment in recent years, reflecting the combination of rising oil prices, sluggish growth in developing and developed countries, and high real interest rates. In Chapter II of the draft report on the World Economic Outlook, a compelling case had been made for the maintenance of appropriate financial policies among the non-oil developing countries, for realistic exchange rates, and for the removal of rigidities resulting from price controls and subsidies. It was therefore of some concern to him that in the staff's judgment a significant proportion of the non-oil developing countries continued to pursue what were termed unduly expansionary financial policies. It seemed crucial for those countries to do all that they could, within the constraints facing them, to tighten demand management, to implement appropriate structural adjustment, and to seek to create an environment conducive to international direct investment. Direct investment had, in the past, been a major and effective vehicle for spreading enterprise capital and managerial skills, together with the industrial technology that many of those countries badly needed. There was thus a case for some of them to review their policies on investment by multinational corporations.

As for the role of international cooperation, Mr. Taylor observed, an important conclusion of the staff's analysis was the strong common interest between the developing and the industrial countries in fighting inflation and establishing a firm basis for sustained growth. His authorities fully shared the concern of the staff and of a number of Executive Directors about the gradual spread and intensification of protectionist measures. An indication of the outward-looking attitude of the U.K. authorities on the general question of international trade and payments restrictions was the general dismantling over the past few years of exchange controls on capital movements, which had generated a large capital outflow.

Cooperation would play a key role in financing deficits of non-oil developing countries and encouraging the flow of private capital, Mr. Taylor added. Industrialized countries would of course have to provide access to their capital markets, and recipient countries would need to try to establish a climate conducive to inward investment. As the staff had indicated, private international bank lending would continue to play an important role in financing external deficits. Although he did not disagree with the staff's guarded optimism about the continued availability of funds from international banks, there had been one or two recent indications of strain with respect to particular regions and particular countries. Private banks might possibly become somewhat more discriminating than they had been in the past as their exposure to problem areas increased. Clearly there was a need for strong and determined domestic adjustment measures in those parts of the world where international banks seemed to be encountering doubts and difficulties.

His authorities supported the view that the Fund, along with other multilateral agencies, had an important role to play in international cooperation, Mr. Taylor stated. Developing countries, and indeed industrial countries, experiencing financial strains should be urged to come to the Fund at an early stage and, where appropriate, to take advantage of the enlarged access policy. Equally, it was important that the Fund should continue to require significant adjustment policies in order to maintain the credibility of the programs that it supported. Only in that way would Fund approval elicit the additional commercial financing for members that might otherwise be unable to continue to borrow.

The Fund had a special and possibly unique role to play in the complex of relationships among borrower, creditors, and international aid donors, in what he hoped would be the rare situations in which Fund members ran into acute problems of external financing and debt rescheduling, Mr. Taylor observed. Unfortunately, that role might grow somewhat in importance, and the time was approaching for more consideration to be given to the practices and the procedures that the Fund should follow in attempting to cope with those difficult situations.

Finally, Mr. Taylor remarked, his chair supported the comments made by Mr. Erb and Mr. Laske on the section on the size of the Fund in Chapter II of the draft World Economic Outlook report. In the circumstances, and given the nature of the report, the relevant passages might be shortened.

The Executive Directors agreed to resume their discussion of the World Economic Outlook in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/51 (4/19/82) and EBM/82/52 (4/21/82).

2. KOREA - TECHNICAL ASSISTANCE

In response to a request from the Government of Korea for technical assistance, the Executive Board approves the proposal set forth in EBD/82/91 (4/15/82).

Adopted April 20, 1982

3. MALAYSIA - TECHNICAL ASSISTANCE

In response to a request from the Government of Malaysia for technical assistance, the Executive Board approves the proposal set forth in EBD/82/90 (4/15/82).

Adopted April 20, 1982

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/82/143 (4/16/82) and EBAP/82/144 (4/20/82), and by secretarial assistants to Executive Directors as set forth in EBAP/82/97, Supplement 1 (4/15/82), is approved.

APPROVED: September 29, 1982

LEO VAN HOUTVEN
Secretary