INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 81/24

10:00 a.m., February 20, 1981

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	O. Kabbaj
J. Anson	L. D. D. Price
A. Buira	M. A. Senior
	D. E. Syvrud
	J. E. Leimone, Temporary
J. de Groote	
B. J. Drabble	M. Casey
M. Finaish	K. A. Al-Eyd
T. Hirao	
J. C. Iarezza	R. T. Salazar
	Y. A. Nimatallah
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	
	F. Sangare
G. Laske	
G. Lovato	C. P. Caranicas
	P. D. Peroz, Temporary
S. Nana-Sinkam	
M. Narasimham	D. L. Kannangara
J. J. Polak	T. de Vries
A. R. G. Prowse	
	G. Blöndal
	Tai Q.

J. W. Lang, Jr., Acting Secretary
M. P. Blackwell, Assistant

Also Present

African Department: O. B. Makalou, Deputy Director; B. Rajcoomar. Asian Department: R. J. Hides, W. R. Mahler. European Department: L. A. Whittome, Counsellor and Director; P. B. de Fontenay, 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. Middle Eastern Department: A. S. Gerakis. Research Department: M. E. Bond, A. W. R. Braun. Office of External Relations: A. F. Mohammed, Director; S. I. Katz. Personal Assistant to the Managing Director: C. M. Watson. Advisors to Executive Directors: C. Bouchard, M. A. Janjua, G. Jauregui, A. K. Mullei. Assistants to Executive Directors: E. M. Ainley, H. G. Askari, C. J. Batliwalla, M. J. Callaghan, M. V. Carković, L. E. J. Coene, J. L. Feito, J. U. Holst, K. V. Jännäri, M. Kusakabe, J. S. Mair, M. Michelangeli, V. K. S. Nair, J. Reddy, M. Shadman, H. Suzuki, P. S. Tjokronegoro, O. Üçer, J. F. Williams, T. H. Williams.

1. UNITED KINGDOM - 1980 ARTICLE IV CONSULTATION

The Executive Directors considered 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).

Mr. Anson made the following statement:

I would like to thank the staff for these very clear papers. They give a thorough and balanced description of economic developments in the United Kingdom since the last Article IV consultations, and provide a good basis for our present discussion. My authorities agree with the general thrust of the staff's appraisal.

The Medium-Term Financial Strategy

Last March, in the context of the budget statement for the financial year 1980/81, the U.K. Government announced a medium-term financial strategy as a framework for their economic policy. The objectives of this strategy for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment. To this end, the Government proposed a progressive reduction in the growth of the money stock to a range of 4-8 per cent in the financial year 1983/84. The target rates of growth for the intervening period would be decided at the time. The monetary target for 1981/82 will thus be announced at the time of the next budget statement on March 10.

A second component of the strategy was the strengthening of the supply side of the economy by improving the working of the market mechanism. Exchange controls have been abolished. Controls have been removed from prices and dividends. Greater realism has been sought in nationalized industry pricing, especially for energy, and in the setting of public sector pay. There has been a switch in emphasis in personal taxation from taxes on income to taxes on expenditure.

Progress So Far

The Government has consistently made it clear that this strategy, which is designed to attack deep-rooted structural problems, would take time to produce results. Some of the measures have had short-term effects which made progress toward the inflation objective initially more difficult, but were adopted for their beneficial effects in the longer term.

Nevertheless, some results are now becoming apparent in regard to inflation. The increase in retail prices over

12 months, which reached a peak of 22 per cent in May 1980, has declined to 13 per cent in January 1981. Over the last 6 months the increase has been equivalent to a 7 per cent annual rate.

The previous rise in inflation to May 1980 was stimulated to a considerable extent by large wage settlements which had been trigerred by the distortions resulting from the previous incomes policy. One of the main purposes of announcing a medium-term target for money supply growth was to influence expectations and so create conditions for more moderate wage settlements, thus helping to reduce the inevitable transitional loss of output during the adjustment period.

In recent months there have been some encouraging signs of moderation in both the public and private sectors. In the private sector, in the current pay round which began last August, about one quarter of those employees whose settlements are monitored by the Department of Employment have now settled at a weighted average close to 10 per cent. In manufacturing, the Department of Employment and the Confederation of British Industry both report average settlements of under 10 per cent, and of the known settlements in November and December, over half were under 10 per cent. In the public sector, there have been relatively few settlements at this stage in the pay round, but with local authority manual workers settling at 7.5 per cent, the weighted average of public sector settlements so far has also been under 10 per cent.

This deceleration in wage settlements was not accompanied, as some had feared, by an increase in industrial action. The number of man-hours lost in strikes in 1980 was somewhat below the recent average; and the number of strikes was the lowest for well over 30 years.

Output and Employment

As was to be expected, a similar improvement has not yet been observed in the field of output and employment. Laying sound foundations for sustainabble growth in the medium term has necessarily involved a considerable transitional cost. In the 1980/81 budget, gross domestic product in 1980 was forecast to be 2.5 per cent lower than in 1979. In the event, it appears to have fallen rather more, by about 3 per cent, the difference being due mainly to a more rapid rundown of stocks than previously foreseen. This development has benefited the current balance of payments at the expense of manufacturing output and employment, and unemployment has risen to historically high levels. The rise in unemployment, and the associated fall in employment, have gone further than might have been expected simply from the decline in economic activity. The implication is that manufacturing industry is being forced into overdue improvements in manning levels, the benefits of which should be felt later on in better productivity and trade performance.

The staff suggests that the patterns of destocking, exports, and savings might delay the bottoming out of the recession in 1981. While this is quite possible, most other forecasters, together with the latest surveys of business opinion, suggest an outlook that is no more pessimistic, and in some cases less so, than the official forecast published last November (which itself allowed for some weakening in exports and savings, and for a further rundown in stocks in 1981 larger than recorded in any year before 1980). The prospects for improvement in output thereafter will depend both on progress in reducing inflation and on how quickly the world as a whole emerges from recession.

The Public Sector

A key element in the medium-term strategy is a reduction in the role of the public sector and the containment of public expenditure. The planned fall of 4 per cent in the volume of expenditure between 1979/80 and 1983/84 was designed to make possible the desired deceleration in the money supply without excessive nominal interest rates, and so help to improve the environment for private investment. Over the last year public expenditure rose above plan, due in large part to the impact of the recession on expenditures whose level is affected by economic conditions, including social security payments and the uptake of the special employment measures. The Government is continuing to exercise a rigorous control of other expenditure through cash limits. The higher total of public expenditure has made it necessary for the Government to contemplate increasing revenues so as to ensure that its overall fiscal stance is compatible with the monetary target and a downward trend in interest rates. Although the depth of the recession means that some increase in public borrowing is acceptable for the time being, the underlying rate needs to be reduced over the medium term.

Last November, a number of new measures were announced to this end. Action was put in hand on both expenditure and revenue so as to reduce the prospective level of borrowing in 1981/82; and plans were announced to finance a larger part of this borrowing by direct sales of debt to the private sector. Cash limits on grants to local authorities for 1981/82 were calculated on the basis of a 6 per cent increase in the wage bill from settlements in the current pay round. The provision for pay in other parts of the public services will be subject to broadly the same financial disciplines.

Monetary Developments

The staff has drawn attention to the difficulty at present in interpreting the various available monetary indicators. The growth in £M-3, the aggregate in terms of which the monetary target has been expressed, was distorted first by disintermediation while the supplementary special deposits scheme was in force, and then by reintermediation since its removal in June 1980. Even if allowance is made for this, the growth has certainly been more rapid than intended, and other factors must have affected it, notably the higher public sector borrowing, the surplus on external current account, and the liquidity needs of companies. There has in fact been some deceleration since the discussions recorded in the staff paper. £M-3 grew by 0.5 per cent in December and by 0.7 per cent in January.

On the other hand, narrow aggregates such as M-1 have grown at a considerably lower rate than than £M-3, and as the staff paper notes, the effective exchange rate rose by 12 per cent during 1980. The increase in M-1 to January brings the growth over the target period so far to an annual rate of about 8 per cent.

The staff appraisal recognizes the impact of these developments on the rate of inflation, but raises the question whether monetary policy has been tighter during this period than was strictly required for the success of the medium-term strategy. Monetary conditions have undoubtedly been tight, despite the waywardness of £M-3. This reflects the need to give priority to reducing inflation, and has made possible some reduction in short-term interest rates. The Government will be reviewing monetary policy in the forthcoming budget with the object of carrying forward the medium-term financial strategy. While maintaining the impetus of this strategy, the Government has always recognized the need to pursue monetary policy by reference to a wide range of indicators and to relate it to developments elsewhere in the economy. This approach will be further reflected in the budget decisions for 1981/82 and subsequent years.

The Company Sector

Given the high exchange rate and the limited prospects for recovery of profit margins or sales volumes this year, the immediate outlook is that the profitability of the company sector will remain weak. Looking further forward, however, the substantial response of wages to the new policies, the possibility of above-average gains in productivity, and a steady decline in the rate of inflation point to the likelihood of improvement in the company sector's position some time after 1981. The faster the slowdown in the rise in domestic costs, the better the prospects.

The revenue adjustments announced in November should help to ensure that the personal and oil producing sectors, rather than the non-oil company sector, bear a greater share of the burdens imposed by recession and by the adjustment to reduce inflation. The Government recognizes that the appreciation of the exchange rate has increased the problems of industry, and will be mindful of that in determining its fiscal position in the coming year. Industry will however need to make major adustments itself, particularly in maintaining the momentum toward more realistic wage settlements.

Exchange Rate

The Government's policy remains to allow the exchange rate to be determined by market forces. The appreciation during 1980 must have been due to a mixture of factors, including especially the existence of indigenous sources of oil at a time of great uncertainty about future prices and supplies. A substantial part of the rise remains unexplained. It has helped to hold down import prices, as well as sharpening the incentive to U.K. industry to become more efficient and to adjust to the general impact of North Sea oil on the economy.

In current circumstances, my authorities have not felt able to participate in the exchange rate mechanism of the European Monetary System. Given the upward pressure on sterling, its inclusion would have placed considerable strain upon the mechanism and would have created difficulties in its operation. But my authorities have already indicated that they would like sterling to participate when it is clear that this can be achieved without damage. They are keeping this under review and are also participating actively in the work on the future of the European Currency Unit (ECU) and the creation of a European Monetary Fund.

I look forward with great interest to the comments of my colleagues.

Mr. Peroz noted that the British authorities had consistently held the view that the most practicable way of achieving sustained economic growth and a winding down of inflation was through a reduction of monetary growth and a diminution of the public sector borrowing requirement (PSBR). The staff paper revealed that their medium-term strategy had run into some difficulties and had probably proved more detrimental to economic activity and employment than originally expected. Because of those difficulties, and because the strategy had only been followed for a relatively short time, it was not yet possible to make a firm assessment of British experience over the past two years.

A number of expectations raised by the medium-term strategy had not been fulfilled, Mr. Peroz remarked. M-3 growth in 1980 had been at more than twice the level projected, and the PSBR, expressed in terms of a percentage of GDP, had remained unchanged from 1979, making the target of a PSBR equivalent to 1.5 per cent of GDP by 1983/84 seem unrealistic. Developments in the real economy were not promising. It was clear, for instance, that the slowing down in economic activity had been significantly more pronounced than expected, and had resulted in an abrupt surge in unemployment and a sizable fall in both private and public investment.

In spite of those unfavorable results, however, the economy was showing some positive signs of progress, Mr. Peroz remarked. It was clear, for example, that monetary policy had remained quite restrictive during 1980. The surge in M-3 during that year had not developed until the last six months and had coincided with the abolition of the "corset." Furthermore, the increasingly severe cash flow problems of the corporate sector in 1980--as was evidenced by the contraction of output, the amount of destocking, and the wide-scale layoffs--gave ample proof of the tight liquidity conditions under which the economy had been operating. The sharp deceleration of prices in the second half of the year, even after allowing for the effect of the exchange rate appreciation on the cost of imports, seemed to be mainly a consequence of a strong monetary squeeze. It could be argued that the apparent failure to stick to the objective of a reduction in the PSBR equivalent to 1.25 per cent of GDP had been only partly related to the performance of the authorities in limiting expenditures, and in raising new revenues. The staff had demonstrated that most of the £3 billion increase in the PSBR in 1980/81 could be accounted for by higher social security spending, reflecting the deterioration in employment conditions, or by expenditures directly related to the tightness of monetary conditions, such as high interest payments, or higher contributions to the financial balance of public enterprises.

Provided that the present medium-term strategy was retained, Mr. Peroz continued, the prospects seemed good for bringing the inflation rate into single digits and bringing the current recession to an end. The significant moderation of pay settlements in the private as well as in the public sectors gave some sign that inflationary expectations had been significantly lowered already, although the effects of stringent cash limits in the public sector and the financial difficulties of the private sector should not be overlooked in that connection. If the trend toward moderate wage settlements were to be confirmed over the coming months, the rate of unemployment among certain categories of the work force could be reduced. The intention to expand the present Youth Opportunities Program as well as the Community Enterprise Program seemed to be sensible. Over the longer term, however, those specific programs should be strengthened by suitable supply-oriented policies. Did the staff have any other information on the authorities' intentions in that regard?

He shared the doubts of the staff about the justification of relying fully on M-3 as a reliable economic indicator, Mr. Peroz commented. He understood, however, that that question would become less important with the likely return to more orderly conditions in the financial market and the changing attitudes of the monetary authorities with regard to the control of the monetary base. In conclusion, the United Kingdom seemed to be in a good position to benefit from the inflow of resources from North Sea oil and to resume a satisfactory rate of growth as soon as the present period of adjustment came to an end.

Mr. Laske remarked that the economic strategy adopted by the British authorities had obviously resulted in a marked slowdown in the inflationary tendencies that had characterized the British economy with such persistence for a number of years. Between May and December 1980 the rate of inflation had been cut almost in half, and it could reasonably be expected that by the end of the current calendar year a single digit rate would have been achieved. The success in lowering inflation had been due, in part, to the significant reduction in the rate of wage increases recorded in the last half of 1980. If that moderation could be extended into future wage negotiations, domestically produced cost and price pressures could be further wound down, and the much needed restoration of the profitability of British companies and increased investment in plant and equipment could take place.

It could not be ignored that the progress recorded in price and wage developments had, in part, been bought at considerable cost in terms of unemployment and business insolvency, Mr. Laske commented. Within the United Kingdom an increasing number of people were asking whether the medication applied to the British economy was curing the diagnosed illness; it was certainly having strong adverse side effects. In the prevailing circumstances would the medicine be capable of generating enough vigor for the economy to assume even a moderate rate of growth?

The objectives that the authorities had established for FY 1980 had only partially been met, Mr. Laske observed. Indeed, some important objectives had been missed by a rather wide margin; for example, the public sector share in GDP had not declined as expected, and the PSBR continued to be as large as during the previous year. Certainly, the cyclical situation had automatically brought about higher public expenditures than had been projected, but there had also been some policy decisions, that, with the benefit of hindsight, seemed to have undermined almost from the beginning the authorities' basic objectives. Another disappointment was the fact that output in manufacturing had declined by as much as 9 per cent during 1980, and that real GDP was estimated to have been 2.5 per cent smaller than the year before. To turn that trend around would require a major effort and perhaps some adjustments in the basically appropriate policy stance.

During 1980, the money supply, as measured by M-3, had expanded much more strongly than had been envisaged by the authorities when they had formulated their initial monetary target, Mr. Laske noted. Despite the considerable overshooting of the range, the staff had argued that monetary policy appeared to have been very tight, perhaps even overly tight; the obvious evidence for that was the strong appreciation of sterling, and in an international context, rather high rates of interest, which in turn had obviously exerted upward pressures on the exchange rate. While there was considerable validity in the staff argument, however, it could also be argued that the continued high PSBR had undermined the possibility of achieving the monetary target. Obviously, there were some uncertainties about how valid M-3 was as a general yardstick for the degree of restrictiveness in monetary policy. If inflation should continue to decelerate, as expected, some cautious easing of monetary restraint with a view to lowering the level of interest rates might not be in contradiction with the correct medium-term financial strategy. The new technical arrangements for the implementation of the monetary strategy described by the staff might indeed permit a more effective use of the monetary tools. The removal of the "corset" could be considered an improvement, and should assist in eliminating the distortions that had complicated the task of monitoring and steering monetary developments.

The levels of public expenditure during 1980 had far exceeded the targets that had been set, Mr. Laske commented. To a considerable extent, the diversion away from the charted course had been caused by certain unrealistic initial assumptions. The fact that public expenditure as a share of GDP had increased during the year raised the question whether some adjustment to the medium-term strategy should be made during the coming fiscal year. It seemed that in the coming budget the authorities were planning to shift away from the emphasis on economy in public expenditures toward the possibility of raising more revenue. Such a course of action might be unavoidable, but it gave the impression that the authorities were in the process of compromising their original objectives.

The dramatic level to which sterling had appreciated over the past 18 months gave grounds for concern, Mr. Laske noted. Some appreciation of the exchange rate could have been expected in view of the current oil supply situation, but the extent of the appreciation might have distorted sterling's cost/price relationships with its major competitors. It was well known that a considerable time gap existed between the occurrence of exchange rate changes and their effects on foreign trade. The relatively satisfactory trade picture for the United Kingdom during the past year might, therefore, conceal the fact that British exporters would find their task increasingly difficult in the months ahead. From that point of view, some slackening of the degree of monetary tightness, with the object of lowering the level of interest rates, might be advisable.

The British authorities and the staff expected that the trough of the recession would be passed during 1981, although a number of caveats were attached to that judgment, Mr. Laske observed. There were a number of uncertainties that made an early recovery from the recession doubtful: for example, the delayed effects of the recent appreciation of sterling, the necessity for continued fiscal restraint, the continuing unsatisfactory profitability of British industry, and the probability of a further slowdown in the world economy. Moderation in wage settlements would enhance the chance of the turning point being rapidly reached; however, neither that nor the highly desirable reduction of government assistance to publicly owned industries would be easy to achieve. The authorities should not give up their efforts to make progress in those areas, even though a number of political pitfalls would have to be overcome.

Mr. Nimatallah commented that the economic difficulties facing the United Kingdom were in many ways a magnified reflection of those prevailing in most other industrial countries; high unemployment, high inflation, large government deficits, inadequate productive growth, and a slow growth of real output. However, the U.K. experience was different from that of most other industrial countries in that the balance of payments was in surplus and sterling had appreciated against other major currencies. The fact that the United Kingdom, a country with substantial oil production and a surplus on its current account, had greater underlying structural economic difficulties than a country like Japan with little or no oil production indicated that oil imports could not be isolated as the underlying cause of current difficulties in the industrial world.

The disappointing performance of the economy, Mr. Nimatallah continued, was due in large part to two adverse developments: large wage settlements and large government deficits. Wage settlements from the middle of 1979 to the end of 1980 had been in excess of 20 per cent and had been higher than the rate of inflation. The Japanese experience demonstrated the critical effects of the behavior of real wages in achieving domestic economic stability. If wage increases were not moderated, and if profit ratios were not increased, or at least stabilized, the process of achieving economic balance would be drawn out. The reliance on monetary policy in the United Kingdom had not been effective in moderating wages or in boosting profit ratios in the non-oil sector. It had resulted in a record postwar level of unemployment of about 9 per cent and in an appreciation of the exchange rate. Although the rate of inflation and wage increases had started to decelerate recently, the battle against inflation was not over. In fact, inflation might increase yet again as a result of past wage settlements and declining profit ratios, thus fueling higher wage settlements. Heavy reliance on monetary policy alone could only break that spiral at the cost of increasing unemployment and declining output.

The combination of a heavy reliance on monetary policy, a large PSBR, and the absence of an incomes policy had squeezed the private sector while increasing the importance of the public sector at a time when the opposite was needed, Mr. Nimatallah suggested. To achieve sustained growth of output coupled with low rates of inflation and unemployment, a different combination of policies was needed to redirect resources to the private sector. A substantial reduction in PSBR coupled with a less restrictive monetary policy would help to direct resources to the private sector, increase investment expenditures, and enhance the competitiveness of the British economy. Moreover, selective tax incentives to increase investments in the private sector would raise business profitability and enhance productivity growth, thus expanding output and employment while reducing inflationary pressures. Within such a policy framework, current disappointments could be accepted if the long-term goals seemed likely to be realized within a reasonable period of time. There were some indications that the rate of inflation was being cut back, but it was not yet clear whether the underlying difficulties would soon disappear.

In concluding, Mr. Nimatallah said, he would like to ask Mr. Anson for further elaboration on three points. First, could he comment on the potential to expand oil production in order to meet world energy needs? Second, did the authorities plan to make any early repayments of drawings under the oil facility? Third, why, after an increase in 1979, did the authorities plan to allow a decline in official development assistance in the period up to FY 1983/84? Surely, untied aid expenditures could not add to domestic inflationary pressures.

Mr. Finaish said that the U.K. authorities had introduced a set of important policy measures that were planned to bring about market-oriented adjustment, the elimination of market imperfections, deregulation, and the restoration of incentives. The key policy objective had been the control of inflation as a necessary precondition for a sustained improvement in output and employment. It was encouraging to note the growing evidence of the effectiveness of that policy. A reduction of the rate of inflation to a single digit, expected by the end of the current year, would constitute an important step toward the long-term objective of sustained growth in output and employment.

Understandably, to control inflation was not an easy task, Mr. Finaish commented. The measures taken by the authorities, which marked a significant departure from past policies, had involved transitional costs in the form of a considerable reduction in output and an unexpectedly large increase in unemployment; however, significant success in controlling inflation had been achieved. The authorities now faced the more challenging task of bringing about changes of a structural nature involving some modification of the respective roles of the public and the private sectors. It appeared that thus far the authorities' efforts to reduce the size of the public sector by reducing expenditure, public ownership of assets, and government involvement in industry had been less successful than expected. Because of the structural nature of the problems, progress in those areas was likely to be slow and painful. A number of recent measures had been designed to limit public sector claims on financial resources so that the private sector could meet its credit requirements without intensifying inflationary pressures. Although the recovery of profit margins was not yet in prospect, several of those measures were yielding positive results.

Progress with wage settlements, which the authorities rightly regarded as a critical element in their overall strategy, was quite encouraging, Mr. Finaish said. While the Government had avoided interfering in the wage bargaining process, it had endeavored to make labor unions aware of the fact that excessive wage demands would lead to difficulties and loss of jobs. Those developments had relevance to other countries suffering from similar problems. The authorities hoped to make progress soon in correcting market imperfections and improving resource allocations. They hoped to correct the relative imbalance between company and personal taxes and to change their techniques of monetary control.

All recent developments had taken place against the background of an appreciating exchange rate, Mr. Finaish observed. The authorities had allowed the exchange rate to float without intervention, but a large appreciation of a floating currency affected companies' competitiveness and profit margins, and therefore affected investment and economic activity, with subsequent consequences for investment and employment. It was quite possible that the situation in the United Kingdom at the moment could develop into a vicious appreciation/deflation cycle. There was a divergence of views between the staff and the British authorities on whether the reduced level of activity and high rate of unemployment would persist beyond 1981. Perhaps the staff could comment further on that.

The comparison made by Mr. Nimatallah between the British and the Japanese economies had been useful and pertinent, Mr. Finaish commented. Indeed, as he indicated, oil imports could not be isolated as the underlying cause of difficulties in the industrial countries. Regarding energy, the British authorities' pricing and conservation policies were commendable. The reduction in oil consumption provided yet another proof of the effectiveness of realistic prices in promoting conservation and encouraging the use of alternative sources of energy. However, the trend of energy consumption per unit of output had not been specified in the staff papers. The authorities were determined to prolong the life of North Sea oil, while at the same time meeting the international commitments made by their predecessors. He noted in this regard the authorities' determination to continue laying emphasis on the need to preserve this depletable asset in the context of a highly advanced and well diversified economy, in which the oil sector represents only a minute proportion of GDP. This gave an added significance to the need for such concerns in many oil exporting countries where oil constitutes a major part of GDP and where the welfare of entire generations--present and to come--very much depended on its conservation and judicious use.

There was concern in the United Kingdom, Mr. Finaish continued, at least among industrial concerns, that the increase in domestic oil prices had been relatively high compared with other industrial countries, and that as a result competitiveness might suffer, particularly for energy intensive industries. Could the staff or Mr. Anson comment on whether that concern was well founded? Finally, it was commendable that despite a decline in output and a record increase in the level of unemployment, the U.K. authorities had indicated their intention not to resort to protectionist measures. It was regrettable, however, that they had decided to reduce considerably outlays for official development assistance.

Mr. Drabble expressed commendation for the courageous approach that the U.K. authorities had taken in trying to resolve the serious underlying economic problems of their country. Admittedly, the painful side effects of their medium-term adjustment program had been somewhat greater than had been foreseen earlier, particularly in the areas of growth and employment. However, the structural problems of the industrial sector were particularly serious in the United Kingdom, in part due to inadequate levels of investment in industry for a number of years, and to the fact that Britain still suffered from having been a leader in industrialization and possessed more than its fair share of obsolescent plant. Difficult as the structural adjustment would have been at any time, it had been made more difficult by the growth of the oil sector and the generalized recession in the United Kingdom's major trading partners.

Against such a background had to be set other problems of long standing with regard to wage policies and general labor relations, Mr. Drabble remarked. It was clear that the many years of various forms of incomes policy, frequently accompanied by control of prices, had left a difficult set of problems behind them; indeed, one problem had been the difficulty of bearing down on public sector pay levels following various distortions in the relative pay structure that had developed in previous years. Another problem was the high level of inflationary expectations that had prevailed in the United Kingdom at the introduction of the new strategy.

In addition to all those problems, Mr. Drabble continued, the authorities might have made their task more difficult by some of the tactical decisions they had taken with regard to the implementation of their policies. He tended to agree with the staff that the large effective appreciation of sterling could not be attributed solely to the impact of North Sea oil. The appreciation, together with the welcome abatement of domestic price inflation in recent months and the severity of the recession itself, lent support to the staff conclusion that monetary policy had in fact been quite restrictive, despite the indications given by M-3 levels. The effects of monetary policy on sterling appreciation and on corporate profits, output, investment, and employment--beyond those which would anyway have been induced by energy developments--were a matter of some concern, notwithstanding the favorable impact that was now being seen on wages and prices. Inevitably, the question was raised as to how appropriate M-3 was as an indicator of monetary restraint. Should government monetary policy objectives be cast so rigidly in terms of an explicit target for a single indicator? The breadth of the M-3 aggregate had made it difficult to control in the short term. It had of course been particularly difficult when the original targets had been implemented before the "corset" had been removed.

It could in fact be argued that restricting the growth of M-3 was more useful as a fiscal than as a monetary restraint, Mr. Drabble remarked. Indeed, the adoption of M-3 as a target had been favored under the Fund program because it provided an effective restraint on the fiscal side. He welcomed the indications that a general review of the suitability of M-3 was now being undertaken and that alternative approaches were being evaluated. One problem with M-3 was that it tended to lag and could be giving a misleading signal at the present time. However, in making any adjustments to monetary policy, it would be desirable to ensure that any easing of monetary restraint was not overdone; perhaps more attention to M-1, while it could be rather variable in the very short term, would be helpful.

Decisions with regard to the PSBR and the general problems posed by the coming budget would be extremely difficult to take, Mr. Drabble observed. The authorities would have to consider, for example, the extent to which the divergence of the PSBR from the target had been due to cyclical effects. In that context, Table 17 of SM/81/30 provided some interesting estimates of the noncyclical impact of fiscal policy. The table showed that on a cyclically neutral basis there had been a move in the direction of constraint of as much as 1.8 per cent of GDP. Some account should be taken of the effect of a further cyclical deterioration in setting targets for the coming fiscal year: care should be taken not to go too far in offsetting the working of automatic stabilizers. It had to be recognized that, as a result of unemployment and redundancy payments, the cost of the almost inevitable further growth in unemployment in the period ahead would be high.

It was obviously desirable that the Government should do everything possible to contain expenditure and, especially, to ensure moderate pay settlements for the coming year, Mr. Drabble said. He welcomed the guidelines that had been laid down by the authorities with regard to public sector pay, and he hoped that they would be enforced. It had been most unfortunate that over the past year public sector pay awards had been so much higher than those in the private sector. There were some indications that public sector pay awards had recently come down quite sharply; if that moderation could be maintained it would assist the authorities in achieving their goals with regard to the PSBR.

The question of whether the authorities should attempt to raise revenues further was difficult to answer, Mr. Drabble continued. The higher rates of taxation for the oil sector already announced certainly seemed acceptable. It was less clear, however, whether it would be appropriate in present circumstances for the Government to consider increasing personal taxation. The staff seemed to feel that perhaps some such increases in taxation might be warranted if they would permit further measures to ease the tax burden on the company sector. Could the staff comment further on that? He understood that companies in the United Kingdom were already treated quite generously in comparison with those in most other industrial countries.

The Government owned part of the industrial sector that required the most far-reaching adjustment, Mr. Drabble observed. Inevitably, to bring about restructuring--for example, in the automobile industry--a fair amount of investment would be needed. The staff had expressed concern that levels of investment in the public sector had dropped in the same way as in the private sector. It would be interesting to know the authorities' reactions to that situation. Decisions regarding public investment were of course bound up with the targets for the PSBR. It should be noted, in that context, that there was a surplus on current account and hence an overall adequate level of gross domestic saving in relation to the current, admittedly unsatisfactory, level of fixed investment.

It was not easy to reach firm conclusions on what policies the authorities ought to follow, Mr. Drabble concluded. He would be concerned if overly strong measures were taken to offset the adverse cyclical effects that had contributed to the high PSBR. He hoped very much that the introduction of greater incentives into the U.K. economy, the exposure to competition, and the other efforts to strengthen the overall economic base would soon be crowned with success.

Mr. de Groote remarked that it would have been more useful to have considered the U.K. economy after a further two or three months, when it would have been clearer whether the authorities' program had started yielding the expected results or seemed likely to fail. At present, it was disturbing that the burden of adjustment was falling on the private rather than the public sector, contrary to the authorities' initial objective. The PSBR had increased and monetary targets had not been met. Perhaps most disturbing of all was that the appreciation of the exchange rate, unequaled in recent history, had not exercised a noticeable effect on prices. Mr. Anson and the staff seemed to believe that the authorities' policy stance was correct, and that the high level of unemployment and the increase in some taxes were part of the cost to be paid during the initial stages of an adjustment program. He had some reservations about that view because some of the mechanisms that worked seemed inefficient or contradictory. The most fundamental weakness of the program was the absence of coordination between the main objective of fighting inflation and the effects of the oil situation. The stabilization of prices was regarded as a prerequisite of orderly growth based on private sector initiatives; the oil situation, on the other hand, was bound to lead to a sizable appreciation of the exchange rate, once it was accepted that the quantity of money would be the main policy target and that interest and exchange rates would therefore respond to market forces.

In Appendix I to SM/81/30, the staff made it clear that the appreciation of the exchange rate was already higher than would have been needed to offset, over a medium-term period, present and future effects of North Sea oil, Mr. de Groote continued. Maintaining a fully flexible exchange rate meant that the consequences of appreciation acted directly against the very objective of the stabilization program. Appreciation reduced the competitiveness of enterprises and led to the elimination of economic activities that traditionally supplied the internal market. If those effects were maintained over a number of years, there would be a shift in resources in favor of imports and away from exports and production for the internal market, which would make most improbable the achievement of the program's basic aim of a recovery of growth in the non-oil sector. While the staff had shown that the exchange rate increase had been excessive, it had not shown how that problem could be corrected; the merits of using a quantitative monetary target as principal or almost exclusive policy instrument had not been seriously questioned. In his view, the contradiction between the objective of restoring conditions for balanced growth and the effects of the oil situation under the present exchange rate system would induce a structural disadjustment of the economy, thus putting in question the validity of the choice of policy instruments. It would be interesting to consider how things would have been different if the U.K. authorities had adopted an exchange rate target, had allowed reserves to increase more than they would otherwise have done, and had adjusted interest rates predominantly to balance of payments objectives. Such an alternative policy approach would probably not have given worse results in terms of inflation, since the effects on prices of the appreciation of the exchange rate were, in any event, hardly discernible, but the effects on medium-term recovery prospects would have been far better.

If it were realized that the authorities had pursued the correct objectives with the wrong policies, would it be politically unthinkable that they would give up their reliance on quantitative monetary targets, Mr. de Groote inquired? The authorities had said that monetary targets were essential for influencing inflationary expectations; but that supposed that the monetary target was rigorously adhered to, which was not the case. Would not expectations be more favorably influenced if an end was brought to the impact of the oil situation on the exchange rate? The comments of Mr. Anson and the staff on that point would be interesting.

Another weakness of the U.K. program was the inappropriate composition of government spending, Mr. de Groote commented. He understood that, once it had become impossible to oppose an excessive increase in public sector compensation, the brunt of the expenditure reduction had had to fall on capital outlays. Such a situation was regrettable in a country where the productive contribution of the public sector remained important, and where the economic structure should be kept intact. Maintaining the current policy stance would be most harmful over the medium term. Might it not have been advisable to accept some increase in public sector borrowing in order to maintain an appropriate level of investment in the public sector? The effects on interest rates would probably not have been very substantial and could have been counteracted by appropriate monetary techniques. Had the authorities been justified in endangering the economy's medium-term capacity for the sake of achieving a target that had, in any event, proved impossible to achieve?

He would like to have some explanation of how the measures announced by the Chancellor of the Exchequer in November 1980 could lead to a progressive reduction of the monetary base, Mr. de Groote said. While it was true that a greater emphasis on open market operations and less on discount lending might enable the authorities to influence the base more directly, it had been stated that those operations would be used to obtain interest rate objectives, which implied that the base would vary as a consequence and no longer as a target. He would also appreciate the staff's comments on whether an indexation of salaries might have been valuable. One of the difficulties in implementing the present program was the effect of wages increasing beyond the level of price increases. Was it not possible that a rational system of indexation could have avoided that difficulty by ensuring that no compensation was given for price increases that had not yet materialized? In his view, a rational indexation system need not have been inflationary, and could have played a useful role in maintaining wage increases within appropriate levels. Finally, could the staff say why unemployment in the United Kingdom was much higher for men than for women, contrary to what seemed to be the case in many other European countries?

Mr. Polak remarked that when the present U.K. Government had taken office in May 1979 it had adopted an ambitious economic strategy designed to correct a number of long-standing weaknesses in the economy: perennial inflation, a low rate of production investment, weak economic growth, and a steady price rise in the share of resources claimed by the public sector. The results of such an ambitious strategy by the authorities would not only affect the future of Britain, but would certainly have an effect on policies on the European continent and elsewhere.

It was clear that the policy had been successful in cutting inflation, Mr. Polak observed. The rate of increase of the consumer price index for the year up to May 1980 had been 22 per cent, whereas for the year up to January 1981 it had been 13 per cent. Such annual figures tended to lag badly behind actual achievements, and the rate of increase on average over the last six months had been 7 per cent a year. Similarly, the rate of pay settlements had been brought down noticeably. In other respects, however, the program had been less successful. Its original intention had been to restrain public expenditure so as to enable a reduction of the burden of taxation, in spite of a necessary reduction in the PSBR. In fact, however, general government expenditure had risen from 43 per cent of GDP in 1979/80 to 46 per cent in 1980/81, and it appeared to have stabilized at approximately that level. A reduction in the PSBR and the taxation burden was, however, a prerequisite for creating a climate in which the private sector could flourish. Partly as a result of the difficulties in cutting the PSBR, excessive pressure had fallen on monetary policy. The heavy reliance on monetary policy had been particularly disadvantageous in its results because of the coincident major changes in the economy caused by the coming on stream of North Sea oil.

North Sea oil had provided new resources that could be used to modernize industry by stimulating investments or, through the pursuit of appropriate policies, to export capital, Mr. Polak said. While it could have been expected that the coming on stream of North Sea oil would have led to some appreciation of the exchange rate, the staff appeared to have assumed too readily some kind of an automatic link between the rise in oil exports and the rise in the real exchange rate. Admittedly, the staff had shown that the real exchange rate had gone beyond what would have come as a result of the improvement of the current account due to oil, but even that part attributable to the increase in the current account should not be assumed to be automatic; not all major oil exporters underwent a strong improvement in their real rate of exchange. In some oil exporting countries, the capital surplus had been used to increase reserves or investments. That had not happened in the United Kingdom; the liberalization of capital exports in the United Kingdom had provided a matching outflow of private capital, which, in effect, was in excess of the current surplus, at least during 1980. It would have been useful if the staff could have provided a somewhat more refined balance of payments statement that would have shown such information; the figures in SM/81/26 did not distinguish between outflows of long-term capital and short-term inflows, which had been attracted by high interest rates and perhaps in part by speculative factors. Absorbing the oil surplus fully in the exchange rate had meant that the benefits of oil had gone totally into consumption through lower import prices. While that had helped to cut inflation, it had reduced the profitability of export and import competing enterprises, which formed such a large proportion of British industry. Moreover, the profits from oil had not led to greater home or foreign investment.

The U.K. economy had been subjected to two negative pressures in recent months, the anti-inflation policy and the appreciation of the pound, Mr. Polak continued. The anti-inflation policy had been inevitable, but the appreciation of the pound had been due in part to the effects of a tight money policy combined with the oil surplus. There seemed to be some difference in the views taken by the staff and by the authorities on the effect of the sharp rise in the real exchange rate. Whereas the staff had said that its consequences for activity and employment might have been tighter than was strictly required for the success of the medium-term strategy, Mr. Anson had welcomed that same effect as "sharpening the incentive to U.K. industry to become more efficient." But, surely, a line had to be drawn at some point between invigorating competitive conditions and a climate where even the fittest could not survive. He would be interested to hear Mr. Anson's view of where that point might lie.

Particularly now that there were encouraging signs that prices and wages were coming under control, the authorities would probably be best advised to place more emphasis on fiscal and less on monetary policy, Mr. Polak suggested. If the authorities were to carry out their original intention, they would have to achieve a significant and sustained reduction in general government expenditures as a proportion of GNP over a number of years. It was vitally important that that policy should be carried out steadily over the medium term, whatever the temporary vagaries in the economic climate. That could be done while still reducing the importance of monetary policy in the fight against inflation; in that way upward pressure on the pound would be dampened and the profitability of U.K. industry increased accordingly. The increased production of tradable goods by industry was an indispensable prerequisite for the economic recovery that was the ultimate aim of the authorities' policy package. He agreed with the staff that a further contribution to increased profitability could come from some shift of taxation away from business and toward consumers.

Mr. Hirao noted that the prime objective of the medium-term strategy followed by the U.K. authorities was to reduce inflation and to create conditions for sustainable growth. The main tools being used were financial restraint and a greater recourse to the market mechanism. During the first 18 months of the new strategy, in spite of the critical views it had aroused, some clear progress had been made. The rate of inflation had been decelerating remarkably in recent months and was expected to be down to a single digit by the end of 1981. Wage increases appeared to be slowing down from 22 per cent in the previous wage round to about half that level in the current round. However, the short-term cost of the policies had been significant. There had been no growth in real GDP and the unemployment rate had climbed to historically high levels. In spite of the difficulties, the British authorities were determined to pursue their medium-term strategy.

Although the rate of inflation was decelerating sharply, it was still at a high level and continued efforts would be needed in order to bring it down to a single digit figure, which was essential if inflationary expectations were to be contained, Mr. Hirao continued. The outcome of the current wage negotiations would have significant implications in that regard; if wage increases were moderate, the trend of decelerating inflation could be consolidated. Furthermore, a vigorous recovery of private investment, which was essential for stable self-sustained economic growth, could be expected only after corporate sector profits improved; in consequence, moderate wage settlements were essential. It was highly advisable, therefore, that the present degree of tightness be maintained, at least until wage settlements were fixed within the anticipated range. Any fine tuning of financial policies, if needed, should be limited to actions that would not affect the public perception of governmental firmness.

He could support the authorities' medium-term objective of reducing the money supply gradually, Mr. Hirao said. The reduction had proved more difficult than expected; the level of M-3 in particular had far exceeded the official target following the reintermediation associated with the abolition of the "corset" and the impact of the recession on public expenditure. Fortunately, other monetary aggregates, such as M-1, had shown only a moderate increase. Furthermore, the high short-term interest rates and the strength of the exchange rate were indications that the monetary situation had been extremely tight. Against that background the recent reduction of the minimum lending rate had been appropriate.

There had been a number of difficulties on the fiscal side, Mr. Hirao remarked. Despite the authorities' efforts to contain public spending, the PSBR was expected to exceed the original budget estimate and to reach 5 per cent of GDP in FY 1980/81. Government expenditure had increased rapidly and its share of GDP had risen from 43 per cent in 1979/80 to 46 per cent in 1980/81, contrary to the authorities' medium-term goal. The rise in public expenditure had been caused in part by the large increase in public service pay, and it was hoped that the authorities would be successful in containing public service wages in the coming fiscal year. Recently, a rumor had circulated that the budget deficit in 1980/81 would become much larger than the revised official estimate; comments from the staff or from Mr. Anson on that report would be helpful. He welcomed the authorities' renewed efforts to cut the PSBR and thus restrict public expenditure in 1981/82. The unduly large role in the economy of the government sector was no doubt one of the major underlying causes for structural weakness common in many advanced economies; he hoped that the authorities would be able to make steady progress toward reducing it.

On the external side, Mr. Hirao continued, the prospects for the balance of payments seemed to be good. The staff had noted that the appreciation of sterling had facilitated the necessary structural change in the economy and had contributed to moderating domestic inflation. However, the sharp appreciation of the pound had exacted enormous transitional costs that had been borne by the industrial sector. The authorities could have employed a reflationary policy to avoid such a sharp appreciation but, given the high rate of inflation, reflation might in the long term have done more harm than good. He therefore supported the authorities' policy of allowing the exchange rate to be determined by market forces. In conclusion, he found the general strategy pursued by the authorities to be going in the right direction, and he believed that adherence to that strategy would lay firm ground for sustainable economic growth without inflation in the future.

Mr. Iarezza commended the U.K. authorities for their courage in implementing an ambitious program designed to reduce the rate of inflation and to overcome some of the long-standing weaknesses in the economy, such as the low level of activity and the loss in international competitiveness. He welcomed the general approach that had been followed to achieve those targets: on the demand side, the control and progressive reduction of the rate of monetary expansion, and allowing the exchange rate to find its own equilibrium level; and, on the supply side, the great reliance on market forces, as evidenced by the removal of exchange, trade, and price controls, by the shift of the tax burden toward the value-added tax (VAT), and by a more selective use of tax incentives. The reduction and size of the public sector relative to GNP and in its borrowing requirements would be a necessary complement to those policies. The share of resources preempted by the public sector and the public sector's claims on total financial resources should be reduced.

In analyzing the U.K. economy it was necessary to differentiate between the stabilization program and the structural adjustment that was taking place as a consequence of the increase in oil production and exports, Mr. Iarezza remarked. He agreed with the stabilization program adopted by the authorities. On the monetary side, the increase in M-3, even though it was above the original target, was in line with the greater demand for interest-bearing financial assets that could be expected in the context of a slowing down of inflation. The use of M-3 as a relevant money supply indicator should not be abandoned. Over the coming months the authorities should aim for a lower rate of increase in that money aggregate, given that money demand should have already adapted itself to the new level of inflation and interest rates.

In the fiscal sector, Mr. Iarezza commented, a policy designed to reduce the level of the public sector deficit and to control more closely the finances of public industries should be maintained. It could be shown that the present level of the PSBR, in fact, had dropped by some 2 per cent in terms of GNP when cyclical factors were taken into account. In the real sector, he shared the authorities' view that any reduction in economic activity that might be attributed to the stabilization program could be promptly reversed as soon as price expectations adjusted to a level consistent with present policies. Such an adjustment would bring wages, profits, and interest rates into line, and the exchange rate in turn would be stabilized. With regard to the exchange rate, he wondered whether the proportion of the appreciation of the pound attributed to the effects of the stabilization program could not be considered as being caused mainly by a catching up from a previous undervaluation due to the past high rate of inflation and weak economic prospects of the economy in general. If that were the case, no depreciation of the exchange rate could be expected in the near future.

In considering the structural adjustment of the economy following the increase in oil production and in exports, Mr. Iarezza continued, he supported the authorities' decision to let adjustment be brought about mainly by market mechanisms. Even when the pound had been appreciating rapidly, at least two thirds of that appreciation could have been attributed to improvements in the terms of trade. There was no other practical alternative but to let the pound reflect the new fundamentals of the economy. Market intervention would have impaired the control of money supply. He agreed with the authorities that extending control over capital movements or applying taxes on interest or dividends would not be useful.

There were a number of questions on which he would like further information, Mr. Iarezza indicated. How did the British authorities expect that structural adjustment would take place in the future and at what cost? How useful did they consider it would be for the Government to take action through tax subsidies or incentives to encourage adjustment in the industrial sector? Did they expect that relative factor prices would change following the switch to more capital intensive means of production associated with the greater importance of oil related activities to the economy? The answers to such questions would be of great interest to other countries that were watching the U.K. experience with interest. In conclusion, he welcomed the United Kingdom's continuing openness to international trade.

Mr. Buira expressed his broad agreement with the staff appraisal of the U.K. economy. The authorities' objective was to correct certain long-standing weaknesses of their country's economy. The annual rate of growth of real GNP in the United Kingdom had declined from an average of 2.8 per cent in the period 1960 to 1970 to about 1.7 per cent in the period 1970 to 1980; in both periods the rate had been about half that experienced in other major industrial economies. The rate of growth of production might be related to the quantity and quality of capital formation, in other words, the amount of investment relative to output and the incremental capital ratio and the organizational aspects of that investment. Available data indicated that the investment and the loss in incremental capital/output ratio had been unfavorable during that 20-year period, when compared with other major industrial countries; the apparent productivity of gross investment in the United Kingdom had been estimated at well below the average of the other major economies.

Perhaps the main reason for the low rate of capital formation and economic growth in the United Kingdom could be found in the performance of domestic savings, Mr. Buira continued. The decline in net domestic savings over the past few years had been the result primarily of a marked fall in the rate of savings by the government sector, particularly since 1979. Over those years, with domestic savings falling in the face of higher gross capital formation, borrowing had had to rise sharply, and that development had contributed to high nominal interest rates, which in turn had had a detrimental effect on the rate of private investment. The public sector, therefore, had had to some extent a crowding out effect on private capital formation, limiting the possibility for sustained growth in the economy. The authorities had recognized that fact in justifying their efforts to reduce the PSBR.

Despite some slippages, the authorities had made progress in reducing the public sector deficit, Mr. Buira commented. In his view, however, they should place more reliance on fiscal policy and rather less on monetary policy. He shared the staff's view that monetary policy had turned out to be somewhat tighter than the circumstances had required. As a result of the very high interest rates, and the appreciation of the pound, both of which were mutually reinforcing, export industries had suffered and there had been adverse effects on the long-term structure of industry. A greater effort should be made to allow oil revenues to sustain a higher rate of savings and investment in the modernization of industry, which was essential for the long-term success of the economy.

The disappointing performance of capital formation could also be explained in part by the low rate of return on corporate capital, Mr. Buira suggested. The growth of real average labor earnings had been appreciably greater than that of labor productivity, thereby substantially undercutting the profitability of industry. Bearing in mind the relatively high proportion of value added by labor costs in the United Kingdom, the current strategy of the authorities for attacking deep-rooted structural problems seemed quite appropriate. Of course, the behavior of the trade unions was a crucial variable for the success of that strategy, and although the reduction in the share of the social product taken up by wages was more difficult to achieve at a time when the social product was shrinking, it appeared that some progress had, nevertheless, been made.

Another factor that might have contributed to the somewhat lower efficiency of the economy over the past few years might have been the impact of integration within the European Community, Mr. Buira commented. Recent studies suggested that while the trade creation effects for the United Kingdom had not been significant, the trade diversion effects of integration within the Community had been considerable. The United Kindgom had been particularly affected by its inability to purchase agricultural products from the most competitive world markets. He hoped that the Community would be able to make reforms that would alleviate that problem.

The problems of the economy had to be seen in a medium-term context, Mr. Buira observed. If that were done, the short-term adjustment costs could be seen as bringing benefits in the long term. The rationale of such a strategy was based on an implicit cost-benefit analysis implying that over the coming decade the rate of growth would rise to levels that would compensate for the loss of output between 1980 and 1982. He would be grateful to hear Mr. Anson's comments on that point.

The strengthening of the supply side of the economy as a result of improving and expanding market mechanisms on the one hand, and cutting the rate of inflation on the other, should give rise to substantial economic and social benefits in the medium term, Mr. Buira remarked. He was glad to note that the United Kingdom had maintained the same degree of openness in its trade policy despite the strong recessionary tendencies, but he noted with concern the prospective decline in official development assistance at a time when the balance of payments was in surplus. In conclusion, the authorities had already made considerable progress in the fight against inflation, and he hoped that they would be able to make progress soon on all other fronts.

Mr. Narasimham commented that the new policies being implemented by the U.K. authorities represented a break from the economic philosophy of the past. Their purpose was to control inflation through the use of firm financial policies, and particularly through a strict control of the money supply. Both the staff and Mr. Anson had recognized that it would be some time before the policies could be expected to produce results, and had acknowledged certain difficulties in their implementation. In his view, some concern for the short-term effects of the authorities' strategy was legitimate and it could well be asked whether the performance of key economic variables, such as prices, output, and productivity, demonstrated that the economy was moving on the right track and away from the previous experience of high inflation and slow growth. It was difficult to make firm judgments, because the economy was still in a transitional stage and the structural changes would inevitably involve transitional costs in terms of lost output and employment, which had been further aggravated by a strong pound and tight money.

The authorities' major success had been in controlling inflation and in winding down inflationary expectations, Mr. Narasimham said. Retail price inflation, after having accelerated to a peak of 22 per cent during the year ended May 1980, had by January 1981 come down to 13 per cent, generating hopes for reaching a single digit rate in 1981. That decline in inflation had regrettably coincided with a larger than anticipated decline in output and a historically high level of unemployment. That was more than a coincidence and he wondered whether the factors that had contributed to the sharp deceleration of inflation--a tight monetary stance and a rising pound--had not also been responsible for the decline in output and employment. The decline in output had been broadly based, affecting both capital and consumer goods industries. Industrial output had dropped more in 1980 than in any year since the 1930s and was reported to be no higher than in 1967. The combination of monetary stringency, high interest rates, and a high exchange rate had created financial stringency and a profit squeeze in the corporate sector. The larger than anticipated decline in output had been ascribed mainly to a rapid rundown in stocks--a development that benefited the external sector at the expense of domestic output and employment. There could be little doubt that controlling inflation and reversing inflationary expectations would provide a secure base for further growth, but were the transitional costs for the United Kingdom too high in social terms?

The authorities' new policies had come to be seen as a field experiment for the monetarist approach and the use of the monetary instruments to tackle the short-term problem of inflation and to set the stage for medium-term structural transformation, Mr. Narasimham commented. It was puzzling therefore to note that while the objective of controlling inflation had been largely met, the specific monetary targets had been breached. Monetarism had apparently succeeded in bringing about deflation without succeeding in controlling money supply. He agreed with the staff that the authorities' monetary policies had perhaps been tighter than warranted and that some moderation would have been appropriate. Could the staff comment on what it would consider an appropriate degree of tightness that would not have adverse consequences on output and employment? Could it also explain why, despite a restrictive monetary policy, the PSBR had exceeded its target? Could it be inferred that the resources available to the private sector had been inadequate in proportion to those available to the public sector? If so, that would seem to be contrary to the stated intention of the authorities. Perhaps the staff could also comment on why, after making allowance for the unwinding of the distortions associated with the "corset," M-3 had clearly exceeded targets while narrower money aggregates appeared to have kept close to them. In his view, despite the possibility of lagged effects, the relationship between M-1 and M-3 was governed by behavioral variables and the pattern of asset preferences, which was unlikely to vary greatly in the short run. Why had narrow money and quasi-money moved in the way they had? Did the U.K. experience suggest that more significance was being given to M-3 than was justified in relating monetary aggregates to real variables?

The key element in the authorities' effort to control monetary expansion, to bring about structural change, and to reduce the proportionate role of the public sector was the containment of public sector expenditure, Mr. Narasimham said. Unfortunately, such expenditure had risen well beyond expectations; in fact, the PSBR for the financial year to March 1981 might rise as high as £13.5 billion, or £5 billion more than the target set in spring 1980. The Government had made serious efforts to hold down expenditures through cash limits. Was he right in believing that there were some public expenditures, for example those by local authorities, where the cash limits did not operate? Whatever the answer, the overruns in expenditures had been high and had been attributed to the impact of the recession, which apart from its impact on revenues required heavy outlays on social security payments and special employment measures. He wondered whether the concern of the authorities to reduce public sector expenditures might affect public investment in essential areas and, at one remove, corporate investment, while at the same time driving unemployment up with consequent increases in social security payments. He wondered whether the private sector's problems would not have been worse in the absence of government expenditures rising by as much as they had. Selective assistance to industrial units facing difficulties could not but increase in the short run and become another source of unanticipated expenditures. The combination of higher social security payments and industrial rescue expenditure could put the authorities' fiscal objectives out of reach.

While cuts in corporate tax rates were planned, Mr. Narasimham continued, rates of national insurance contributions and taxes on expenditure were due to be raised. He wondered whether the overall effect of such measures would not be regressive and possibly cause a decline in the household savings ratio. Another area where the new policy stance appeared to have met with some degree of success was in the hitherto intractable area of wages. Recent trends indicated a moderation in wage demands and more reasonable wage settlements in the private and public sectors. What was particularly significant was that there had been less industrial action in pursuit of wage settlements. The key to the recovery of the economy according to the authorities was based on a further decline in wage inflation, which it was believed would restore profit margins and improve competitiveness of the non-oil sector. He wondered whether present trends could continue without a further decline in real wages.

The squeeze on the corporate sector and its constricted liquidity had also been aggravated by the declining competitiveness of British industry following the appreciation of the pound, Mr. Narasimham said.

He wondered whether the impact of a strong pound on corporate profits and liquidity was not negating the authorities' objective of relying on the private sector to stimulate growth and employment. The exchange rate had clearly been affected by the tight monetary stance and the impact of North Sea oil, as other aspects of the economy did not warrant such a high degree of appreciation. It might well be that the combination of high interest rates in the international context and the strong pound would cause additional strains on international currency movements. The authorities remained committed not to intervene actively in the market, and that inaction might result in the United Kingdom drifting into selective import controls as the lack of competitiveness grew more serious. With the staff he hoped that the United Kingdom would not succumb to protectionist pressures.

He regretted the reduction in outlays for official development assistance, particularly when the United Kingdom had such an excellent past record, Mr. Narasimham stated. In 1979 the level of British aid had risen by 28 per cent to reach the equivalent of 0.52 per cent of GNP. Much of that aid had taken the form of grants, and the U.K. share in International Development Association contributions had been proportionately higher than those for several other donors. The decision to cut aid allocations by 16 per cent in real terms over four years was disproportionately large in relation to other public spending cuts and could therefore only cause dismay, especially as the country was benefiting from North Sea oil and had large and growing reserves. He realized that freeing external transactions would permit a larger capital outflow to developing countries, but that was not the same as official development assistance. He wondered whether the budget of the Commonwealth Development Corporation would also be affected by the cuts in PSBR. He hoped that the authorities would reconsider their stand on cutting overseas aid.

Mr. Kafka said that, like Mr. de Groote, he would have preferred to have discussed the U.K. economy after the forthcoming budget had been published. Many countries were watching with fascination the courageous efforts and experiments being made by the U.K. authorities in trying to reduce inflation and lay the groundwork for the resumption of sustained growth after many years of stop-go policies. The program, which was designed to increase emphasis on the private sector and to increase the efficiency of resource allocation, could not be achieved rapidly. The delays and difficulties that had been encountered were not unexpected, and the authorities should not be influenced by them to make concessions, although they could not, obviously, wholly ignore the transitional costs that the program had incurred. Success required that the public should be convinced that the goal of reduced monetary and public expenditure growth would continue to be pursued relentlessly. Like the staff, he believed that the basic stance of the program was correct. Until expectations could be changed, an industrial democracy had no alternative but to buy wage restraint by some increase in unemployment. Most developing countries had to proceed more gradually and carefully in following such a course of action, because they lacked the social mechanisms necessary to make unemployment tolerable. Moreover, not all countries embarking on the sort of economic program adopted in the United Kingdom could count on oil revenues.

It was difficult to say whether the staff was right in maintaining that the authorities' monetary policy had been tighter than it needed to be, Mr. Kafka remarked. In the absence of a more stringent public sector expenditure policy, an error in the direction of monetary stringency was certainly safer than an error in the opposite direction. That did not mean that, at present, no liberalization of monetary policy should be contemplated. The interplay of the exchange rate, monetary policy, the oil situation, public sector expenditures, the resulting PSBR, and higher interest rates had probably created more of an appreciation of sterling than might otherwise have happened. The appreciation, in the context of a world recession, had contributed to unemployment, but ultimately it was to be hoped to greater efficiency. The appreciation had helped to reduce inflation; once the appreciation stopped, inflation could well rise again.

Encouraging results had been achieved with regard to wages, Mr. Kafka commented. Perhaps the greatest danger to the success of the U.K. experiment was the remarkable resilience of public sector expenditure. Such resilience was not surprising, but the authorities should not be hesitant in cutting down on redundant plant. He regretted the fact that the authorities had found it necessary to cut back on official development assistance. He joined those who had expressed the hope that the United Kingdom would be able to maintain a liberal trading stance.

Mr. Blöndal remarked that the United Kingdom's experiment in curing inflation through monetary restraint had attracted a great deal of interest. The measures taken to deal with the problems had thus far had mainly painful consequences in terms of depressed activity and high unemployment, and criticisms had been voiced by many observers; however, there had been some indications of a certain degree of success in the struggle against inflation, and the policies implemented had to be seen in the context of the authorities' medium-term strategy. It was difficult to judge what degree of stringency was appropriate in the United Kingdom, but in general he could go along with the staff's appraisal.

The depressed state of the non-oil company sector was traceable to certain structural weaknesses that had existed before the emergence of North Sea oil, and which had in a way been aggravated by it, Mr. Blöndal commented. It had also been caused by the combined effects of a strict monetary policy and a high exchange rate, which had arisen in part from the country's favorable energy situation. The present position posed a difficult dilemma for economic policy. Monetary restraint and the high exchange rate served to reduce inflation, but, at the same time, they hindered economic recovery and a reduction of unemployment. The authorities were thus confronted with the question of how much reduction in economic activity they should accept in order to come to grips with the problem of inflation, and conversely how much growth they could allow without creating inflationary pressures.

Given the authorities' preoccupation with inflation, it seemed appropriate that a special effort should be devoted to the containment of wage increases, Mr. Blöndal noted. Success in that area would help both to contain inflation and to improve profitability in the private sector, and would ultimately lead to the resumption of economic growth and the reduction of unemployment. In their relations with the labor market, the authorities had largely confined themselves to making participants aware of the consequences of excessive wage settlements on activity and employment. Such a stance, although not appropriate in all conditions, seemed quite reasonable in the present state of the economy, where labor market participants might be expected to assign particularly high priority to improvements in activity and employment. Recent wage settlements had to be regarded as encouraging in that respect.

He agreed with the staff that monetary policy might have been tighter than required, Mr. Blöndal said, as was indicated by the development of the narrow monetary aggregates. The high level of interest rates had obviously contributed to the strong appreciation of the exchange rate and to the unemployment rate that had reached historically high levels without showing signs of improvement in the near future. GNP was in substantial decline, and industrial production of the manufacturing sector was no larger than it had been during the second half of the 1960s. Although recent measures such as the reduction in the minimum lending rate were welcome, further easing of monetary restraint seemed advisable. A lower interest rate level could stimulate investment in the company sector directly, through lower investment costs, and also indirectly through the effects on the exchange rate and competitiveness. An improved environment for investment would eventually lead to higher productivity. Given the fact that North Sea oil was likely to decline in importance by the end of the century, it could be argued that restructuring should take place within the existing manufacturing sector, and that that sector should not be reduced in size any further.

In the field of fiscal policy, Mr. Blöndal noted, the Government's objective of reducing the PSBR in order to facilitate private sector access to credit in a noninflationary manner had been rendered difficult by the present state of the economy. Depressed activity had called for increased government spending on unemployment benefits and other social security outlays as well as for financial assistance to public enterprises. That fact might be regarded as another reason favoring some further monetary stimulus.

On the external side, the major problem had been the strong exchange rate and its repercussions on the non-oil company sector, Mr. Blöndal observed. While he agreed that the appreciation of the pound had been consistent with certain aspects of economic policy, its effects were certainly a cause of concern; on balance the appreciation had probably gone too far. As to other external developments, he regretted that the authorities planned to reduce their development aid as a proportion of GNP. In conclusion, he found it hard to see how a continuing emphasis on demand management measures could bring about a satisfactory level of employment once again. Somewhat more emphasis on measures on the supply side would seem to be appropriate. He hoped that the authorities would be able to place more emphasis on economic growth and employment.

Mr. Lovato remarked that the problems in the United Kingdom were similar to those in many other countries: a slow economic growth, a low level of productivity, and a relatively high rate of inflation. Particular to the U.K. economy, however, were the building up of oil production to the point of self-sufficiency and a strong currency. Within that framework the authorities had decided to work above all for a substantial reduction in the rate of inflation in order to create conditions under which sustainable and better economic growth could be resumed. The central feature of the anti-inflationary strategy was the pursuit of firm financial policies over the medium term directed at a progressive reduction of the rate of monetary expansion. In his view, the U.K. authorities had failed to recognize in their strategy the key role of productivity in price formation and of public sector borrowing in the expansion of personal income, with the consequent growth of personal demand for goods and services and of bank deposits that provided the basis for credit expansion.

The authorities were finding it difficult to meet their goals for broad money supply and for public sector borrowing, Mr. Lovato remarked. The price deflator and unit labor costs in manufacturing had both risen with the average wage earnings, which would suggest that labor costs were moving rapidly higher than prices, while productivity was lagging behind labor costs. The increase of the money supply beyond the level envisaged by the authorities had been due to a large recourse to bank credit; in other words, bank liquidity had been allowed to rise sufficiently to finance high costs rather than high production. Even the surplus on the current account resulting from higher oil production and higher exports had contributed to a net inflow of funds and to domestic inflationary pressures.

The targets for monetary expansion seemed appropriate, Mr. Lovato said, but he believed that they would be difficult to achieve without restraint in public expenditures and in wage increases. It was encouraging that average wage settlements in recent months had been under 10 per cent. Even so, the increases had been higher than the increase in retail prices over the past six months. Since the United Kingdom did not need high interest rates to support the pound, he wondered why the authorities wished to prevent banks from expanding loans by more than was necessary to reach monetary policy targets and to restrain inflation.

He shared the staff's opinion that it was urgent that the authorities should continue their efforts to reduce the pace of wage settlements below the ratio of increase in prices, particularly since it was unlikely that inflation would be cut back any further by an appreciating exchange rate, Mr. Lovato concluded. He believed that the authorities should put more emphasis on productivity in the private sector and particularly in the public sector; he would like to know what efforts were being made in that direction.

Mr. Prowse considered that it might have been helpful if more attention could have been paid by the staff and Mr. Anson to the causes of the present problems confronting the U.K. economy, and the ways in which current and proposed policies were expected to deal with those causes. In the absence of an agreed exposition of that kind, there had been some confusion in the discussion about the nature of the problems concerned, the causes of those problems, and hence about the appropriateness of the policies that were being implemented. In his view, some speakers had gone beyond the Executive Board's field of interest by commenting on the authorities' political objectives.

He strongly endorsed the anti-inflationary objective of the U.K. program, Mr. Prowse noted. He also agreed with the comments on overall policy made by the staff on pages 15 and 16 of SM/81/26. The authorities accepted the general thrust of the staff papers but differed somewhat with the staff on the appropriate stance of monetary policy. He did not agree with those Executive Directors who had supported the staff in its view that there might be a case for easing monetary policy immediately. He did not believe that a deliberate easing of monetary policy as an isolated action, either for perceived employment or exchange rate purposes, would be appropriate. The underlying growth in M-3 was still about 20 per cent a year. The staff report had indicated that the recent decline in prices justified an easing of monetary policy, but surely the purpose of the tight monetary stance was to cause a drop in prices. The Executive Board would have deduced that monetary policy had not been tight enough if prices had not fallen; he could not accept, therefore, that the decline in prices should be used to justify an immediate easing of monetary policy.

There was no evidence or theory to support the argument that a narrower measure of money would be a better indicator for monetary action than M-3, Mr. Prowse continued. Any move to disregard broad monetary measures should be considered only with the greatest caution. Moreover, it should be noted that the authorities did not base their monetary policy decisions on one single indicator. They had claimed that the deviations in the aggregates from the intermediate quantitative targets were not of great concern as long as the final monetary target for 1983/84 continued to be achievable. In fact, the deviations had been so large that it was now questionable whether the 1983/84 target was still achievable. The deviations might have contributed to a loss of confidence in the authorities' ability and determination to maintain and to achieve their targets. The authorities should try to ensure, therefore, that any short-term deviations were minimized as much as possible.

It was a matter of serious concern that the objective set for the PSBR had not been achieved, Mr. Prowse said. Obviously a large part of the increase in the PSBR had been an automatic response to the recession, but, nevertheless, the continual failure to achieve the set target was most disappointing. The problem would need to be mastered through a renewed commitment to the control of public expenditure. It would be self-defeating to seek monetary objectives without also seeking complementary fiscal objectives. Achieving the objectives set for the PSBR would be admirable; without a renewed commitment, however, the prospects for achievement were slim.

While there appeared to have been some improvement with regard to the level of wage settlements, Mr. Prowse observed, he believed that the major weakness of the policy over the past year had been the authorities' failure to contain public sector pay. They should renew their emphasis on the need for restraint. A renewed emphasis should also be placed on the need for appropriate pricing and investment policies in public enterprises; at the moment, the recognition of that need seemed to be more theoretical than practical.

The authorities had placed too much weight and attention on monetary policy, and in the future should broaden their focus and pursue a more vigorous and deliberate attack on the most significant problem areas, Mr. Prowse recommended. They could do well to bear in mind the comments made by Mr. Ryrie in speaking of the U.K. economy at EBM/79/148 (8/29/79) when he had said "none of the available economic explanations can be regarded as wholly convincing, and one is driven to the conclusion that at least part of the explanation lies outside the field amenable to economic policy, and that there is a social phenomenon which is not only difficult to define but, also still more difficult to respond to in terms of any government policy." Could Mr. Anson say whether that realistic attitude toward noneconomic matters had been acted upon?

Mr. Sangare expressed his broad agreement with the staff appraisal. He commended the U.K. authorities for their commitment to correcting long-standing weaknesses in the economy and their courageous determination to pursue policies aimed at controlling inflation, while attempting, in a medium-term context, to establish the basis for a sustainable expansion of output and employment.

Although he endorsed the emphasis being placed on the need to strengthen the supply side of the economy, Mr. Sangare continued, he had been disappointed to learn from the staff papers and from Mr. Anson that, despite the progress being made in reducing inflation, improvement in the real sector of the economy had been meager. The prospect of a continuing reduction in the level of economic activity in the United Kingdom should be regarded as an issue of international concern, not only in view of the importance of the U.K. market for the exports of other countries but also in view of the political problems that might arise from the present high rate of unemployment. Any indications that the authorities planned to intensify their efforts to improve the performance of the real sector of the economy would be most welcome.

The authorities remained fully committed to a strict monetary policy, Mr. Sangare noted. The impact of such policies on domestic interest rates, on the exchange rate, and on the manufacturing sector was clearly worrying. Admittedly the effect of the strict monetary policy on the appreciation of the pound was not clear, but he wondered whether the staff could comment on whether the recent sharp increase in interest rates had led to the increase in the cost of market borrowing, which had led to the limitation of access of certain countries to financial markets in the United Kingdom.

It would be in the interest of non-oil developing countries if the United Kingdom could adopt a more flexible and yet effective monetary policy, Mr. Sangare commented. He welcomed the recent relaxing of monetary policy that had been evidenced in the reduction of the minimum lending rate. With regard to fiscal policy, he welcomed the measures taken recently to bring the PSBR back on track. It was crucial for the authorities to be able to balance the public sector finances if they were to achieve their aim of restructuring the economy, improving the working of the market mechanism, and restoring conditions for a sustained expansion of output and employment without inflation.

The authorities in his constituency had consistently opposed the adoption of protectionist measures, which had the effect of curtailing the expansion of output by competitive industries in other countries, Mr. Sangare recalled. He failed to see how increased protection by any country could be judged as correct, given the importance of promoting economic efficiency on the supply side. In the present interdependent world, all countries should show a determined commitment to the basic tenets of comparative advantage, which underlay the principle of free trading. All countries should resist domestic pressures for the protection of industries that were unable to stand on their own. He hoped that the authorities of the European Community would act in due course to minimize recourse to protectionist measures.

After official development assistance had increased by 28 per cent, or 0.52 per cent of GNP, in the United Kingdom in 1979, it was regrettable that the authorities now planned to cut foreign aid by more than 14 per cent in real terms between 1979/80 and 1983/84, Mr. Sangare said. In view of the relative strength and the continuing improvement of the U.K. balance of payments, and in view of the more pressing needs of many developing countries, the intention of the U.K. authorities to cut back on aid flows was disappointing. He hoped that in future it might be possible to shield expenditure on aid from the policy of reducing government spending for reasons of domestic stabilization. He hoped also that future aid levels would be permitted to increase as soon as a greater economic stability was achieved.

Mr. Leimone remarked that the U.K. authorities had embarked on an ambitious and important medium-term program; ambitious in terms of objectives, and important not only to the United Kingdom but to the world economy. The program was clearly deserving of support. In the process of its implementation, the authorities had predictably encountered difficulties in achieving a number of its aims: the share of public sector expenditures in GNP in 1980 had increased instead of declining; the PSBR had increased substantially; the growth of broad money had significantly exceeded the target range; and unemployment had increased beyond official expectations. On the other hand, wage increases and the rate of inflation now appeared to be decelerating, and there had been a significant move back toward market mechanisms in both the domestic and external sectors. On the external side, the elimination of capital controls had enhanced the United Kingdom's role as a center for international financial intermediation.

Because of the medium-term nature of the program, it would be premature to attempt an assessment of the eventual outcome, Mr. Leimone observed. However, the experience to date suggested several questions that seemed important to that outcome. The overrun in public sector expenditures had been caused primarily by larger than anticipated social security spending and grants to public sector enterprises. The increased social security spending had arisen from the large increase in unemployment, and he wondered what the authorities' projections were of future trends in employment, and where they foresaw sources of employment growth emerging. In that context, the authorities had apparently accepted that the real appreciation of the exchange rate had resulted in a shift in demand from domestic tradable goods, largely in manufacturing, in favor of domestic absorption of imported goods. Did that imply that the authorities expected a permanent decline of the share of manufacturing in output and employment?

The authorities anticipated that future reduction in public sector spending would come mostly from controls on "the finances of nationalized industries and local authority housing expenditures," Mr. Leimone noted. He would like some further information on how those reductions were to be accomplished, and how soon it would be before their effects became apparent.

Given the crucial role that monetary policy had been assigned in the Government's program, Mr. Leimone continued, the staff had rightly raised questions about the appropriate indicator for monetary growth, given the wide diversions between growth in broad money and other monetary aggregates. Were the authorities considering giving a greater weight to monetary aggregates other than broad money as a guide for policy? He understood that M-1 growth had accelerated in recent months; would a continuation of that trend create cause for concern? Alternatively, should it be viewed as an easing of monetary policy?

Revitalizing an economy that had suffered from serious long-term structural problems would be a difficult and time-consuming process, Mr. Leimone concluded. Implementation of the revitalizing process through the kind of program adopted by the British authorities might well entail large costs with respect to real growth and labor force dislocation in the short term, in the hope of achieving a more dynamic economy over the long term. He awaited the outcome of the British economic program with keen interest.

Mr. Nana-Sinkam said that he shared the views expressed in the staff appraisal. With their economy characterized by high inflation, a slow rate of output, and a decreasing level of productivity as a consequence of an outmoded industrial sector, the authorities deserved commendation for their courageous medium-term strategy. It was only unfortunate that the present discussion came too soon to evaluate the strategy fully. Comments at the present time could only be based on uncertain assumptions. He understood the authorities' belief that the combination of their various policy measures would make more resources available to the private sector and would strengthen that sector's role in the economy. However, it was regrettable that the authorities had placed the major burden of the adjustment process on the private sector. It was difficult to understand how such a policy could be consistent with their underlying objectives.

With the strong appreciation of sterling, it might be appropriate to place more emphasis on fiscal policy and less on monetary policy, Mr. Nana-Sinkam suggested. In fact, the combination of a high level of sterling appreciation, high interest rates, and high unemployment had largely negated the commendable achievements in the fight against inflation. In consequence, it might be that the social costs of the present course of action were unacceptably high and that a new policy mix was required.

It was understandable that with increased revenue from the oil sector the authorities should decide to modernize the industrial sector and improve productivity through a medium-term strategy, Mr. Nana-Sinkam commented. What was not understandable, and therefore regrettable, was that at a time when the balance of payments situation was improving, the authorities had decided to reduce their development assistance. That decision was even more regrettable because it involved not only a reduction in official development assistance, but also an intention to distribute assistance on the basis of noneconomic criteria. He hoped that the authorities were not planning to re-establish preferential and discriminatory treatment of potential beneficiaries. Official development assistance was not internally inflationary, and it was difficult to see why the authorities should have decided to reduce it.

The Executive Directors adjourned their discussion of the 1980 Article IV consultation with the United Kingdom until the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/23 (2/18/81) and EBM/81/24 (2/20/81).

2. DOMINICA - PURCHASE TRANSACTION - FIRST CREDIT TRANCHE

1. The Fund has received a request from the Government of Dominica for a purchase equivalent to SDR 25,007, which is the remaining portion of its first credit tranche.

2. The Fund approves the purchase in accordance with the request. (EBS/81/12, Supplement 2, 2/18/81)

Decision No. 6749-(81/24), adopted
February 18, 1981

3. PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN PURCHASE TRANSACTION - RESERVE TRANCHE

The People's Democratic Republic of Yemen is making a reserve tranche purchase equivalent to SDR 9,429,777 in Nigerian naira pursuant to its request dated February 11 and 15, 1981. The Fund notes the People's Democratic Republic of Yemen's request, including its representation in accordance with Article V, Section 3(b). (EBS/81/37, 2/18/81)

Decision No. 6750-(81/24), adopted
February 18, 1981

4. TUNISIA - 1980 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/81/42 (2/17/81). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1980 Article IV consultation with Tunisia until not later than March 6, 1981.

Decision No. 6751-(81/24), adopted
February 19, 1981

5. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/81/48 (2/14/81).

Adopted February 18, 1981

6. LIBREVILLE MEETINGS - TRAVEL ALLOWANCES

The Executive Board approves the recommendation set forth in EBD/81/43 (2/17/81).

Adopted February 19, 1981

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/81/51 (2/18/81) and EBAP/81/52 (2/18/81) is approved.

APPROVED: July 29, 1981

LEO VAN HOUTVEN
Secretary