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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/56

10:00 a.m., April 23, 1982

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

Executive Directors	Alternate Executive Directors
M. Abdollahi	
	C. Taylor
	J. L. Feito, Temporary
	H. G. Schneider
	A. Le Lorier
R. D. Erb	
	T. Alhaimus
T. Hirao	T. Yamashita
	R. T. Salazar
R. K. Joyce	
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
	F. Sangare
G. Laske	G. Winkelmann
G. Lovato	
	C. Bouchard, Temporary
	C. J. Batliwalla, Temporary
	S. El-Khouri
J. J. Polak	
	C. N. Pinfield, Temporary
	S.-W. Kwon, Temporary
	L. Vidvei
	Tai Q.

L. Van Houtven, Secretary
M. P. Blackwell, Assistant

Also Present

H. Barber, Financial Secretary, Ministry of Finance of Jamaica. Exchange and Trade Relations Department: C. D. Finch, Director; S. Mookerjee, Deputy Director; H. W. Gerhard, M. Guitian, E. R. J. Kalter. External Relations Department: H. P. G. Handy, H. Puentes. Legal Department G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel. W. E. Holder, S. A. Silard. Middle Eastern Department: H. E. Jakubiak. Research Department: R. R. Rhomberg, Deputy Director; N. M. Kaibni. Treasurer's Department: D. Williams, Deputy Treasurer; D. Berthet, K. Boese, D. S. Cutler, H. Flinch, D. Gupta, Q. M. Hafiz, A. W. Lake, O. Roncesvalles, T. M. Tran, G. Wittich, P. K. Woolley, B. B. Zavoico. Western Hemisphere Department: E. W. Robichek, Director; S. T. Beza, Deputy Director; C. E. Sansón, Deputy Director; E. O. Bell, H. Bierman, C. S. Lee, L. M. Valdivieso, J. F. van Houten, E. V. Zayas. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, M. A. Janjua, K. V. Jännäri, G. Jauregui, P. D. Peroz, F. A. Tourreilles, F. Yeo T. Y. Assistants to Executive Directors: E. M. Ainley, T. A. Connors, R. J. J. Costa, M. K. Diallo, A. Halevi, J. S. Mair, M. Michelangeli, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, D. Pritchett, J. Reddy, D. I. S. Shaw, H. Suzuki, O. Üçer, J. F. Williams, A. Yasseri, A. A. Yousef.

1. JAMAICA - CONSULTATION UNDER EXTENDED ARRANGEMENT

The Executive Directors considered a staff paper on a consultation under the extended arrangement for Jamaica (EBS/82/50, 3/29/82; Cor. 1, 4/5/82; and Cor. 2, 4/16/82). Mr. Horace Barber, Financial Secretary in the Ministry of Finance of Jamaica, was present for the discussion.

The staff representative from the Western Hemisphere Department stated that on March 31, 1982, before making any adjustments for shortfalls in foreign aid disbursements, Jamaica had been in compliance with all the performance criteria established for 1981/82 in the extended arrangement. All remaining arrears on payments and transfers for current international transactions had been paid off well ahead of December 31, 1982, the scheduled date for their elimination. The balance of payments for 1981/82 had registered a surplus of $43 million compared to an estimated surplus of $9 million, to which reference had been made in EBS/82/50. The improvement in the balance of payments stemmed from a better than expected export performance and a slightly lower than expected import level. The surplus of $43 million represented a strong turnaround in the overall balance of payments from the $150 million deficit registered in 1980/81.

The latest information on the rate of inflation, as measured by changes in the consumer price index, indicated that in the 12-month period ended February 1982 the rate of price increase had been 6 per cent, compared with 21 per cent for a similar period ended February 1981, the staff representative continued. Data for 1981/82 indicated that the improvement in the operations of the Central Government had been somewhat greater than had previously been reflected in the staff paper. Both the overall deficit and the deficit on current operations were now expected to be somewhat smaller than previously indicated. On March 23, 1982, the Jamaican authorities had announced that 50 per cent of the specific consumption duties on spirits, beer, and cigarettes, and 100 per cent of the duty on gasoline and diesel oil had been converted to an ad valorem rate. The authorities had earlier indicated that such a change would be made before the Executive Board discussion of the second year of the extended arrangement.

Mr. Joyce made the following statement:

> Jamaica's performance under the first year of the program was in many ways encouraging. My authorities plan to build on the successes already achieved in the first year. The Government attaches particular importance to fostering economic conditions and a regulatory and fiscal climate that will encourage additional private investment, and hence the program continues to rely heavily on private market forces and on the private sector. My authorities believe that this is the best way to achieve higher growth in output and employment on a sustainable basis. They plan to take further steps in the coming year to reinforce current fiscal and monetary policies, to improve the country's infrastructure and production base, and to provide greater investment opportunities for private entrepreneurs.

Directors now have before them the results of the consultation under the extended arrangement, together with the letter of intent and the economic policy memorandum setting out the Government's policies for the fiscal year 1982/83. Under these proposals Jamaica will--subject to meeting certain performance criteria--be entitled to purchase an additional SDR 149.8 million during the coming year for a total purchase of SDR 328 million in the first two years of the program.

Performance in 1981/82

I am happy to say that Jamaica made substantial progress toward achieving the objectives of the medium-term program in 1981/82. As is clear from the staff papers, economic growth resumed, inflation was brought down to less than 10 per cent compared with 28 per cent in FY 1980/81, and the overall balance of payments was brought into surplus. These developments permitted a reduction in arrears in external payments as well as some rebuilding of international reserves. Indeed, I have now been informed by my authorities that arrears were in fact eliminated as of March 31, 1982. Finally, all performance criteria under the program were met last year.

These are heartening developments, particularly in contrast to the fall in output in the previous seven years. My authorities feel that the Jamaican economy is clearly coming back on track and that the strategy and policies being pursued are bearing fruit.

There have of course been some disappointments. Growth in GDP in 1981/82 at 2 per cent was lower than originally targeted. This was principally because of softer export markets, particularly for bauxite and alumina, but it also reflected the fact that rehabilitation measures in some of the traditional agricultural export sectors did not take hold as rapidly as anticipated, as well as the impact of strikes in both the sugar and aluminum sectors.

The weakness of export markets, coupled with the high level of imports associated with restocking, also resulted in a larger current account deficit than targeted. According to the staff papers, the current account deficit in FY 1981/82 is estimated to have reached $505 million, or double that of FY 1980/81.

The current account deficit was more than offset by higher net capital inflows on both public and private account. The dramatic improvement in private capital flows, which were considerably stronger than originally estimated, led to a sizable net capital inflow, compared with the large private capital outflows before the program started. These movements were associated with increased use of the informal exchange market and, in the view of my authorities, demonstrate the renewed confidence in Jamaica's economic future. Use of the informal market to assist in trade financing was also facilitated by greater flexibility in the issuance of "no funds" import licences.

The staff papers indicate that the overall balance of payments surplus in 1981/82 was $9 million. I am now advised by my authorities that in fact the surplus last year may have been close to the originally projected figure of $40 million.

There were other promising developments in 1981/82. Wage increases were cut in half, and average wage settlements were not far out of line with rates of inflation.

There was also strong growth in output in construction, in agriculture for domestic consumption, and in certain manufacturing industries. Considerable success was also achieved in rebuilding tourist receipts.

The Government demonstrated during the year its determination to pursue policies aimed at reducing imbalances in the public sector. A significant fiscal adjustment was achieved, with total expenditures being held below targeted levels and the revenue performance in the first year of the program exceeding expectations. The revenue improvement, which occurred despite a fall in bauxite levies, is attributable to a strengthening of the collection machinery and a general tightening up of the tax administration. Both the current account deficit and the overall deficit of the Government in FY 1981/82 are now expected to be substantially lower than in the previous year. In terms of GDP, the improvement is of the order of 2.5 per cent, at least three times better than originally expected under the program. There was a marked reduction in domestic financing, and bank financing of the public sector was well below permitted limits, although net foreign financing of the public sector deficit was less than expected.

The Government made further progress in deregulating prices, reducing subsidies, liberalizing the import regime, and divesting itself of a number of publicly owned properties. Five hotels have now been leased, and two more are under negotiation, two manufacturing enterprises have been sold, and negotiations are proceeding on sales or leases of other properties, including two sugar factories.

In the monetary field, the Bank of Jamaica tightened monetary policy although accommodating the needs of the private sector relating to restocking. Interest rates moved up sharply, with rates on 6-to-12month deposits reaching 10-12.5 per cent by February 1982. Net domestic assets of the Bank were well short of the adjusted program ceiling.

In summary, the policies envisaged under the program have been largely implemented: recovery is now well under way, private capital is flowing into Jamaica, bank lending to the private sector is picking up, and an upswing in private investment is in prospect.

Program for FY 1982/83

The program for the coming year proposes additional fiscal action to reduce the overall government deficit, new limits on the use of domestic credit by the public sector, ceilings on the net domestic assets of the Bank of Jamaica, and balance of payments targets expressed in terms of the net international reserve position of the Bank of Jamaica.

On the fiscal and monetary side, the program calls for a further significant improvement in public sector finances and continued restraint on overall growth in domestic credit while permitting greater access for the private sector to bank financing.

The planned reduction in both the current and overall government budget deficits will result in a cumulative reduction in these deficits as a proportion of GNP of 6 per cent and 4.7 per cent, respectively for the first two years of the program. This major adjustment effort is in line with that originally projected in the extended arrangement and will facilitate achievement of the fiscal targets in the third year of the program. It is to be accomplished in part through further expenditure restraint, including reductions in subsidies and in transfers to local government, a freeze in the number of government employees at 1981 levels, and an improvement in the overall financial position of state enterprises through divestment and more flexible pricing policies. The overall deficit will be reduced to 12.9 per cent of GDP.

It is true, as the staff argues, that the rise in expenditure could be further restrained in the current year if the Government were to pursue a more active policy in manpower reduction through attrition. The Government now in fact is making an audit of posts in various Ministries with a view to accelerating the attrition process. It is the Government's view, however, that further action can only be limited until there is some improvement in the overall unemployment situation, which still remains extremely serious.

My authorities are projecting a 19 per cent increase in tax revenue for 1982/83, partly as a result of improvements in tax collection. The Government has already committed itself to further changes in the fiscal regime. In accordance with its earlier undertaking, it has taken a first step toward replacing specific duties with ad valorem rates. The changes cover four key products--cigarettes, beer, spirits and liquor, and gasoline. The first stage involves 100 per cent conversion of the gasoline tax and 50 per cent of the remainder. Further action will be taken in the light of experience.

On the monetary side, the Bank of Jamaica is expecting a further decline in the velocity of broad money, chiefly because of the move to positive rates of interest and continued increase in public confidence. My authorities intend to continue to let interest rates be determined by market forces. No change is contemplated in the present 40 per cent liquid asset ratio for commercial banks.

The program looks for further improvement in the balance of payments in 1982/83. My authorities believe that the current account deficit can be reduced to 14.2 per cent of GDP, with consequent improvement in the overall balance of payments surplus. Imports are not expected to grow as rapidly as in 1981/82, although higher imports of capital goods are anticipated. The Government is taking steps to encourage exports and stimulate export-oriented industries. No immediate improvement is assumed for exports of bauxite, alumina, bananas, or sugar, although additional investment is planned in these sectors. However, sales of manufactured goods and other nontraditional exports are expected to expand strongly. As a result total exports, which fell in 1981/82, will show some recovery. The authorities also anticipate further increases in tourist revenues. As against this, debt service payments, now equivalent to 20 per cent of export receipts, will also be higher.

On the capital side, Jamaica expects to receive continued large inflows of special balance of payments assistance from other multilateral institutions, bilateral donors, and commercial lenders. These represent new commitments as well as disbursements of commitments made in 1981/82. As part of this process, the authorities plan to borrow $50 million from the commercial banks and have negotiated a deferral on amortization payments due to certain official and commercial creditors. They recognize that Jamaica's public and publicly guaranteed debt is and will remain large for some time and that service of this debt will continue to impose a heavy burden on the country's resources. They are taking steps to limit disbursements on account of external debt. Net private capital inflows are expected to equal those of 1981/82.

My authorities believe that achievement of these objectives will permit a further strengthening of Jamaica's net international reserve position.

The program for 1982/83 anticipates an increase in real GDP of 4-5 per cent, with growth again concentrated in construction and tourism and some further progress in agriculture and manufacturing. This will be accompanied by additional divestment by the Government, further deregulation and liberalization of the economy, as well as expansion of tourism and export-oriented activities.

My authorities agree with the staff's view that the pace of deregulation should be accelerated. The Government is determined to press forward with this process as rapidly as possible. The number of goods subject to specific price controls, as well as those subject to prior notification of price changes, is to be reduced. There will also be substantial further liberalization of import controls, and additional measures are to be considered in September 1982, when current cost studies are completed. Divestment and leasing of government properties is now gaining speed, and discontinuance of the publicly owned Jamaica Omnibus Services in the near future is contemplated. At the same time, the Government plans selective new investments to improve infrastructure, particularly in electricity generation.

Jamaica maintained its competitiveness last year, and the real effective value of the Jamaican dollar did not vary appreciably. It is not anticipated that competitiveness will be eroded in 1982/83, but if this were to happen the authorities would of course wish to review existing exchange rate policies. The Government recognizes that the informal exchange market may not be working as effectively as it might and has undertaken to consider ways of improving its efficiency. Possible changes in present arrangements will be looked at in the context of the mid-year review.

Finally, my authorities are grateful for the understanding and financial assistance provided by the international community. Because of its continued support and the improvement in the key economic and financial policies projected, my authorities believe the targets and objectives of the program for 1982/83 are realistic and attainable, that they will advance the overall adjustment of the Jamaican economy along the lines envisaged in the three-year extended arrangement, and that hence they are worthy of support.

Extending his statement, Mr. Joyce remarked that the Jamaican Prime Minister, in a speech on April 22, 1982, had announced certain additional tax measures; for example, the import tax on automobiles with an engine capacity of less than 2 litres was being reduced from 150 per cent to 75 per cent. As part of the efforts to improve revenue collection and, indeed, the revenue position, the Prime Minister had announced a re-evaluation and reassessment of land with a view to increasing land tax revenues. Finally, a 3 per cent levy was to be applied to the wage bill of employers with a view to financing increased employment and training.

Mr. Erb said that it was clear that the Jamaican economy had performed well during the first year of the extended arrangement. Although the growth performance had not met initial expectations, at least growth had turned positive after several years of declining output. Inflation had fallen below 10 per cent. The current account deficit had turned out to be larger than expected, but that development had been due mainly to an unanticipated slack in world demand for Jamaican exports. In implementing the program, the authorities had performed well and had met all performance criteria. Government fiscal performance had been better than expected, although the remaining imbalances were still rather large. With regard to monetary policy, the authorities had followed the appropriate course in allowing the market to determine virtually all interest rates.

Although the Jamaican economy had performed well in relation to the adjustment objectives set out at the beginning of the extended arrangement, he had some significant concerns about the rate of adjustment over the course of the coming two to three years, Mr. Erb remarked. With the experience of the first year of the arrangement now clear, it was appropriate to question the time frame of adjustment originally envisaged under the program. The Jamaican authorities should seriously consider taking additional measures if the economy was to be restored to a sustainable balance of payments position over the coming few years. Jamaica's current account deficit was large relative to GDP, even taking into consideration any data problems. In 1982/83 the program called for a reduction in the current account deficit in relation to GDP to about 14.2 per cent; while that figure compared favorably to the 1981/82 deficit of 16.5 per cent, it was still quite large.

Jamaica had been been able to finance such a large current account deficit with exceptional assistance from foreign sources in addition to Fund resources, Mr. Erb continued. It was important that measures be taken to ensure that, in the medium term, the current account would reach a sustainable position with more normal financial flows. Could the staff comment on the speed with which Jamaica was approaching a current account position that was likely to be financeable in the medium term? Did the staff think that more measures should be taken to speed the pace of adjustment, even though the possibility of such measures might not have have been apparent at the outset of the arrangement?

He was particularly concerned at the authorities' exchange rate policy, Mr. Erb commented. Could the staff say what additional steps, if any might be needed on the exchange rate side to improve the external competitiveness of the economy, which it had identified as crucial to the adjustment process? Although the real effective exchange rate had depreciated in relation to the high levels of 1978, it was still high in comparison with the effective exchange rates prevailing in 1976/77. While recognizing that the difference was not a perfect indicator of the country's competitive position, it did raise some questions about the appropriateness of the exchange rate. Evidence from the informal exchange market indicated that the official exchange rate was overvalued. In the light of such evidence, and of the staff conclusion that the informal market was operating inefficiently, it would be interesting to know why the staff was waiting for the mid-term review with the authorities to discuss the efficiency of the present exchange system. Perhaps a review could be brought forward, so that any measures that might be necessary could be implemented and thus help to reduce distortions to trade and investment flows.

The fact that the budget deficit as a percentage of GDP would remain large even at the end of the program period gave particular grounds for concern, Mr. Erb observed. The budget deficit had been about 16 per cent of GDP in 1980/81, and although progress had been made in bringing it down, it was likely to remain at about 10 per cent of GDP at the end of the program. That figure might be unacceptably high. Could the staff comment on the implications of a budget deficit of that size for the allocation of domestic credit and for the current account position? In conclusion, Jamaica's economy had performed well under the program thus far. He was concerned, however, that the present rate of adjustment might not bring Jamaica to a sustainable position over the coming two years.

Mr. Taylor indicated his agreement with the staff appraisal and his support for the proposed decision. Following a number of years of economic decline, there were now some encouraging signs that the Jamaican economy was responding to the program supported by the extended arrangement. The authorities deserved commendation for their achievements during 1981/82. Positive real growth had occurred for the first time in seven years, and inflation had decelerated significantly. The fiscal position now seemed firmer; there had been an improvement in the balance of payments, and a substantial reduction in external payments arrears. In addition, the authorities had made good progress in tackling economic rigidities through liberalizing the system of price controls and somewhat simplifying the import licensing system. Such encouraging signs should help to boost international confidence in the economy and perhaps attract much-needed private capital. There had been some slippages in one or two areas, but basically the economic policies had been moving in the right direction. Exports had been noticeably below program projections, however, largely because of production problems in the sugar and bauxite industries. It should not be overlooked either that unemployment had remained high and that the outturn for GDP seemed to have been somewhat below expectations. The authorities, therefore, needed to pursue their policies with continued resolution and energy if economic stability was to be achieved and the heavy dependence on foreign credit was to be reduced.

The broad shape of the second-year program seemed to be appropriate and well designed, Mr. Taylor said. He attached particular importance to the need to continue giving market mechanisms a greater role and to continue reducing the size and the resource claims of the public sector. It would have been useful if the staff paper could have given more details about the process of structural adjustment, which was so important to the medium-term program. Considerable supply and production difficulties had been experienced, and he would have liked to have seen more information on the investment program and, in particular, on the thinking of the World Bank in that area.

The fiscal deficit, equivalent to about 15 per cent of GDP, was uncomfortably high, Mr. Taylor remarked. However, he understood that the outturn for 1981/82 would be better than expected. He agreed with Mr. Erb that further efforts in the fiscal area were needed. He welcomed the efforts that had been made to restrain expenditure, in particular the intention to eliminate budget support for public entities by 1983/84. Some relaxation of the policy of allowing the public sector to act as an employer of last resort would be desirable, particularly in view of the present excessive manpower levels. Did the staff feel that the current system of public expenditure control and planning was adequate?

On the revenue side, Mr. Taylor continued, commendable efforts were being made to improve tax administration and revenue collection. Those efforts should help to enhance tax receipts in 1982/83; he wondered, however, whether additional revenue-raising initiatives might not be necessary to sustain revenues at their projected levels. In any event, he hoped that revenue performance would continue to be closely monitored and that the authorities would be prepared to take swift corrective action if the program's projections were not met. As to monetary policy, he welcomed the commitment to let interest rates be determined by market forces. The policy might mean that interest rates would continue to rise somewhat as economic activity picked up, but restraint on such a rise could lead to resource misallocation and capital outflows.

The performance of the external sector was crucial to Jamaica's success, Mr. Taylor commented. There had to be some uncertainty about the export projections for 1982/83 in view of the continued world recession and of production difficulties seen in some industries over the previous year. Was the staff confident that its projections in that area were still valid? The authorities intended to improve the efficiency of the parallel exchange market at the time of the mid-year review and to eliminate external payments arrears during 1982/83. They would need to ensure that the balance of payments moved into a sustainable position over the course of the coming two years, and success in that area would be dependent on maintaining competitiveness. It was not clear in the staff paper whether the exchange rate would itself be subject to consideration in the mid-year review; some comment from the staff would be welcome.

Miss Le Lorier remarked that it was evident from the staff paper that Jamaica would remain dependent for a number of years on financial assistance from the international community, including the banking institutions. It was most interesting to note, however, that the assistance received by Jamaica during the previous year had been used in a productive manner. As long as the present adjustment efforts were maintained, the objectives set out for the third year of the program should be obtainable. After a protracted period of difficult relations with the Fund and the international community, the stage now seemed set for Jamaica to become another example of success in the same way as Turkey. The adjustment taking place in Jamaica would not have been possible without an adequate level of external financing, particularly the assistance provided by the Fund. Jamaica provided an excellent example of the merits of the Fund's enlarged access policy, at a time when proposals were being considered for a possible reversal of the policy.

Economic performance under the first year of the program had been impressive, with all performance criteria having been met and with progress in some areas having been more rapid than expected, Miss Le Lorier noted. In the fiscal area, current receipts were now estimated to be 8 per cent higher than originally expected, while total expenditures had been kept slightly below the initial objective. As a result, both the current and the overall deficit should be significantly smaller than expected. Success in the fight against inflation had been impressive and the current rate of below 10 per cent was about half the rate projected.

Progress on the external side might at first glance seem less favorable, Miss Le Lorier commented. However, when developments beyond the control of authorities were taken into account, performance had been quite impressive. What had happened to Jamaica's balance of payments clearly illustrated the consequences of the present recession in industrial countries on the export receipts of primary commodity producers, particularly when the degree of dependence on one or two commodities was fairly high. It was significant, for example, that Jamaica's shortfall on bauxite and alumina exports, at $106 million, matched almost exactly the $110 million shortfall in total receipts.

She was not sure that she could agree with the staff statement that "a basic feature of the medium-term program being undertaken by Jamaica is the gradualism of domestic adjustment over time," Miss Le Lorier stated. Surely Jamaica's approach to adjustment was far less gradual than that seen in many other countries. For example, efforts were being made to cut back public finance by an amount equivalent to 4.7 per cent of GDP during the first two years of the program. Like Mr. Erb, she would appreciate some comments from the staff on the relationship between the pace of adjustment and the rate of growth in Jamaica. She had no difficulties in endorsing the main objectives of the second-year program. The level of imports should decline after the initial surge caused by the need for restocking had abated. The projected 11 per cent increase in export value might, however, be more difficult to attain, in view of the present prospects for demand from industrial countries for alumina and bauxite, which accounted for 70 per cent of Jamaica's exports. It was quite probable that the first part of 1982/83 would see a repetition, although perhaps on a more moderate scale, of what had happened during the first year of the program.

Mr. Lovato noted that Jamaica had succeeded in keeping within the ceilings of all the quantitative performance criteria established under the extended arrangement and that the country's economic situation was improving. He could approve the proposed decision.

During the first year of the extended arrangement, the Jamaican authorities had intended to revive an economy that had suffered a long period of stagnation through a program designed not only to moderate domestic demand by reducing the financing requirements of the public sector, but also to assign a greater role to the private sector, Mr. Lovato remarked. The decision to increase current receipts and to curb expenditures while deregulating prices had contributed to the change in the island's business climate, and to the modest but significant improvements in many fields. GDP had grown by about 2 per cent in spite of slack economic conditions in Jamaica's principal trading partners; there had been a marked deceleration in the rate of consumer price increases; and there had been a substantial increase in private sector deposits in the banking system. Restocking had taken place in the private sector; net capital inflows had increased; external payments arrears had been reduced; and there had been a marked improvement in public confidence in the authorities' ability to manage the economy.

Much progress had been made, Mr. Lovato continued, but much still remained to be done. Extended arrangements were supposed to assist countries in making structural improvements. The authorities needed to continue tightening fiscal policies by cutting current transfers and subsidies and by implementing reasonable wage policies and reducing overmanning in the public sector. There should be a shift of expenditure away from the current account to the capital account. The structure of interest rates should be determined by market forces, and efforts should be made to deregulate the economy so as to encourage initiatives in the private sector. By taking such measures and by maintaining a realistic and effective exchange system, competitiveness could be improved and the foundation could be laid for increased exports and a strong improvement in the balance of payments. In view of the uncertainties and difficulties that lay ahead, the authorities would need to observe some flexibility in implementing their medium-term program. While he could agree, therefore, with the flexibility built into the performance criteria, he urged the authorities to make all possible efforts to reach the targets described in the letter of intent.

Mr. Winkelmann noted that substantial progress had already been achieved in Jamaica. The inflation rate had declined sharply from 20 per cent to 6 per cent, and there had been a positive rate of economic growth. There had been some improvement in the balance of payments, with room for guarded optimism about the future. Perhaps the staff could explain its view of the viability of the medium-term balance of payments situation. Foreign assistance over the past year equivalent to $300 million, or about $150 per capita, had done much to help solve the country's difficulties. The authorities had made structural adjustments, and external aid had not been used totally for expanding consumption. Some of it had been used for restocking in an effort to revitalize the economy, some to increase external reserves, and some to repay arrears. All in all, the program for the first year had been realistic, all performance criteria had been met, and recovery was now well under way.

The budget deficit had been reduced substantially over the previous year, Mr. Winkelmann commented. It was to be hoped that with the more vigorous growth rate envisaged for the coming fiscal year, tax revenues would increase more rapidly. Moreover, if expenditure could be tightly controlled, the deficit could perhaps fall rather more rapidly than had been foreseen. By holding down expenditure, the authorities should be able to give a boost to more rapid growth. Some staff comments on the prospects for the budget deficit would be useful.

A public sector wage settlement providing for an increase of 20 per cent over two years had been agreed in June 1981, Mr. Winkelmann observed. Now that the inflation rate had fallen to 6 per cent, that wage settlement would lead to a real increase in wages of about 14 per cent. It would seem that similar real wage increases were being enjoyed by most, as average wage increases were currently about 13 per cent. The public sector had for some time been an employer of last resort, and with the national unemployment rate at about 25 per cent, the authorities would have to approach problems of overmanning in the public sector with some caution. However, caution in that area should be accompanied by caution with regard to wage increases. If wage increases were to continue rising significantly in the public sector, the authorities would have no alternative but to reduce manning levels.

The authorities' monetary policy seemed to be satisfactory, Mr. Winkelmann remarked. Interest rates were at more appropriate levels, and there had been a strong growth of private sector claims on the banking system, which demonstrated a return in confidence in depositing money. As far as he could understand, mortgage rates were still being subsidized. As a consequence, investment in the construction industry had been much stronger than investment in manufacturing. Did the staff feel that capital for investment was being misallocated? Was too much being directed into construction and not enough into the revitalization of manufacturing?

There were two exchange rates in Jamaica, one official and one unofficial, and an increasing amount of trade was being financed at the unofficial rate, Mr. Winkelmann noted. The fact that there was a spread of 20 per cent between the two rates seem to point to some inefficiency in the market. Perhaps more rapid progress should be made toward unifying the two rates and toward creating a freer market, particularly in view of the net capital inflows expected in the coming period. Such a move could facilitate the financing of trade, improve the export performance of nontraditional exports, and attract more tourists. A more stable exchange rate could lead to a greater use of tourist facilities and alleviate some pressure on the current account deficit.

After a long period of decline, the Jamaican economy now seemed to be on the right track, Mr. Winkelmann considered. The movement away from regulation to deregulation, and from state intervention to private sector management could only lead to success in the medium term. The authorities should be encouraged to proceed as rapidly as possible with deregulation, both domestically and with regard to the exchange rate. They should observe more prudence with wage increases in the public sector in order to bring about fast export promotion and a more viable balance of payments. Success in those fields would encourage investment from abroad, which in turn would assist in restructuring and the return of high growth rates.

Mr. Gabriel-Peña indicated his support for the program for the second year of the extended arrangement and his general agreement with the staff appraisal. Jamaica's economic performance was showing hopeful signs of recovery even against the somber background of the present world economic outlook. Although the 2 per cent growth rate achieved had been below target, it had nevertheless represented an important step forward. With the decline in the shipments of bauxite and alumina, which represented about 70 per cent of exports, economic growth had been made possible by an increase in capacity utilization in the agricultural and manufacturing sectors, and by the increase in the tourist trade. The moderate wage settlements in the public and private sectors, the return of confidence in the economy represented by the substantial increase in bank liabilities to the private sector, the important steps taken toward greater import liberalization, the improvement in the overall balance of payments, and the reduction in total expenditure all confirmed that the authorities were committed to maintaining the economy on track and that they would comply with the program laid down for the second year of the extended arrangement.

The inclusion in the program of an automatic adjustment in the case of a shortfall in disbursements of external loans had proved extremely helpful, Mr. Gabriel-Peña remarked. Net domestic financing during 1981/82 had been J$100 million more than programed, without stimulating a rise in inflation or disequilibrium in the fiscal sector. He supported the authorities' efforts to reduce price controls further and to expand the import liberalization process. The forthcoming study on cost structures would be fundamental to that liberalization process.

The adjustment of fiscal policy had been most encouraging, Mr. Gabriel-Peña said. Reducing the fiscal deficit by 4.7 per cent in terms of GDP over the first two years of the arrangement demonstrated the authorities' determination. Their efforts to compress recurrent expenditures further were limited, however, by the large share of interest and wage payments. Important progress had been made in the area of tax collection and compliance, and it had been conservatively estimated that the measures involved would yield an additional revenue of J$80 million in 1982/83.

The decrease in the velocity of broad money was consistent with the strong growth of quasi-money, Mr. Gabriel-Peña commented. The staff had stated that interest rates had become positive in real terms and that they were largely determined by market forces. However, Table 15 on page 39 of the staff paper seemed to indicate that interest rates were still too low, particularly for a developing country, where capital was scarce.

The automatic adjustment of the ceiling relating to foreign loan disbursements should continue in force during the second year of the arrangement, since it gave the authorities more room to maneuver in the adjustment process, Mr. Gabriel-Peña considered. To maintain progress in reversing the balance of payments deficit, the authorities should be willing to use the exchange rate more flexibly. They should avoid any further erosion in the country's competitiveness and should make sure that any gains made by exchange rate adjustment were not offset by substantial wage pressures. In conclusion, Jamaica's program was bringing down inflation through import liberalization and the concomitant effects on wages, through an increase in economic activity as a result of supply side incentives to the private sector, and through reordering fiscal policy. The program was going in the right direction and should be continued.

Mr. Salazar indicated his general agreement with the staff appraisal and his support for the proposed decision. After the first year of implementation of the economic program supported by drawings under the extended Fund facility, it was reassuring that Jamaica's economy was already showing evidence of concrete achievements. GDP had increased in real terms for the first time in seven years, inflation had fallen to near international levels, the balance of payments had achieved a small surplus after large deficits in previous years, arrears had been eliminated, and, more important, the whole economy was in a process of structural change that would allow Jamaica to build a firm foundation for lasting development. Although there had been problems in some areas, the whole program seemed to be well on track. All performance criteria had been observed, and reassurances had been received from the authorities that the program would continue to be fully implemented.

Important advances had been made in the fiscal area, Mr. Salazar remarked. The current account deficit and the overall deficit had both been reduced ahead of the targets of the program because of a better than expected performance of revenue and the maintenance of expenditure below the program limits. He agreed with the staff that further strong efforts would be required in 1982/83 to achieve a deficit consistent with sustainable levels of nonconcessional foreign credits and a moderate reliance on domestic financing. He welcomed the authorities' intentions to implement a set of measures designed to reduce further the public sector deficit, particularly those measures designed to limit the wage bill, to reduce current subsidies and transfers, and to continue strengthening the tax administration.

The overall balance of payments results were close to the program's objectives, despite the below-target performance of exports as a result of weak world demand for bauxite and alumina, Mr. Salazar noted. He had been concerned, however, at the appreciation of the Jamaican dollar during 1980 and the effects that the appreciation might have on the economy's competitiveness. Like the staff, he recommended that the authorities closely monitor the exchange system and make efforts to improve the efficiency of the informal exchange market.

He welcomed the decision of the authorities to free interest rates, Mr. Salazar observed. In Table 15 of EBS/82/50, however, it appeared that the authorities' policies had resulted in no significant changes in nominal interest rates, and that the achievement of positive real rates of interest might be attributable to the sharp reduction in the rate of inflation. Besides, some interest rates were still negative and, in relation to comparable rates abroad, they had lost competitiveness. Perhaps the staff or Mr. Joyce could comment on that point. On a related matter, it appeared from Table 3 that between March 1981 and March 1982 domestic credit to the private sector had increased by over 40 per cent or well above the program target, which had assumed an inflation rate of 18 per cent. He was concerned about the projected expansion for 1982/83; according to Table 7, domestic credit to the private sector was expected to increase by 20 per cent, or by twice the rate of inflation. Had the policy on domestic credit been designed to stimulate domestic activity? If so, what were the risks, taking into consideration the situation of the balance of payments, the appreciation of the Jamaican dollar, and the existence of interest rate differentials against Jamaica? Any comments from the staff would be appreciated.

Mr. El-Khouri commended the Jamaican authorities on their performance thus far under the extended arrangement. The pace of adjustment described in the program was appropriate. In view of Jamaica's progress and the size of the existing imbalances, it was perhaps understandable that the question should be raised as to whether the country's pace of adjustment could not be accelerated further. He was afraid, however, that if the pace of adjustment were made too rapid, the program might well collapse. It should be left to the authorities to determine whether they could take more adjustment measures than described in the program. If they were able to, the support of the international financial community would be even stronger. However, that judgment should be left entirely to the authorities.

The staff representative from the Western Hemisphere Department remarked that the staff believed that the second-year program was appropriately in line with the final objectives of the three-year extended arrangement. Admittedly, at the end of the three-year program further adjustment measures would need to be taken. In fact, the authorities were talking about adjustment measures to be taken over the coming decade. They expected that the period of the extended arrangement would be a first stage in adjustment, and that in subsequent years the country would experience the benefits in terms of exports and tourism growth. They also expected to benefit in the future from the measures being taken to eliminate quantitative import restrictions that had protected domestic industries for over a decade. A relatively gradual adjustment program had been believed appropriate for Jamaica, because of the economic decline that the country had suffered over the previous seven years. At the beginning of the arrangement, the economy had been operating much below capacity, as indicated by an unemployment rate of over 25 per cent. At the conclusion of the extended arrangement, the deficit on the current account of the balance of payments would still be rather large, and the country would require external assistance for several years to come.

He could understand, therefore, why some speakers had called for a more rapid pace of adjustment, the staff representative continued. By the third year of the arrangement, it was hoped that the deficit on the central government budget would have been reduced to 10 per cent. The staff foresaw that the largest share of that 10 per cent deficit would be financed by recourse to inflows from abroad, presumably on concessional terms. If such inflows were not forthcoming at that time, in order to avoid an excessive reliance on domestic financial resources, Jamaica would be forced to make an abrupt and short-term adjustment effort of the type that the staff had tried to avoid at the beginning of the present extended arrangement.

Some speakers considered the expansion of credit to the private sector to have been rather too rapid, the staff representative recalled. It should be pointed out, however, that the change in the Bank of Jamaica's net domestic assets was negative. In the first year, no change had been projected, and the outcome had been a decline. In the program for the second year, the net domestic assets of the Bank of Jamaica were expected to show a sharp decline. In other words, the authorities were following a tight credit policy, which did not mean that credit to the private sector could not expand at a rather rapid rate. The expansion would, however, be related to the willingness of the public to increase its financial holdings in the commercial banks. Such an increase had occurred during the first year of the program, and it had made possible positive real growth in credit to the private sector given the decline in inflation. During the second year of the program, a certain expansion in financial assets held by the public in the commercial banks had been envisaged. If that expansion took place, there would be an expansion of credit to the private sector by the commercial banks. If it did not take place, given the monetary authorities' stance of not giving credit to the commercial banks, credit to the private sector would not expand as projected.

At the beginning of the negotiations on the extended arrangement, there had been considerable discussion about exchange rate policy, the staff representative recalled. There had been some differences of opinion about the viability of the official exchange rate over the medium term, and about its appropriateness for encouraging exports and tourism and, therefore, for improving the balance of payments. It had been the view of the authorities that the official exchange rate would be appropriate over the medium term. They had remarked that the economy had been so much in recession that time would be required to re-establish production and exports. The staff had had some difficulty in going along with that view and had convinced the authorities to allow the parallel market to be used as an indicator of which exchange rate was appropriate. The parallel market had expanded greatly during the first year of the program; however, it was still inefficient and not entirely legal. Although its use was permitted, bona fide intermediaries, such as commercial banks, did not operate in that market.

The staff believed that the market should be legalized so that it could act as an efficient indicator of the trend of the exchange rate, the staff representative continued. The program for the second year called for a review of developments in that area after six months. During that period the authorities were expected to develop measures that would make the market more efficient and to allow it to operate in a way that was deemed suitable. Looking at export performance over the previous year, against the backdrop of a world economic situation in which many countries had found difficulty in selling their products, it was clear that bauxite and alumina had performed badly for reasons that were not directly related to exchange rate considerations. The poor performance of the sugar sector could be explained by a number of social and political problems, and the banana sector had not recuperated as rapidly as had been anticipated from the hurricane damage. On account of the poor performance of traditional exports, total exports had declined by 4 per cent during 1981/82; fortunately, nontraditional exports were expanding strongly. The strength in that area gave some justification to staff estimates of 11 per cent nominal growth in exports over the coming year. The expansion of bauxite and alumina exports was being helped by a special arrangement with the United States for stockpiling. Banana exports should recover, but the sugar sector was likely to remain in some difficulty.

Some Executive Directors had asked whether controls on public sector spending were adequate, the staff representative remarked. The fact that current spending during the first year had been below the level estimated in the program was strong evidence of the efforts being made by the authorities to control public spending. Economic growth in Jamaica was closely connected to the prospects of the export and tourism sectors. For those sectors to succeed would require an improvement in the world economy. It was conceivable that the pace of adjustment could be increased without affecting the pace of growth in the economy.

While it was correct that public sector wages had increased in real terms, such an increase was not uncommon at a period of rapidly declining inflation, the staff representative explained. At the wage negotiations it had not been expected that inflation would come down so rapidly. The decline was not necessarily harmful to the economy, but obviously future wage increases ought to be lower in nominal terms. As to the possibility of a misallocation of financial resources, it had to be acknowledged that the construction sector would expand much more rapidly than the manufacturing sector. However, the construction sector had been declining for most of the past decade; now that financial resources were available, the demand for housing had increased strongly. Manufacturing, on the other hand, was in the process of seeking a reorientation after a decade of high protectionism. It was expected that some parts of the manufacturing sector would pass through a difficult period needing to confront problems posed by high interest rates, and by a number of other factors.

A higher growth rate in the Jamaican economy should help to bring down unemployment from the present level of 25 per cent, the staff representative from the Western Hemisphere Department concluded, although by lowering protection to the manufacturing sector, the authorities might well contribute to increasing unemployment. Similarly, rectifying the financial situation in a number of public sector enterprises might also lead to lost jobs. In other words, some of the authorities' measures would cause more unemployment, while the general growth of the economy should reduce it. The reduction of unemployment in absolute terms would, therefore, be a slow process.

The staff representative from the Exchange and Trade Relations Department, noting the concern of a number of Executive Directors about the relatively large size of the deficit in the current account of the balance of payments, remarked that comparisons of current account deficits, even if scaled in relation to the size of the economy, were not very meaningful across countries or in any one country at different points in time. In Jamaica, at present, there was a considerable inflow of capital on concessional terms. If the Jamaican authorities were successful in establishing a realistic exchange rate, an appropriate price and interest rate structure, and an exchange system free of restrictions, the particular magnitude of the current account deficit would not in itself be a matter of particular concern. Concern could, of course, arise if the current account deficit reflected an imbalance in the government or public sector budget, particularly if there were already difficulties with respect to the size and profile of the external public debt. Jamaica, as a developing country, was a capital importer, and the amortization of external debt did not represent the same type of claim on foreign exchange resources as the interest payments on such a debt; the debt could be expected to continue growing over time, and therefore, in effect, the amortization would be rolled over. The important issue was to ensure that the rate of growth of debt was sustainable, and that interest rate payments did not pre-empt too large a share of foreign exchange receipts.

Mr. Erb said that he could go along with what the staff representative from the Exchange and Trade Relations Department had said. He was concerned, however, as to whether the external financing potentially available to Jamaica was coming into line with the mix of domestic policies, so that by the end of the arrangement the current account would be sustainable.

Mr. Winkelmann asked whether, in view of the authorities' greater than expected success in bringing down the rate of inflation, the two-year wage agreements in the public sector should not be renegotiated. Excessively high real wage increases in the public sector might send an inappropriate signal for the future to other sectors of the economy and slow down the adjustment process. If a similarly high settlement had been reached in the private sector, he could imagine that there would be some pressure from employers to renegotiate wage settlements. It had not been the authorities' intention to grant high real wage increases at the time of the negotiations.

The staff representative from the Western Hemisphere Department recalled that at the time of the negotiations there had been the possibility of agreeing to a three-year wage settlement. Because inflation had been a problem in the past and current rates had then been 20 per cent or higher, it had been considered important to fix public sector wages for a three-year period. Although the authorities had not managed to negotiate a three-year contract, they had felt pleased at their success in negotiating one for two years with a 10 per cent increase in each year. Even though it might be useful to renegotiate that settlement downward, he was not sure that the staff ought to recommend doing so to the authorities. The authorities should, however, indicate to the private sector what levels of wage settlements they would consider reasonable. Normally, the authorities should give an example and set wage increases in the public sector that were in line with the rates of inflation and with productivity growth in the economy.

Mr. Taylor asked whether the staff could say more exactly whether the mid-term review would cover the question of the official exchange rate, and whether agreement on the appropriateness of the official exchange rate would be made a performance criterion.

The staff representative from the Western Hemisphere Department said that the staff intended to bring up the issue of the official exchange rate at the time of the mid-term review. The economy would have picked up more, and data would be available concerning exports and tourism for a further six to eight months. With such additional information, it would be easier for the staff to resolve with the authorities questions relating to the appropriateness of the exchange rate. However, no firm performance criterion relating to the exchange rate would be set for the mid-term review. The Jamaican economy would still be operating well below capacity; in other words, the growth of exports and tourism would probably still be well below the level at which the appropriateness of the exchange rate could be judged.

The staff would, however, seek an understanding from the authorities that they considered the parallel market rate as an indicator over the medium term of what the official rate should be, the staff representative from the Western Hemisphere Department commented. The staff would also expect that some action be taken to make the market more efficient, either by legalizing the parallel market or by taking some other action with similar effect. At the time of the mid-term review, the staff would also expect to see some related measures being enforced; for example, perhaps some changes in the export surrender requirements. At present "no fund import licenses" were being used by certain parts of the export sector, thus permitting the payment for imports at one rate, while export proceeds were surrendered and changed at the official rate. The authorities would probably be able to take some measures to permit nontraditional exporters to sell part of their additional exchange earnings in the parallel market.

Mr. Joyce said that at a time when so many unsuccessful Fund programs had been seen, it was refreshing to study one that was working, and which could not have been conceived without the possibility of the large access available under the extended Fund facility. Jamaica's success strengthened the arguments in favor of continuing to give large access to Fund resources.

Most speakers had discussed Jamaica's need of adjustment and the sustainability of the present adjustment program, Mr. Joyce recalled. In view of the progress being made, it was understandable that some should have asked why the pace of adjustment could not be quickened. However, he agreed with Mr. El-Khouri that great caution was necessary. It was the authorities of a country that had to be the best judges of what was sustainable in both economic and political terms. That did not mean to say that the Fund's advice could be taken lightly, but it did suggest that in embarking upon a three-year program the authorities should not make radical changes in mid-stream. It would be quite wrong to penalize success by insisting on even more rigid or more demanding conditions. The Jamaican authorities had demonstrated their belief that they did not regard the Fund's conditions as the minimum to be achieved. They were extremely anxious to adjust the country's economy as rapidly as possible. To the extent that greater speed could be achieved, they would achieve it, as had been demonstrated by the greater than anticipated success in the overall balance of payments, and in the reduction of the deficit on the fiscal account.

The discussion about sustainability referred mainly to the period that would follow the termination of the arrangement, Mr. Joyce considered. It was true that at that time Jamaica's access to Fund resources would be extremely limited. The authorities had been well aware of that when they had entered into the program. It was their hope that the adjustments that could be achieved during the program period would put the economy in a position where future balance of payments deficits would be sustainable. As the staff representative from the Exchange and Trade Relations Department had pointed out, a developing country might need to run a current account deficit of some magnitude for an extended time. That statement was certainly true if there were to be large-scale capital investments, particularly capital investments financed from foreign sources.

One of the key questions to be answered in judging the sustainability of a current account deficit was whether the debt profile would be manageable, Mr. Joyce suggested. Another key question was whether the funds being borrowed were being used for productive purposes, in the sense that they would in turn generate a stream of foreign exchange that would accommodate the servicing, and ultimately the possible repayment, of the debt or the investment. Because of their concern for such matters, the authorities had already embarked on a study of possible growth scenarios, and particularly of the investment that those scenarios might require, and the likely exchange requirements that might be called for over the decade. There was considerable planning now under way in Jamaica for the period after the end of the extended arrangement.

While it was true that public investment was large in Jamaica, a distinction had to be drawn between the various purposes of that investment, because, as in many developing countries, much public investment was of a type that in other countries might be undertaken solely by the private sector, Mr. Joyce continued. Broadly speaking, the three-year public investment program for Jamaica envisaged public investment of the order of slightly under $3 billion. Of that amount, approximately 50 per cent would be for social infrastructure, including transportation and communications, and the remaining amount would be production oriented, and would be used among other things to develop energy sources and the tourist industry. The World Bank was at present reviewing the public investment program. The World Bank staff was considering extending by two years the time frame of the review process beyond the three years of the program, in order to ascertain whether the investments that were now being put in place, and their phasing, would be appropriate in a slightly longer time horizon. There were substantial plans for investment in the bauxite and alumina industries. Some of the plans were proceeding rather more slowly than had been anticipated originally, mainly because of the continued weakness in that market. Nevertheless, all three of the major alumina companies were either engaged in, or had a mind to undertake in the near future, major investments that would make possible the recovery of additional bauxite, or would further upgrade bauxite into alumina.

Over the previous year some 50 new enterprises had been established in Jamaica, Mr. Joyce said. Thirty of them had been in the manufacturing sector, 14 in agriculture, and only 3 in tourism. In 1982/83, 17 projects had been approved for implementation, and a further 47 were at present being evaluated by the authorities in order to determine the extent to which they could or should qualify for fiscal or other incentives. There were a further 370 dossiers in the hands of the authorities. Many of them represented simple inquiries, but the large number gave some idea of the dynamism of the Jamaican economy. The refurbishing and the restocking stage was past, and signs of a pick up in investment, particularly in the manufacturing sector, were evident. He hoped that at the conclusion of the second year of the program, he would be able to report to the Executive Board of progress made in the investment programs.

He found it difficult to accept the suggestion that the public sector was the employer of last resort, Mr. Joyce stated. That view was widely held, not only with respect to Jamaica, but indeed in other countries as well. The Jamaican authorities were only too well aware that the public sector in Jamaica had been overextended and that a number of public enterprises were involved in activities that could equally well be accomplished by the private sector. The authorities had not only started a process of divestment of many of those public enterprises but, in addition, had imposed an employment freeze within the public sector. They were carrying out a review of employment in all departments and agencies to ascertain whether, in fact, it might not be possible to introduce a program of attrition. In other words, the authorities were trying not only to hold existing employment levels stable, but to reduce employment in the public sector. In an economy in which the unemployment rate was running at 25 per cent, there were some social constraints that limited the authorities' freedom of action. Similarly, there were social constraints on the degree to which the agricultural sector could be made more efficient. Adjustment measures that caused more unemployment in the short term might not in fact prove tolerable.

The Chairman noted that all speakers had commented on the significant progress that had been achieved in the Jamaican economy over the previous year, particularly the achievement of real growth after a long period of negative growth. Speakers had also welcomed the fact that all the performance criteria set out in the program had been observed. The fact that the inflation rate had decelerated considerably over the period had been seen as evidence of the removal of rigidities in the economy, and as a most favorable aspect of the adjustment that was under way.

The question had been raised as to whether the pace of adjustment in Jamaica should be accelerated, the Chairman remarked. His own approach to the problem was quite similar to that of Mr. Joyce. It was true that the imbalances envisaged at the end of the extended arrangement were too large. If it were possible to reduce the fiscal and the balance of payments deficits rather more than foreseen in the program, it would be most valuable. That point of view would be conveyed to the Jamaican authorities. However, it was also most important to be sure that any acceleration in the pace of adjustment would not be counterproductive. Whether it would be so was extremely difficult to determine for those that were not deeply involved in the management of the country.

From the Fund's point of view, it was important that the authorities should move toward a current surplus on the fiscal side, the Chairman said. It was one of the objectives of the program that the current account of the budget should be in surplus, or close to surplus. Obviously, a country where the budget was an engine of the development process could not have a structural deficit while pursuing a development program. It was most important to bear in mind that any budget deficit and any related balance of payments deficit should be sustainable. In that context, the debt profile had to be looked at carefully, with regard to both interest and amortization. The economy as a whole had to be in a position to refinance the amortization components without raising the total debt to intolerable levels. A question of judgment was involved. Over the coming months the Executive Board would have to decide whether the imbalances envisaged in the Jamaican adjustment program were sustainable, and whether production was increasing in a way that would make possible the type of economic situation for which the Jamaican authorities were striving.

A number of Executive Directors had mentioned the need to enhance the vitality and realism of the parallel market, the Chairman recalled. If that need were met, it would be easier to assess the competitiveness of the exchange rate, and to determine whether it was at the level required for the economic program to succeed. In conclusion, he had been impressed by the results already obtained in Jamaica. The Fund would keep events in Jamaica under close scrutiny, and would continue to work closely with the authorities toward achieving the objectives of the extended arrangement. Jamaica's experience had demonstrated the value of enlarged access programs in such difficult situations.

The Executive Board then approved the following decision:

1. Jamaica has consulted with the Fund in accordance with paragraph 5 of the letter of March 24, 1981 attached to the extended arrangement for Jamaica (EBS/81/79, Supplement 3, April 15, 1981), as amended, in order to reach understandings with the Fund regarding policies and measures that Jamaica will pursue during the second year of the extended arrangement.

2. The letter dated March 31, 1982 from the Prime Minister and Minister of Finance and Planning, and the Acting Governor of the Bank of Jamaica, together with the annexed Economic Policy Memorandum of the Government of Jamaica for FY 1982/83, and the Technical Memorandum of Understanding shall be attached to the extended arrangement for Jamaica (EBS/81/79, Supplement 3, April 15, 1981), as amended, and the letter dated March 24, 1981 together with the annexed Economic Policy Memorandum of the Government of Jamaica and the Technical Memorandum of Understanding shall be read as supplemented and modified by the letter dated March 31, 1982.

3. Accordingly, Jamaica will not make purchases under this extended arrangement throughout the second year:

(a) during any period in which

(i) the limit on the net domestic credit to the public sector as specified in paragraph 2 of the Technical Memorandum of Understanding annexed to the letter dated March 31, 1982; or

(ii) the limit on the net domestic assets of the Bank of Jamaica as specified in paragraph 3 of the Technical Memorandum of Understanding annexed to the letter dated March 31, 1982; or

(iii) the target for the net international reserves of the Bank of Jamaica as specified in paragraph 4 of the Technical Memorandum of Understanding annexed to the letter dated March 31, 1982; or

(iv) the limit on disbursements on account of new external debt as specified in paragraph 6 of the Technical Memorandum of Understanding annexed to the letter dated March 31, 1982

is not observed; or

(b) during any period after November 30, 1982, until the mid-year consultation with the Fund described in paragraph 4 of the letter dated March 31, 1982 has been completed; or

(c) during any period after December 31, 1982 in which external payments arrears have not been eliminated as described in paragraph 5 of the Technical Memorandum of Understanding annexed to the letter dated March 31, 1982.

4. Purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 215.7 million until July 15, 1982; the equivalent of SDR 253.2 million until October 15, 1982; and the equivalent of SDR 290.6 million until January 15, 1983.

Decision No. 7095-(82/56), adopted
April 23, 1982

2. THE FUND'S LIQUIDITY POSITION AND FINANCING NEEDS

The Executive Directors considered a staff paper on the Fund's liquidity position and financing needs (EBS/82/60, 4/2/82).

Mr. Schneider expressed his broad agreement with the staff paper. Even if it was assumed that the figures for the Fund's financing needs until April 1984 were rather on the high side--because the staff generally tended to be rather cautious--it still seemed probable that there would be a considerable liquidity squeeze in 1983/84. In studying the figures, not too much weight should be put on the precision of the projections, which only indicated possible developments over the coming years, and which could well change as new data became available. In addition, it was not impossible that a country with a large quota might request financial support from the Fund.

While borrowing by the Fund should only be a temporary bridging device, the Fund should always be in a position to accommodate all members seeking financing on appropriate terms, Mr. Schneider commented. In consequence, it seemed necessary for the Fund to conclude further medium-term borrowing arrangements in time to avoid undue pressures in 1983. It might also be advisable to conclude lines of credit with those members that were already in a position to offer them, or might soon be in a position to do so. Finally, the staff analysis underlined clearly the need for a rapid and sizable increase of quotas in the Eighth General Review of Quotas.

Mr. Alhaimus inquired why the estimates did not extend beyond April 1984. Why could they not have been extended to April 1985, when the increase might come into effect? It would be useful if some indication of the likely course of events between April 1984 and April 1985 could be made available to Executive Directors so that they could be reassured that no unexpected surprises were likely, especially in the area of borrowing.

Mr. Laske considered that there was no need for immediate concern about the Fund's liquidity situation. The estimates were, as always, conservative and cautious. According to Table 2, the adjusted uncommitted ordinary resources at the end of April 1982 would amount to no less than SDR 15.2 billion, which translated into a comfortable liquidity ratio of close to 70 per cent. As to the Fund's borrowed resources, it was true that there was a small technical gap at present on a commitment basis. However, the gap would soon be covered, when the second tranche of the borrowing arrangement with the Saudi Arabian Monetary Authority (SAMA) became available. In short, from the point of view both of the Fund's own resources and of its borrowed resources, the situation seemed comfortable for the immediate future.

For the financial years ending in April 1983 and in April 1984, the staff had projected a significant deterioration of the liquidity situation for both ordinary and borrowed resources, Mr. Laske noted. Requests for drawings of SDR 6.5 billion were projected for FY 1983 and of SDR 10 billion for FY 1984. However, experience with liquidity reviews had shown that projections of future use of Fund resources had been scaled down from one review to the next. For example, in November 1980 the staff had projected the use of SDR 20 billion of Fund resources during the current financial year, whereas the actual use had been only slightly above SDR 9 billion.

At the discussions of the World Economic Outlook (EBM/82/50 and EBM/82/51, 4/19/82; EBM/82/52 and EBM/82/53, 4/21/82; EBM/82/54, 4/22/82), Executive Directors had acknowledged that a continuation of large external imbalances for some groups of countries was not improbable, Mr. Laske recalled. The projections in EBS/82/60, however, were likely to contain a large measure of uncertainty. It had been remarked during the discussion of the World Economic Outlook that financing conditions in the markets might become somewhat less strained following the expected improvement in the distribution of payments imbalances between the oil exporting countries and the major industrial countries. The commitment gap calculated by the staff for April 1984 of slightly more than SDR 5 billion, and the financing need excluding the GAB of about SDR 14 billion, therefore, appeared to be rather high.

Any necessary additional borrowing should be sought from official sources on a medium-term basis, Mr. Laske recommended. If countries in strong balance of payments and reserve positions could provide resources to the Fund, arrangements should be made for them to do so as a precautionary measure. However, in view of the comfortable supply of ordinary resources in the period immediately ahead, and in view of the coming availability of the second tranche of credit from SAMA, there seemed to be no urgent need for the Fund to consider additional borrowing arrangements.

Mr. Hirao noted that over the three-year period ending April 1984, commitments--net of cancellation and of replacements--were now estimated to total SDR 25.7 billion. The amount of borrowing needed to meet that total commitment was estimated at SDR 14.7 billion, a slightly lower figure than had been estimated in previous reviews. The staff had cautioned that since the present downward revision in the estimates might be reversed, there was no indication that the demand for Fund resources would fall over the coming few years. The staff's estimates did not include the possible use of Fund resources by industrial countries or by large developing countries. A great deal of caution was needed, therefore, in interpreting the estimates. In his view, however, the Fund's liquidity position had improved somewhat.

In view of the Fund's projected commitment gap in April 1984, it was to be hoped that SAMA would agree to make a third tranche of credit available available to the Fund, Mr. Hirao remarked. The estimate that the Fund's adjusted and committed ordinary resources would stand at about SDR 15.2 billion as of April 30, 1982 was approximately SDR 1 billion higher than the estimate made the previous November (EBS/81/226, 11/20/81). However, the figure was expected to decline to SDR 7.4 billion by April 1984. The liquidity ratio could decline rapidly from about 69 per cent in April 1982 to about 18 per cent in April 1984. If members with large quotas used Fund resources, the ratio could decline to a level of only 6-10 per cent. The staff had pointed out that the low end of the range would be close to the historically low level of 1977. In conclusion, he endorsed the staff's view that the projection of a substantial reduction in the Fund's ordinary resources from mid-1983 onward underscored the need for an early completion of the Eighth General Review of Quotas.

Mr. Lovato recalled that at the most recent discussion of the Fund's liquidity position (EBM/81/54 and EBM/82/55, 12/11/81), the Executive Board had concluded that the commitment gap forecast for the period ending April 1982 was essentially technical and did not require any special action, while medium-term prospects gave some grounds for concern. Although the new figures presented in the present staff paper showed a net marginal improvement in the Fund's liquidity over both the short term and the medium term, he had not changed his position on the question; he still believed that Fund commitments should be fully covered by Fund resources and borrowing agreements. He could agree, however, that that principle should not be interpreted rigidly, particularly when it could be expected that the gap would be closed in a short time. The reduction in the expected new commitments from SDR 10-12 billion to SDR 9 billion had reduced the commitment gap to SDR 0.5 billion.

The unavoidable degree of uncertainty about liquidity projections made it difficult to take action with regard to the planned commitment gap in 1984, Mr. Lovato remarked. At the time of the previous discussion of the Fund's liquidity position, the Chairman had explained that in arriving at a global figure for Fund borrowing, a provision should be made for borrowing to finance the possible use of Fund resources by industrial countries and large non-oil developing countries. That provision had been set at a level of SDR 12 billion, a figure repeated in the present paper. While he recognized that it was necessary to assume a prudent attitude in such matters, he hoped that the adjustment process might be marked with some success, and that the Fund's financial needs would turn out to be substantially lower in actual terms than estimated. It was essential that the Executive Board continue to monitor the situation, in order to be in the best position to take the necessary decisions.

Mr. Kafka commented that it was quite appropriate for the staff to adopt a cautious approach in making projections of the Fund's liquidity. The projections pointed to the need for continued efforts to conclude additional medium-term borrowing arrangements with official lenders. It was worrying that not much progress had been made in that direction, particularly since the overall balance of payments situation of the developing countries was likely to become more difficult. The inescapable conclusion was that the Fund should make an experimental approach to direct borrowing from the private market. It would not be appropriate for the Fund to reject such a course and simply express the hope that balance of payments problems requiring the Fund's assistance would not emerge. By adopting that attitude, the Fund could find itself in an embarrassing situation by the middle of 1983.

Mr. El-Khouri observed that, according to the staff paper, the level of Fund commitments during 1982 would be some SDR 3-4 billion less than had been estimated in EBS/81/226. It was regrettable that that downward revision in the estimates did not reflect any reduction in members' imbalances. Rather, as the staff paper pointed out, it reflected delays in completing negotiations on several arrangements with the Fund, the replacement of several extended arrangements by stand-by arrangements, and lower amounts of financing made available by the Fund. He hoped that that situation would be altered in the future and that countries would find it desirable to come to the Fund and obtain the financing that they needed.

The staff had estimated the proportion of commitments that would be financed from borrowed resources at 56 per cent, Mr. El-Khouri noted. Yet the staff paper also noted that use of Fund resources of SDR 15 billion by the industrial and larger developing countries would require borrowed resources of the order of SDR 10-12 billion, which represented a financing by borrowed resources of 66-80 per cent. Could the staff explain the divergence in those figures?

Mr. Vidvei agreed with the staff that the Fund had to seek further borrowing, and that in view of the substantial reduction in the Fund's ordinary resources from mid-1983 onward, there was a need for an early resolution of the Eighth General Review of Quotas. The concern about the Fund's financial position in the future had caused his authorities to put forward proposals and to support other endeavors to find possible solutions to the problems associated with increasing quotas. They were quite concerned at the slow speed with which the Review was progressing.

He supported the different borrowing arrangements that the Fund had entered into or was contemplating, with the aim of meeting current financing needs, Mr. Vidvei noted. The Fund should avoid the situation in which the possibility of members' gaining access to the Fund's resources was limited de facto by insufficient liquidity. For that reason, but also because of the difficulties encountered in obtaining loans from official sources, the Fund should be ready to borrow from the private markets. Finally, he commended the staff for the great improvements in clarity in the present paper.

Mr. Taylor considered it important to monitor regularly the Fund's liquidity position. He had found it particularly helpful that the staff had set out the main borrowing and liquidity ratios in the annex to the paper. It would be helpful if future papers could disaggregate those ratios a little further; for example, to show estimates for the ratio of actual borrowing to total quotas, and the ratio of adjusted usable resources to encashable loan claims. The structure of the tables in the staff paper had been changed as a result of requests made by Executive Directors at former meetings. He hoped that no further changes would be necessary, so that it would be easier to draw comparisons between different reviews. It would be helpful if future tables could include figures covering the whole of the latest year for which actual data were available, rather than only part of the year.

As in the past, the staff had adopted a generally cautious approach, consistent with the prudent management of the Fund, Mr. Taylor considered. Cautious as they were, the projections suggested that there was no reason to worry unduly about the Fund's immediate financial position; the prospective liquidity position was better than had been expected at the time of the previous review. A commitment gap was expected to emerge only in late 1983, rather than during the second half of 1982, as projected earlier. The actual position could, indeed, turn out even better, if, as seemed quite possible at the moment, the projections overestimated the potential use of Fund resources.

Even on the most pessimistic assumptions, the 60 per cent ceiling for the borrowing/quota ratio would not be reached until the end of April 1983, and even the 50 per cent mark--the trigger for a special review-would not be reached unless members with large quotas made heavy use of Fund resources, Mr. Taylor noted. However, there was no room for complacency over the medium term or the longer term. The financing gap could re-emerge toward the end of FY 1983, and it could widen after April 1984, if the Eighth General Review of Quotas had not been put into effect by that date. It would be prudent for the Fund to make some provision for the possibility of drawings by developing countries with large quotas, although the figure of SDR 15 billion cited on page 5 of the paper was perhaps on the high side.

The Fund should consider additional borrowing facilities, Mr. Taylor suggested. It would be advisable to conclude new borrowing agreements with members in structurally strong external positions. Consideration should also be given to resolving the problems associated with purchasing agreements. He hoped that the staff would continue its preparatory work on borrowing from the markets, a course that he could support if borrowing from official sources proved inadequate. He agreed with those who argued that if the Fund had to go to the markets, it should do so from a position of strength, ahead of any urgent financing need.

It was perhaps rather strange in the light of recent experience under the enlarged access policy that forecasts of new commitments had remained virtually unchanged from the previous review, Mr. Taylor remarked. Commitments in the current financial year would be considerably lower than projected in the previous paper on Fund liquidity (EBS/81/226, 11/20/81), because a large number of arrangements were currently inoperative, and it was likely that several extended arrangements would be canceled, with some of them being replaced, at least initially, by one-year stand-by arrangements. Could the staff explain the assumptions underlying its projections of future commitments? It would be useful to know to what extent the assumptions were based on the full use of the 450 per cent access limit by members, and whether the staff expected follow-up arrangements to extended arrangements to have a major impact on commitments. Could the staff also say how much allowance had been made for commitments to new members, and what provision, if any, had been made for cancellation of arrangements over the period? Of course, the projections were tentative, but it would be interesting to know how far they had been based on country-by-country analysis, and how far on a broader assessment, as in the case of the previous liquidity review.

He wondered whether the projected drawings under the compensatory financing facility in 1983/84 would actually materialize, Mr. Taylor continued. The estimates for 1983 and for 1984 were larger than had been projected in EBS/81/226, even though the commitments under the current financial year were well below earlier estimates. On the supply side, the reduction from one quarter to one fifth of the adjustment factor for usable currencies seemed quite justified for the present, bearing in mind that only a small proportion of the Fund's present holdings of usable currencies were currencies of members with projected current account deficits. Looking ahead, however, the projections for usable currencies seemed rather conservative, if not pessimistic. Little allowance seemed to have been made for the possibility that currencies not usable at present might return to usability in the period to April 1984. If that were to occur, the effects of other currencies dropping out of the operational budget could be more than offset.

Rather less than SDR 500 million was presently held in the Borrowed Resources Suspense Account, Mr. Taylor noted. He would be interested to know what the net cost of those holdings would be during the current financial year. He assumed that the staff would make every effort to reduce those balances in the near future in line with the Executive Board's agreed policy that they should be kept to a minimum. In conclusion, he had some reservations about the reliability of the staff's projections, but acknowledged that there was a need to err on the side of prudence. While the short-term outlook was reasonably reassuring, every effort should be made to prevent a recurrence of the financing gap in the medium term.

Mr. Pinfield said that, like Mr. Alhaimus, he would have liked to have seen forecasts for the period between April 1984 and the likely effective date of the Eighth Quota Review. Admittedly, it would be difficult to make even tentative estimates of Fund commitments during that period. Nevertheless, given about the disbursement of funds under existing commitments, some information should be available about repurchases and the effects of those operations on liquidity ratios. It was stated in the paper that the level of holdings in the Borrowed Resources Suspense Account would be maintained at about SDR 200 million over the period of the projections. Could the staff say whether it saw a need to maintain significant working balances in that account for liquidity reasons or for some other reason? Other implications of the staff's forecast were: that every effort should be made to maintain, and where possible speed up, the timetable for discussions on the Eighth General Review of Quotas; that there was no early need to review the maximum limits on the enlarged access policy; and that there would be no commitment gap until about the middle of 1983, which was significantly later than forecast previously.

He shared some of the reservations expressed by Mr. Taylor with regard to the projected commitments of Fund resources over the short term, Mr. Pinfield continued. At the same time, he acknowledged the serious medium-term financial constraints and liquidity pressures that the Fund was likely to encounter. For 1982/83, projected net Fund commitments were expected to amount to SDR 6.5 billion, which was broadly in line with the range of SDR 5-6 billion discussed at the time of the previous review. The projection did not, however, seem consistent with the experience of recent months; since the middle of 1981, the pace of new commitments had slowed significantly. During the first three months of 1981, commitments net of cancellations had exceeded SDR 3 billion, whereas during the first three months of 1982 they had amounted to less than SDR 500 million. During the nine-month period from October 1980 to June 1981, the Board had approved 28 new stand-by or extended arrangements, whereas during the nine-month period from July 1981 to March 1982 it had approved only 6. If net commitments had slowed down that far, was it plausible that they would increase to as much as SDR 6.5 billion over the coming 12 months? Area departments might well have hypothetical arrangements in mind that added up to such a figure, but in view of the recent record, he wondered how realistic those expectations were.

Mr. Erb said that he found regular reviews of the Fund's liquidity position to be helpful and important. His own assessment of the Fund's liquidity position was rather more optimistic than that of the staff. However, the staff's conservative approach was appropriate under the current circumstances. The Fund's liquidity position should be kept under close review in the future. He agreed with those who had argued that at the moment there was no urgent need for the Fund to seek new borrowing arrangements.

Mr. Joyce commended the staff for the vastly improved presentation of the Fund's liquidity position, and particularly for the liquidity and asset ratios contained in the paper. The range of potential use of Fund resources had been reduced yet again. He wondered whether the staff was correct in saying that possible difficulties of balance of payments financing through the banking system made it more probable that the higher end of the range of estimated potential use of Fund resources would be realized. He would be more inclined to view the future with the guarded optimism that the staff had shown in discussing prospects for international bank lending over the medium term in the most recent World Economic Outlook exercise. At that time, the staff had indicated that the major constraint on international bank lending was more likely to be the perceived creditworthiness of individual countries.

The projections of Fund commitments appeared to be on the high side, particularly for the latter part of the period covered, and no commitment gap was seen as emerging before the spring of 1983, Mr. Joyce noted. Nevertheless, the Fund should not relax its efforts to obtain further lines of credit from members with strong reserve and balance of payments positions. The Fund had to be in a position to be able to commit resources to any members seeking Fund financing on appropriate terms. Finally, the substantial reduction in the Fund's ordinary resources from mid-1983 onward further emphasized the need for a rapid completion of the Eighth General Review of Quotas. He hoped that the Review would result in a substantial increase in quotas.

Miss Le Lorier said that she had no major difficulties with the conclusions in the staff paper. Although it was difficult to project the availability of usable resources over a long period, the Fund had to make preparations for meeting a significant increase in demand for its resources over the coming few years. The Executive Board should give major importance to carrying out the Eighth General Review of Quotas in a timely and adequate manner. If the review were not completed by 1984, and if the Fund's usable resources were not increased thereby, the pressure on the Fund's liquidity could force it to choose between curtailing access to its resources and making borrowing a permanent feature of its activity. The Fund should always be in a position to respond to the financial needs of its members in an adequate manner, no matter what the difficulties. She hoped that agreement could be reached as soon as possible on the proportions for ordinary and borrowed resources.

Mr. Kharmawan considered that the staff paper pointed to the need to quicken the pace of the Eighth General Review of Quotas and to try to obtain additional credit for the Fund from official sources. He was not wholly in favor of the Fund's borrowing from the markets; nevertheless, if borrowing proved necessary, the Fund should proceed.

Mr. Polak remarked that since the Fund's liquidity position was being reviewed every six months, it was not necessary for Executive Directors to discuss basic policy issues each time. He had a number of comments to make on the staff paper. He had been struck by the large amount that was being held in the Borrowed Resources Suspense Account and would be grateful for some comments by the staff. He would also appreciate comments on what form borrowing by a member of the General Arrangements to Borrow (GAB) might take. In the past, resources from the GAB had been used as a substitute for the ordinary resources of the Fund. Could that remain true in the future if a GAB participant came to the Fund for an extended arrangement? Otherwise, GAB participants drawing on the Fund under an extended arrangement would be able to do so more cheaply than non-GAB participants.

He still had some reservations about the presentation of the tables in the staff paper, Mr. Polak commented. The tables ought to be more self-explanatory and self-contained. It would be useful, for example, if in Table 1 more subtotals could be shown, which would make it possible to relate the figures in that table to those in Table 2. It was not easy to understand what the numerators of the various ratios represented. There seemed to be a number of contradictions in the statistics as well. For example, in the footnote to page 28 it was stated that the numerator of the liquidity ratio included only SDRs and uncommitted adjusted ordinary resources, yet in the footnote to Table 2, in Appendix 1, reference was made only to the uncommitted adjusted ordinary resources and temporary investments in BIS accounts. Giving fuller statistics and a few more subtotals would make the interpretation of the tables easier.

On a more substantive point, Mr. Polak continued, the staff had advanced a valuable argument in saying that the Fund's liquidity could best be measured as a midpoint between the liquidity ratio, which was a ratio of all Fund liabilities, and the ratio of the Fund's assets to the reserve tranche positions. He hoped that the staff would do more work on the velocity of circulation of the Fund's M-1 and M-2, (the reserve positions by themselves and the reserve positions plus loan claims) in order to establish some kind of indicator of the degree of use of the various assets, which ultimately might make it possible to combine both the reserve positions and loan claims with appropriate weights into a denominator for a liquidity ratio.

Miss Batliwalla observed that the staff projections appeared reasonable. Although there was no need for concern about the liquidity constraints immediately, over the medium term there was no room for complacency. The possibility of the larger developing countries' approaching the Fund for substantial assistance over the coming three years could not be ruled out. The Fund had to be ready at all times to meet the legitimate needs of its members. It was only prudent, therefore, that the Fund should have borrowing arrangements in place so that it could respond to needs as they emerged. She therefore endorsed the staff's view that efforts should be continued for concluding additional borrowing arrangements. Finally, she hoped that the Eighth General Review of Quotas would lead to a sizable increase in quotas.

Mr. Sangare noted from Tables 1 and 5 in the staff paper that the Fund expected to provide financing of up to SDR 25.7 billion in the period to April 1985. That sum would be broken down into SDR 11.7 billion from the Fund's own resources and SDR 14 billion from borrowed resources. A commitment gap would open up from the middle of 1983 and would reach an estimated SDR 5.2 billon in April 1984. It was now expected that borrowing under the extended Fund facility would reach SDR 34 billion, compared with SDR 37 billion at the time of the previous review. He supported the staff position that the Fund should not relax its efforts to conclude arrangements for further lines of credit with members in strong positions. He hoped that the Chairman would be determined in pursuing his efforts to conclude further borrowing arrangements. Like Mr. Kharmawan, he had some hesitation in favoring an approach to the private capital markets, but could go along with one if it proved difficult to make adequate borrowing arrangements with member countries.

The magnitude of the Fund's anticipated borrowing to meet members' financing needs pointed once again to the need for a substantial quota increase, Mr. Sangare remarked. He had been interested to note that the estimates of commitments up to the end of April 1982 had been scaled down from the previous Review from about SDR 12 billion to SDR 9.2 billion. The staff explained the reduction by the fact that smaller amounts were being committed. The delay in reaching understanding with member countries reflected a difficulty in compiling appropriate data as well as an inability to prepare programs. In view of the deteriorating situations in many countries needing adjustment assistance, perhaps the staff could comment on the delays and how they might be avoided.

Mr. Feito expressed thanks to the staff for an excellent presentation of the Fund's liquidity position. Like some previous speakers, he urged that the Eighth General Review of Quotas should be accelerated.

Mr. Tourreilles remarked that, according to staff projections, commitments on stand-by and existing arrangements with members with quotas of SDR 100 million or more were expected to be below the range expected by the staff at the time of the previous review (EBM/81/154 and EBM/81/155). The reduction had been caused, among other things, by the cancellation of some existing arrangements and their replacement by shorter-term stand-by arrangements for smaller aggregate amounts. However, the possibility that some members would enter into several successive arrangements after the completion of one stand-by arrangement meant that there could be no certainty that the demand for Fund resources would fall over the next few years. The staff's projections indicated, furthermore, that even though no resource gap was expected on a disbursement basis for the period up to April 1984, a significant commitment gap would occur by the end of that period. The size of the commitment gap would substantially increase if some members with quotas of over SDR 800 million decided to resort to Fund resources. The Executive Board should follow the developments in the Fund's liquidity position with particular attention over the coming months. Like many others, he hoped that SAMA would agree to increase its commitment by a further tranche starting in May 1983. However, even if SAMA were to agree to the increase, it would still be advisable for the Fund to devote the coming months to continuing its efforts to conclude additional borrowing arrangements, so as to maintain its ability to promote international adjustment in the difficult period that lay ahead.

Mr. Tai indicated his general agreement with the conclusions of the staff paper. It was not easy to make projections, especially over the longer term. It was difficult to judge the development of the world economy, and of course even more so to predict any natural calamities that might provoke additional unexpected needs. Under the circumstances, it was appropriate that the staff should be prudent in making projections. He hoped that the staff had taken most of the important factors fully into account and would be able to make timely modifications in response to changed circumstances.

The Deputy Treasurer remarked that, in judging the appropriateness of the staff's projections, Directors might wish to bear two points in mind. First, the projections covered only those countries with quotas of SDR 800 million or less; in other words, a large portion of the Fund had not been covered. Second, for easier presentation, the tables contained the figures at the top end of the ranges explained in the text. As in the past, all of the figures had been worked out in close consultation with the area departments and on the basis of their expectations for requests for drawings country by country over the coming year. The estimates for the coming year were different from the estimates in EBS/81/226 prepared for the previous review because projections tended to become more accurate as the timescale was reduced. The area departments had a much clearer view at present of what could be expected over the coming 12 months than they had had 6 months previously. The figures were not based on the maximum resources available under the enlarged access policy, which provided for limits and not targets. In most cases the area departments did not expect countries to request drawings equivalent to 450 per cent of quota over a three-year period.

In making projections for the year April 1983 to April 1984, the staff, as in the past, had not based the figures on individual country studies, the Deputy Treasurer continued. The staff had taken the estimates of the balance of payments positions of countries with quotas of SDR 800 million or less that were not expected to use the Fund's resources by April 1983, and had calculated requests for Fund financing at 15 per cent of that total, making SDR 10 billion. The figure of 15 per cent was close to the average financed by the Fund over the previous five years. Clearly, however, there was a margin for judgment. Several Executive Directors had also referred to arrangements that had gone off track, or been canceled, or been transformed into smaller one-year stand-by arrangements. The staff had taken such cases into account, along with the indications given by some members to the area departments that if all went well with their new stand-by arrangement, they would request a consecutive stand-by or perhaps even an extended arrangement extending to 1984 or beyond. The staff had not taken into consideration any possible drawings by potential new members.

That the estimates for 1983 and 1984 had turned out to be quite similar in absolute amounts to the estimates made at the time of the previous review was coincidental, the Deputy Treasurer remarked. In EBS/81/226, the tables had included figures for the midpoint of the range, and those figures had turned out to be at the top end of the range for the present review. In the present paper, the staff had not simply used the figures of the previous review, but had undertaken a completely new exercise making estimates country by country.

The staff had not made projections for the period beyond 1984, because of the statement made by the Managing Director at the 1980 Annual Meeting that the Fund was engaging in a three-year borrowing program, the Deputy Treasurer explained. Furthermore, there was, of course, no indication of when the next quota increase would come into effect. The date would be critical for the estimation of liquidity, in terms both of the limits to be applied under the enlarged access policy and of the shape of the quota review, in particular the size of the overall increase. The staff had felt secure in assuming that the quota increases would not take effect by April 1984. The staff had not, therefore, made alternative projections that would take a quota increase into account. However, it would not be difficult, in due course, to extend the present estimates beyond April 1984, if that was the wish of the Executive Board, as long as it could be assumed that quota levels would not change. Obviously, projections beyond 1984 would be less clear than the projections for earlier years.

One of the most interesting trends revealed by the data in the staff paper was the increased and more rapid use of ordinary resources, and the slowing down of the disbursement of borrowed resources, the Deputy Treasurer observed. The trend could best be explained in legal rather than in operational terms. When members shifted from an extended arrangement of three years to a shorter stand-by arrangement, the staff, in calculating the mix of resources between ordinary and borrowed resources, excluded the balance of drawings under the extended arrangement in making provisions for the stand-by arrangement. Therefore, a country that had made drawings in the third credit tranche under an extended arrangement would have those drawings excluded for purposes of calculating the mix of resources to be made available in the lower credit tranches for a stand-by arrangement. Sudan had been one example of a country with drawings in the credit tranches, which after the transformation of its program was able to draw SDR 130 million from ordinary resources rather than borrowed resources. That situation had had a major impact on the way in which borrowed resources and ordinary resources had been used.

With regard to the GAB, Mr. Polak was right in saying that it had been used in the past for a replenishment of ordinary resources, the Deputy Treasurer acknowledged. The staff believed that it would not be impossible that the GAB could also be used to substitute for borrowed resources or perhaps even for both borrowed and ordinary resources, which would be preferable from the point of view of flexibility. It was difficult to judge how to proceed with the GAB at the moment, because the need for drawing under that arrangement did not arise. The estimates on page 5, however, had been calculated on the assumption that the GAB was substituted for borrowed resources. If GAB resources were substituted for ordinary resources, then a return to the rather higher percentages of the past would be needed.

The technical question concerning why the estimates covered only two months for 1982 rather than the full year raised an important point, the Deputy Treasurer commented. For the purpose of the estimates in Table 3, the staff needed an assessment of the unadjusted ordinary resources at the latest time possible before the issue of the paper. The staff would feel quite uncomfortable in making an estimate, say, up to the end of April 1982 because rather substantial operations might take place in the period between the issue of the paper and the end of that month, which would disturb the estimation procedure for the two successive years. He took Mr. Taylor's point that something like Table 2 could be added for the actual position as well as the estimated position for the last two months of the year.

The Borrowed Resources Suspense Account was a difficult account to manage, the Deputy Treasurer explained. The Fund had to call for the resources that it needed some 90 days ahead, and the staff was never quite sure whether during those 90 days a new arrangement would be agreed, which would create a need for unexpectedly large amounts of borrowed resources. It was necessary, therefore, to keep some resources in hand, particularly since the other lines of credit with the BIS and with industrial countries were rather small in relation to the SAMA arrangement. If the staff were caught by surprise on a call, it would be difficult to make the entire drawing from the BIS arrangement. The amount on hand had been assumed to be SDR 200 million in the paper. The actual amount in the account at the moment was SDR 270 million, but it would fall to quite low levels before any new calls were made.

The average interest on the resources in the Account was almost precisely the same as the average cost to the Fund, the Deputy Treasurer continued. The difference on a nine-month period was 0.8 per cent against the Fund, because on one day an expected transaction had not taken place and the Fund had been left uncovered in SDR terms for that day. The Fund would not be left uncovered again after the modification to Rule G-4, and after the agreement by the Executive Board to put the operation of the Borrowed Resources Suspense Account on a three-day value date as opposed to a two-day value date.

With regard to potential drawings under the compensatory financing facility, a number of expected drawings had been pushed back into FY 1983, the Deputy Treasurer remarked. The estimates for drawings under that facility had once again been done on a country-by-country basis and with the help of estimates prepared by the Research Department. For the year 1983 to 1984, where country-by-country analysis was more difficult to undertake, there were likely to be considerable fluctuations in commodity prices and undoubtedly considerable demands under the compensatory financing facility. The figures in the paper represented the staff's best estimates, and were not consciously biased in one way or the other.

With regard to Mr. Polak's remarks about the tables, the staff would see what improvements could be made, the Deputy Treasurer concluded. In particular, efforts would be made to provide sufficient data for Executive

Directors to work out any combination of the ratios, and the staff would add in the coming paper a ratio of Fund liquidity to loan claims as well as to tranches. Over the previous few months, two creditors had cashed in their loan claims. He took note of Mr. Polak's remark on the propensity of members to use reserve tranches and loan claims. The staff had instituted work covering propensities to use the Fund's resources in general, divided into reserve tranches on the one side and credit tranches on the other, in order to obtain some reasonably firm parameters on estimates of the use of Fund resources.

The Executive Board concluded their consideration of the staff report on the Fund's liquidity position and financing needs.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/82/55 (4/22/82) and EBM/82/56 (4/23/82).

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/82/146 (4/21/82) is approved.

APPROVED: October 13, 1982

JOSEPH W. LANG, JR.
Acting Secretary