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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/25

3:00 p.m., February 20, 1981

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

Executive Directors	Alternate Executive Directors
	M. Shadman, Temporary
J. Anson	L. D. D. Price
A. Buira	
	D. E. Syvrud
J. de Groote	
B. J. Drabble	M. Casey
M. Finaish	
T. Hirao	A. Nagashima
J. C. Iarezza	R. T. Salazar
	H. G. Askari, Temporary
	G. Jauregui, Temporary
B. Kharmawan	
	F. Sangare
G. Laske	
G. Lovato	C. P. Caranicas
	P. D. Peroz, Temporary
	C. Bouchard, Temporary
M. Narasimham	
J. J. Polak	T. de Vries
A. R. G. Prowse	
	G. Blöndal
	Tai Q.

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director. Asian Department: W. R. Mahler. European Department: L. A. Whittome, Counsellor and Director; M. Dakolias, U. Dell'Anno, A. Knobl, D. N. Lachman, J. Odling-Smee, H. O. Schmitt, S. M. Thakur, H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Director; E. H. Brau, N. Kirmani, J. B. McLenaghan. IMF Institute: J. C. Townend, Participant. Legal Department: Ph. Lachman. Research Department: M. E. Bond, A. W. R. Braun. Western Hemishpere Department: S. T. Beza, Deputy Director. Personal Assistant to the Managing Director: C. M. Watson. Advisors to Executive Directors: M. A. Janjua, A. K. Mullei. Assistants to Executive Directors: S. R. Abiad, E. M. Ainley, C. J. Batliwalla, M. J. Callaghan, M. V. Carković, L. E. J. Coene, J. L. Fieto, J. U. Holst, K. V. Jännäri, M. Kusakabe, J. E. Leimone, J. S. Mair, M. Michelangeli, J. Reddy, H. Suzuki, O. Uçer, T. H. Williams.

1. UNITED KINGDOM - 1980 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting (EBM/81/24, 2/20/81) their consideration of the staff report for the 1980 Article IV consultation with the United Kingdom (SM/81/26, 1/30/81). They also had before them a paper on recent economic developments in the United Kingdom (SM/81/30, 2/5/81).

The staff representative from the European Department said that, as members of the Executive Board had observed, the medium-term financial strategy of the U.K. authorities was intended to create the conditions for future growth by controlling inflation, but it had to be viewed also in the context of structural adjustments related to the development of North Sea oil. The basic choice that had had to be made by the policy-makers with respect to oil resources was whether to exploit them, and then decide whether or not the proceeds in terms of foreign assets should be saved or absorbed in the domestic economy. The United Kingdom had made its choice, as shown in the official forecast of oil output, which showed a rise from about 80 million tonnes in 1980 to between 95 million and 135 million tonnes in 1984. It was difficult to make an estimate of the extent of the United Kingdom's potential oil supplies, especially as it depended on the decision as to how much oil should be produced in the first place. The United Kingdom had been close to self-sufficiency in oil in 1980, but by 1984, net exports were expected to be in the range of 15 million to 55 million tonnes.

Based on their decision to produce a certain flow of oil, the staff representative continued, the U.K. authorities then had to determine how the economy should be adjusted. They had selected an anti-inflation strategy, which was not necessarily the only choice. For the sake of simplicity, it could be said that, for a given external balance, adjustment to the emergence of North Sea oil as a foreign exchange earner would require that the non-oil sector begin to show less of a surplus or perhaps even a deficit. An adjustment in the non-oil sector of the external account necessarily implied a rise in the real rate of exchange, which could be achieved in either of two ways. The first was by an expansion of the economy, implying that nominal wage rates would increase at a stable nominal exchange rate, which would still reduce the competitiveness of the non-oil traded goods sector. The U.K. authorities had not followed that path because it would essentially lead to an increase in the underlying rate of inflation. They had begun the adjustment to oil output by adopting the alternative of an anti-inflation policy, allowing a relatively stable nominal wage rate to cause the nominal exchange rate to appreciate. The essential point to bear in mind was that whether adjustment took place with constant nominal exchange rates or through an anti-inflationary restraint with a rising nominal exchange rate, the non-oil manufacturing goods sector would suffer transitional costs. It had been generally recognized during the discussion that the anti-inflationary strategy had been effective in that it had in fact led to a substantial deceleration in prices.

Appendix I to SM/81/30 represented an illustrative exercise, the staff representative noted. There was in fact no way of measuring separately the effects of the petroleum factor and of the monetary policy factor on the exchange rate. Whatever increase had taken place in the real exchange rate of sterling had been due to those two factors together; if there had been any overshooting, it was because the anti-inflationary policy had gone beyond what would have been necessitated by the flow of oil revenues.

Turning to the means by which the anti-inflationary strategy had been implemented, the staff representative referred first to the financial targets. Despite the overshoot in the target for £M-3, the degree of financial restraint looked somewhat tighter than the strategy itself would have strictly required, given the drop in production and employment and the rapidity of the decline in prices. While monetary policy had turned out to be more restrictive than originally anticipated in the strategy, the public sector borrowing requirement (PSBR) had been larger than intended and had placed a greater burden on interest rates.

The debate on the suitability of £M-3 as an intermediate target for policy extended well beyond the United Kingdom, the staff representative commented. It was difficult to find a close relationship between £M-3 as a variable and, for instance, the level of activity and expenditures. The reason for the extreme divergence between narrow monetary aggregates and £M-3 might be the tendency in periods of high interest rates for items of the money stock that carried a rate of interest to expand more than items that did not. The stricter the monetary policy, the greater the possibility of divergence might be. In addition, the recession in the United Kingdom had squeezed the company sector somewhat more, while at the same time increasing, or at least maintaining, real household incomes, and the banking sector had been the main channel of intermediation for that shift.

The right degree of monetary tightness remained a question of judgment, the staff representative observed; for Mr. Kafka, the anti-inflationary objective argued in favor of more tightness, while for Mr. Polak, ensuring the survival of the most competitive firms argued for less. To the extent that the monetary base was controlled, interest rates would have to vary; therefore, the experiments being carried out by the Bank of England entailed a target range for interest rates in the intermediate stage, a range that was to be progressively widened.

Public expenditure did appear to be resistant to substantial cuts, the staff representative continued, although considerable reductions had been made. The U.K. authorities were determined to achieve a further reduction, for which there was room. It would be necessary to wait for the budget to know whether the PSBR would be larger than the level of 4.5 per cent of GDP targeted for the coming year. The appropriate size of the PSBR was again a matter of judgment given the rate of private savings. The objective of the U.K. authorities, in the context of the anti-inflationary strategy, had been to reduce the PSBR, and therefore government expenditures, mainly to create room for the private sector. Although companies might appear to have been crowded out of the long end of the market, the commercial banks had thus far taken up the slack. As far as tax reductions were concerned, the pressure on the company sector could certainly be eased if the national insurance surcharge could be reduced; the surcharge amounted at present to 3.5 per cent and its total yield to the Government in 1980/81 had been estimated at about £3.5 billion.

As for the effect of the effort to reduce total government expenditures, the staff representative mentioned that current expenditures had remained high in 1980 because of the increase in the wage bill. Some balance between current and capital spending should be restored as a result of the present attempt to keep the increase in the wage bill to about 6 per cent. However, it should be noted that the U.K. authorities were persuaded that a large part of the recovery in investment in future should come in the private sector. In addition, much of the infrastructure in which the public sector had been investing in the past seemed at present to be in place, so that a certain reduction in public sector investment should not be thought of as deleterious in terms of economic growth. Even though public expenditures had not been restrained as much as had been hoped and, therefore, more emphasis had regrettably had to be placed on the revenue side, the net effect of the change in the direction of fiscal policy had been in the restrictive direction, even in 1980/81.

Another means of adjustment was related to wages, productivity, and employment, the staff representative commented. Wage settlements were in the process of falling, but that did not imply that real wages in the United Kingdom should necessarily fall in future if growth were to be resumed. In general, the emergence of the energy sector made it possible, as part of the structural adjustment, for wages to be somewhat higher than they otherwise would be in its absence. But just as the staff had judged that there might have been some overshoot in terms of the real exchange rate, there might as a result have been some overshoot in real wages, which would in due course be corrected; in fact, wage settlements were already lower than had been anticipated in the official forecast. While indexation might be desirable in countries with an extremely high rate of inflation, in the United Kingdom, apart from meeting with resistance on the part of trade unions--whose margin for activity would have been reduced--it would probably not have had the effect of preventing real wages from rising beyond a level that was considered desirable in the medium term.

Pressures on profit margins were viewed in the United Kingdom as an instrument for fostering increases in productivity, the staff representative noted. There was some evidence of success in particular industries, although a rather fine balance had to be struck between increasing the stimulus and reducing the means of responding to it under the squeeze. It was hard to say why more men were unemployed than women, although one factor might be that the squeeze on activity and production had been more intense in the manufacturing sector, and the employment of women was particularly marked in the services sector. There were also differences, as a matter of circumstance and not of intent, in the social security benefits received by men and women, based on length of employment.

As for the costs of the anti-inflationary strategy and the prospects for recovery, the staff representative went on, a cost-benefit analysis of the overall medium-term financial strategy would be a major effort from which at best uncertain conclusions could be derived. The costs were an observed fact, and perhaps the benefits were about to be felt. As for the sources of the recovery that would produce those anticipated benefits, the progressive reallocation of labor between sectors would presumably permit the economy as a whole to resume its growth. In a world setting that did not favor the rapid growth of exports, views differed as to the precise mechanism for initiating such a recovery. One view was that it would have to come about as a result of a reflationary policy, but the U.K. authorities were of course determined not to make such a turn and undo the benefits of their counterinflationary policy. Another thesis was that as the rate of increase in prices fell, alongside a fall in interest rates, there would be a stimulus to expenditures, and as profit margins were restored by the slowdown in real wages, there would be a stimulus to investment. In the more immediate future, some new stimulus to a moderate resumption of growth was to come from the end of destocking, which was expected to come about toward the middle or in the second half of 1981.

Responding to specific questions that had been raised, the staff representative noted that overseas development assistance was planned to decline in real terms as part of the general effort to reduce government expenditures. Discussions on how the Fund's holdings of sterling might be reduced from their present 90 per cent of quota were at present being held with the U.K. authorities. As for the European Community-related increase in protection, it might be helpful to note that the restrictions on polyester filament and on carpet yarn that had been introduced at the beginning of 1980 had since been phased out. Reference had been made to the fact that the price of energy in the United Kingdom was higher than it was elsewhere; U.K. industries were specifically concerned about the high cost of electricity and natural gas compared with the energy costs of their competitors, in particular the United States, where a process of adjustment in energy prices might soon be under way.

As to whether the high level of sterling interest rates had affected international currency movements, the staff representative from the European Department noted that the effect on net flows of short-term capital movements had in fact been less than the staff might have hoped. U.K. interest rates had still been negative in real terms until about the middle of 1980, although they had since become positive; downward adjustments had been made in November 1980, and the expectation in the press was that further reductions would be made as the rate of inflation declined. The effect on exchange rate movements could be offset by other elements; it was not possible to reach a judgment on whether the high rate of sterling that had taken place might be expected to continue.

Mr. Kharmawan remarked that the strategy being followed in the United Kingdom was apparently based on acceptance of the appreciation of the pound sterling and on a temporary stagnation in the non-oil sector to permit oil revenues to be used. A different policy was pursued by other oil producing countries that also had a non-oil sector; they generally adopted the strategy of promoting the non-oil sector in order to broaden the economic base and lessen its dependence on oil in the long run. He would therefore be interested to know how the United Kingdom expected the non-oil sector, particularly private manufacturing, to recover. Exports were being hampered by the high exchange rate, and a number of other factors were for the time being preventing economic recovery. The cost of the bold new strategy being implemented by the U.K. authorities was unavoidably high; it had been necessary not only to deal with the problem of how to use oil revenues but also to remove the distortions that had previously existed in the economy. Recovery in manufacturing seemed however to be essential if the economy as a whole was ultimately to resume its advance.

The staff representative from the European Department responded that it seemed normal for the relative size of the manufacturing sector to decline in importance, at least while oil revenues were increasing. If, in addition, during the transitional phase there was a decline in employment as well as in output, it could be ascribed in part not only to adjustment to the emergence of oil output but also to the anti-inflationary strategy. The U.K. authorities were prepared to accept temporary costs in that respect; they did not envisage a permanent stagnation of the manufacturing sector but a process of change in the relative contribution of the growing manufacturing sector to GDP as a proportion of output. Looking several decades ahead, when oil resources would be depleted, there should be opportunities for further structural adjustments. Shifts in the relative contribution of various sectors and subsectors of the economy should not be disturbing; they should rather be accepted as part of the normal structural adjustments that were necessitated, for instance, by the growth of manufacturing in recently industrialized countries.

Mr. Kharmawan commented that changes emerging in the structure of an economy should always be of concern to governments. The sooner policies were shaped and measures adopted to adjust to the predictable cessation of the oil flow, the better. He recognized that the setback in the non-oil sector was a necessary consequence of the anti-inflationary policy, as part of the process of restructuring. But it seemed hazardous to attempt in addition to compound the deliberate use of oil revenues, and its corollary of a high exchange rate, with an equally deliberate set of objectives to depress manufacturing activity. It would surely be too late to restructure the manufacturing sector when oil resources had already been exhausted.

Mr. Polak remarked that it had seemed to him that if a country had the benefit of an additional export item of considerable importance, once the decision was taken on how much of the potential oil supply would be conserved and how much would be produced, the authorities would still have a choice between absorbing the benefits of oil revenues in the economy or saving them. In terms of national accounting, the maintenance of a current account balance would mean that the additional oil revenues were being absorbed. They would be saved if total export proceeds were allowed to produce a current account surplus. Absorption, either by means of personal consumption or domestic investment, could be achieved by means of two policy changes, not one. The staff representative had mentioned an increase in the real exchange rate (that also could be brought about in two ways). The other method of absorption could be an expansion of domestic activity, and in countries that had large unemployed resources available that might not necessitate an increase in the real rate of exchange. Saving could take the form of a current account surplus or its counterpart, an accumulation of foreign assets, private or official. Many oil-producing countries that wanted their domestic non-oil sectors to remain in a position to take up the slack when oil resources were depleted preferred to accumulate assets and not absorb the benefits simply in order not to harm unduly the non-oil productive sector. It was that range of possibilities that had not been adequately covered in the staff report, which had seemed to mention only the possibility of absorption through personal consumption helped by an increase in the real rate of exchange.

Mr. Buira noted that his point about cost-benefit analysis also had two aspects. First, the major policy decision about the rate at which oil resources would be developed, and the related decision on whether the revenues should be absorbed or saved and how they would be allowed to affect the exchange rate. The second aspect concerned the rational choice, as opposed to an act of faith, that was presumably made on the basis of the costs and benefits of a strategy that was followed over time. By describing the U.K. strategy as appropriate, the staff suggested that it had, by a process of analysis, endorsed it as the rational choice. The implication of the staff's judgment was that, based on whatever assumptions and rough calculations it had made, the rate of growth, properly discounted, would be sufficiently higher over a given period than would have been achieved otherwise to compensate for the loss of output in 1980, 1981, and probably 1982 that was bound to follow from all the necessary adjustments. He was aware that any such calculations would in no way be precise and that there were social benefits that could not be easily quantified; for instance, a reduction in the rate of inflation would lead to an abatement of social tensions. It was the explicit or implicit decision resulting from an analysis rather than from an act of faith that he had been expecting to find in the staff paper.

The Director of the Exchange and Trade Relations Department said that the problem was complex and was faced by more than one country. The questions that had been raised during the discussion would be addressed more directly in forthcoming staff papers on surveillance and other subjects. As far as the situation in the United Kingdom was concerned, the staff had wished to emphasize two points: first, the effect of the oil sector on the exchange rate at a time when a fight was being waged against inflation; and second, the separate automatic redistributive effects of a change in the productive base. The latter effects could of course be modified by taxation and investment policies, many aspects of which would be addressed in future staff papers, so that the Executive Board would have an opportunity to draw broader conclusions from a wider range of possible cases.

The staff representative from the European Department added that the particular response in the United Kingdom did have to be seen in the context of the anti-inflationary strategy, which had been given overriding priority.

The Chairman noted that, as Executive Directors had been informed, a staff paper was under preparation on the policy choices of countries that had a growing oil sector. He had asked the Deputy Managing Director to set up a small working group, with the assistance of a consultant, to study the matter in depth.

The Deputy Managing Director stated that the working group was beginning to discuss the subject, based on an agreed outline.

Mr. Anson noted that the main difference of approach in the discussion had been related primarily to modalities rather than policy objectives. There had been no real dispute about the importance of the need to follow a radical anti-inflationary policy at the present time. As for cost-benefit analysis, in the sense used by Mr. Buira of comparing present policy with some other policy in its effect on total growth over ten years, the history of the preceding ten years would in some respects provide such an analysis. Without a sufficiently strong anti-inflationary policy, the conditions for sustainable growth did not exist; given the position of the U.K. economy, the authorities had had little choice, and it was on that basic principle that the present Government had begun to operate when it took office.

As to the means of implementing that policy, Mr. Anson continued, the primary element was a reduction over time in the rate of growth of the money supply to reach a target level over the medium term, with a concomitant reduction over time in the PSBR as a proportion of GDP. For the money supply, the medium-term target was set for 1983/84, whereas the PSBR, which was affected by cyclical factors, would be set at levels that would make the achievement of the monetary target possible.

As for the effects on industry of the pursuit of the anti-inflationary policy at a time when the exchange rate was at a high level for reasons that were only in part linked to that policy, Mr. Anson observed that it was extremely difficult to know how much of the exchange rate appreciation could be directly attributed to North Sea oil. The staff estimates were perhaps at the high end of the range of any such calculations, which were of course greatly dependent on the initial assumptions that were made. As Mr. Iarezza had implicitly pointed out, the starting point for the calculation--1976--was perhaps not necessarily the most appropriate. The possibility of putting a top limit on the exchange rate, in order to moderate the problems for industry in the short run, had been mentioned by Mr. de Groote. The history of the many attempts that had been made in the past to lean against market forces on exchange rate movements, in either direction, had not been encouraging. Any such attempt would also make it very difficult to pursue a consistent monetary policy. The U.K. Government had sought to recognize the problems of industry in a practical way, for example, by lowering interest rates in the autumn of 1980. As far as taxation was concerned, the Government announcement in November 1980 had implied some shift in the burden of taxation away from the non-oil corporate sector. But the burden of corporate taxation in the United Kingdom was not high at the present time, and the incentives for investment provided by the tax arrangements for depreciation were already about as generous as they could be made. The Government was well aware that it had to find a course that would lead in the end to a sustained improvement in the general state of industry and of the economy.

As he had explained in his opening statement, Mr. Anson recalled, his authorities had not sought to offset fully the automatic stabilizing of elements in public expenditure at a time when output was lower than had been anticipated at the time of the budget. More recent official information suggested that the level of output for the financial year 1980/81 could be 2 per cent lower than had been envisaged at the time of the budget, and there would clearly be an effect on expenditure and the PSBR that could not, and should not, be fully offset within that time frame. Increased public expenditure on unemployment benefits and on various kinds of special employment measures could not properly be described as placing the entire burden of adjustment on the private sector, because they were in fact a means of softening some of that burden. On the associated question of whether there was excessive reliance on monetary policy and whether the present level of the PSBR was crowding out the private sector from the money markets, that depended on the current demand for investment funds. But it was clear that in the medium and long term the PSBR would have to be sufficiently moderated as a percentage of GDP to enable the private sector to obtain the funds it needed at reasonable interest rates when growth began to pick up again. It was primarily for that reason that the PSBR should represent a lower proportion of GDP in the medium term.

On the usefulness of £M-3 as a measure of monetary control, Mr. Anson remarked, the Government recognized that although £M-3 had value as a medium-term indicator, it was not too amenable to control in the very short term. A continuing examination was being made of other possible methods and although no decision had been taken either for or against a full system of monetary base control, the steps that had been taken had been designed to be compatible with such a system if, after further examination, it was decided to move in that direction.

As the Chancellor of the Exchequer had remarked at the Hamburg meeting of the Interim Committee, Mr. Anson mentioned, there was a limit to what governments could do in economic matters. To promote the supply side of an economy, governments could however seek to promote a better climate, particularly by removing obstacles to enterprise, and the Government had in fact in the past two years removed a number of controls with that end in view. A reduction in the rate of inflation was probably the preeminent condition for an improvement in the supply side. But there was no way to predict precisely whether and how private enterprise would respond when it was given the opportunity. The ultimate incentive was to offer a greater prospect of profitability, and so far as it was practical to do so, the most effective means would perhaps be to reduce the level of direct taxation. The promotion of legislation in the area of industrial relations was another helpful way over time to create a better climate for investment, and the Government had already taken measures in that respect.

A deliberate decision had been taken by the Government not to follow an incomes policy of the type that had been previously in effect, Mr. Anson continued. Of course, like any government, it had to take decisions about pay in the public sector, but it had chosen to frame those in terms of what the Government could afford to pay. Developments in 1979 and during the early part of 1980 had shown the drawbacks of a formalized incomes policy for the economy as a whole. The distortions that were created were fed back sooner or later into the inflationary process. The only attempt in recent years to adopt a system of indexation of wages and salaries in the United Kingdom had had inflationary results. The problem was not solely one of trade union attitudes, as mentioned in the discussion. Indexation left little scope, unless there were large increases in productivity, for relative changes in the level of wages in different industries, so that the adjustments necessary in a constantly developing and changing economy could not be made. Moreover, if gross domestic product actually fell for a temporary period, indexation of wages could create an almost impossible situation.

In answer to other questions, Mr. Anson remarked that the PSBR in FY 1980/81 was more likely to be above than below £11.5 billion. Expenditure on nationalized industries and housing would be reduced primarily by means of realistic pricing policies. In fact, the nationalized industries as a whole were less of a burden on the budget than was generally believed and did not account for a very large proportion of public expenditure. The net flow of funds from the Government to nationalized industries in 1979/80 was under 4 per cent of total public expenditure, and that had been the highest level for some years.

He would convey the comments that had been made on overseas aid to his authorities, Mr. Anson declared. He was grateful to those Directors who had recognized that the decision to reduce somewhat the volume of overseas aid had been taken after a period during which it had increased substantially. The reduction was part of the general process of budgetary control. Furthermore, as his authorities had pointed out in their policy statements, overseas development assistance was only one part of a country's overall economic relationship with developing countries. The total flow of funds to developing countries, which had been further encouraged by the abolition of exchange controls, showed a very different picture. The United Kingdom also continued to maintain a liberal trading regime. The U.K. official aid program was the fifth largest of those of developed donor countries, and a substantial proportion of aid went to the poorest countries. As the Prime Minister had stated in November 1980, the reduction in the planned volume of future spending on official aid was not because its importance was underestimated; it was because ability to give aid was totally dependent on the health of the economy.

In reply to the question from Mr. Nimatallah, the oil facility drawing would continue to be repaid on schedule, Mr. Anson commented. His authorities had been in touch with the Fund management on the possibility, in addition, for the Fund to sell sterling in a way that would effectively help the Fund's liquidity, and discussions on some associated technical points were continuing.

The Chairman then made the following summing up:

> Executive Directors expressed keen interest in the ambitious medium-term economic strategy which the United Kingdom's authorities have adopted with the aim of correcting long-standing weaknesses in the economy, including a high rate of inflation, a sluggish rate of output growth, and a low level of productivity. Directors agreed with the view of the U.K. authorities that the reduction of inflation was essential in order to create conditions for a sustained expansion of output and employment.
>
> Directors felt that the emphasis placed on combating inflation by means of financial restraint alone entailed very significant short-term costs in terms of a decline in economic activity and increased unemployment. They noted that these transitional costs had been exacerbated by the country's emergence as a significant oil producer, which had fostered major structural changes in the economy. The oil factor, together with a tight monetary policy, had entailed a steep appreciation of sterling in the exchange market, which had subjected the manufaturing sector to severe pressures.
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> Some Directors were of the view that the appreciation of sterling in real terms may have gone further than can probably be justified on a medium-term basis, and they encouraged the authorities to consider adaptations in the mix of fiscal and monetary policies that might bring about a more satisfactory outcome. Noting the increased share of public expenditure in GDP and the slippage of PSBR beyond that due to cyclical conditions, a number of Directors argued that increased emphasis on fiscal restraint and on holding down the rise in wages could help to moderate or reverse pressures on the exchange rate, mitigate the costs of the

anti-inflationary strategy, and bring forward the recovery phase. In the light of these considerations, Directors welcomed the authorities' intention to limit public service pay in the current pay round and to reduce the volume of public expenditure. They were also encouraged by recent signs of moderation in wage settlements, though some doubted whether this had been adequate to permit an early restoration of profit margins and a resumption of economic growth. Underlining the very high costs of the present mix of policies in terms of unemployment and industrial output, some Directors stressed the need to put more emphasis on measures to increase productivity and private investment.

Directors expressed satisfaction with the growing evidence of a sharp reduction in the rate of inflation and commended the authorities for this notable achievement. It was noted that the lowering of the rate of inflation has been faster than the authorities had expected and could be traced to a monetary policy which, on balance, had been tight. Most Directors considered that there were unusual difficulties in judging the exact tightness of monetary conditions on the basis of the evolution of the official target variable, and suggested that there may be room for allowing interest rates to ease somewhat further in the near future without detriment to price objectives.

Directors welcomed the continued openness of the U.K. economy to international trade and finance, but, in spite of the sharp increase noted in 1979, many Directors regretted the reduction in development aid envisaged in the expenditure plans for the public sector.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/24 (2/20/81) and EBM/81/25 (2/20/81).

2. SPAIN - SCHEDULE OF REPURCHASES

Spain has proposed that repurchase in respect of the purchase equivalent to SDR 98,750,000 on February 9, 1978, under the Decision on Compensatory Financing of Export Fluctuations, be made in eight quarterly installments equivalent to SDR 12,343,750 each starting not later than February 9, 1981. The Fund agrees to the proposal of Spain. (EBS/81/38, 2/18/81)

Decision No. 6752-(81/25), adopted
February 20, 1981

3. INTER-AMERICAN DEVELOPMENT BANK (IDB) - TWENTY-SECOND ANNUAL MEETING - FUND REPRESENTATION

The Executive Board approves Fund representation at the Twenty-Second Annual Meeting of the Board of Governors of the Inter-American Development Bank to be held in Madrid, as set forth in EBD/81/40 (2/17/81).

Adopted February 20, 1981

4. UN ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA) - NINETEENTH SESSION - FUND REPRESENTATION

The Executive Board approves Fund representation at the Nineteenth Session of the United Nations Economic Commission for Latin America to be held in Montevideo, Uruguay as set forth in EBD/81/41 (2/17/81).

Adopted February 20, 1981

APPROVED: July 29, 1981

LEO VAN HOUTVEN
Secretary