March 28, 1995

Approval: 4/4/95

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 94/58

10:00 a.m., June 30, 1994

Contents

Executive Board Attendance

R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	M. Sirat
	E. Srejber
H. Evans	
	T. Fukuyama
K. P. Geethakrishnan	
J.E. Ismael	K.-T. Hetrakul
	K. Link
A. Kafka	
	A. V. Mozhin
	B. Lvin, Temporary
W. Kiekens	
	N. Coumbis
K. Lissakers	B. S. Newman
R. Marino	
A. Mirakhor	M. Daïri
L. J. Mwananshiku	B. S. Dlamini
	J. M. Jones, Temporary
	O. Havrylyshyn
	B. A. Sarr, Temporary
	G. M. Blome, Temporary
A. S. Shaalan	Y. Y. Mohammed
D. E. Smee	
E. L. Waterman	A. M. Tetangco, Jr.
Zhang M.	Wei B.
	A. F. Jiménez de Lucio

A. Mountford, Acting Secretary
M. J. Miller, Assistant

Also Present

IBRD: M. Baird, Office of Development Economics. African Department: G. E. Gondwe, Deputy Director; O. P. Brekk, H. Hino, M. Nowak, R. C. Williams. Central Asia Department: D. J. Goldsbrough, K. Kochhar. European I Department: M. Russo, Director; G. Bélanger. European II Department: L. Hansen. External Relations Department: S. J. Anjaria, Director; M. R. Kelly, Deputy Director. Fiscal Affairs Department: E. F. Offerdal, J. A. Schiff, G. C. Tsibouris. Legal Department: F. P. Gianviti, General Counsel; H. Cisse, D. E. Siegel. Monetary and Exchange Affairs Department: J. M. Jimenez. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; A. F. Adams, A. G. G. Bennett, H. W. Bredenkamp, D. Burton, K. G. Fitchett, H. M. Flickenschild, N. Kirmani, M. Mecagni, A. K. McGuirk, M. A. Savastano, S. M. Schadler, A. Singh, J. F. van Houten. Research Department: M. Mussa, Economic Counsellor and Director; M. S. Khan, N. Ul Haque, P. Wickham. Secretary's Department: S. Bhatia, K. Friedman. Western Hemisphere Department: C. M. Loser, Deputy Director; L. H. Duran-Downing. Advisors to Executive Directors: J. M. Abbott, M. C. B. Arraes, A. Cserés, T. K. Gaspard, J. Jamnik, M. F. Melhem, J. Ortiz Vely, J. R. Suárez, J. W. van der Kaaij. Assistants to Executive Directors: S. Al-Huseini, R. Bessone Basto, P. I. Botoucharov, M. A. Brettschneider, D. Desruelle, G. Z. El-Masry, L. Fontaine, A. Galicia, C. Gaseltine, N. F. Gregory, O. A. Himani, C. Imashev, P. Jilek, V. Kural, K. J. Langdon, G. J. Matthews, V. Rigász, S. Rouai, M. Ryan, D. Saha, G. A. Sánchez, S. Vori, J. B. Wire.

1. KENYA - REPORT BY STAFF

The staff representative from the African Department made the following statement:

> The arrangement under the enhanced structural adjustment facility (ESAF) was approved in December 1993 in support of an economic program covering the period October 1993 to September 1994.
>
> The performance under the program has, on the whole, been good. Substantial progress has been made in restoring macroeconomic stability. Inflation decelerated from the annual rate of 55 percent in the third quarter of 1993 to 19 percent in the quarter ended in May; inflation in the quarter ended May was somewhat above the target, mainly because of the impact on food prices of the drought. The balance of payments was stronger than programmed. The current account, excluding transfers, was in balance in 1993, compared with the projected deficit of 1.6 percent of GDP, and gross international reserves reached 4 1/2 months of imports in May, compared with a target of 1.8 months of imports for June. The Kenyan shilling appreciated from 67 shillings per dollar in September last year to 56 shillings per dollar at present.
>
> Further major economic liberalization was achieved. The maize market was fully liberalized in December 1993 and all exchange controls were removed by May 1994, except those relating to foreigners' investment in shares and government securities. The restrictions on foreign inward investment will be liberalized once appropriate laws and regulations are put in place. The only substantial remaining controls relate to petroleum marketing and pricing. Measures to protect vulnerable groups from adverse consequences of liberalizing petroleum prices will be put in place in the coming weeks, and the controls will be removed before the conclusion of the review, thus meeting the remaining structural performance criteria, albeit with a delay of a couple of months.
>
> Structural reforms in other areas were broadly on schedule; all structural benchmarks were observed, except those concerning staff retrenchment of the National Cereals and Produce Board (NCPB).
>
> The main area of weakness in performance was the execution of the central government budget. The budget deficit for the first nine months of the fiscal year, which is July to June, exceeded the target of K Sh 24.5 billion by K Sh 4.3 billion. This target is a performance criterion. This overrun mainly reflected larger than programmed interest payments associated with sterilization of foreign exchange inflows and unanticipated external debt servicing

on behalf of public enterprises. Unauthorized expenditures also played a role, as government expenditure control mechanisms were not implemented as planned. The Kenyan authorities have taken a number of measures to raise additional revenue, and they aim to limit the deficit for 1993/94 as a whole to K Sh 27.5 billion, which is higher than the program target by K Sh 2.9 billion, equivalent to 0.8 percent of GDP.

Except for the budget deficit, all quantitative performance criteria for end-March were observed. In particular, net domestic assets of the Central Bank of Kenya and net central bank credit to the Central Government were both lower than the performance ceiling by more than one half of reserve money stock. Reserve money was nevertheless above the program path through April, as the Central Bank was unable to fully sterilize the foreign inflows. However, monetary conditions have been tightened through treasury bill sales, an increase in the cash ratio, and tightened access to central bank credit. Interest rates on 90-day treasury bills now stand at about 32 percent--positive in real terms.

The 1994/95 budget proposal, which was presented to Parliament on June 16, is stronger than the program. The deficit of 2.0 percent of GDP, excluding grants and on a commitment basis, is almost one third below the program target, and will permit a critically needed reduction of domestic debt. Total expenditure will be reduced by 4.6 percent of GDP, mainly through lower interest payments, while allowing moderately higher wages, as well as increases in maintenance and development expenditures to recoup some of the compression in recent years. The budget speech also announced strengthened expenditure control. The tax measures aim at reducing tax rates and broadening the base, while maintaining the revenue/GDP ratio.

Notwithstanding the overall good performance and recent policy measures, the staff considers it prudent to temporarily postpone the completion of the review discussions to allow time for the Government to mobilize additional revenue, meet the revised deficit target for 1993/94, and strengthen the expenditure control mechanisms. Also, this will allow the implementation of petroleum market liberalization and retrenchment of the NCPB, so that all actions constituting structural performance criteria and benchmarks will be taken before the completion of the review. Assuming that these actions are taken, the staff expects Board consideration to take place in late September 1994. Completion of the review on this basis would require the Board to grant waivers for the performance criteria on the budget deficit and petroleum liberalization.

The Kenyan Government has informed us today of its acceptance of the obligations of Article VIII, Sections 2, 3, and 4 of the

Articles of Agreement. The staff paper on Kenya's acceptance of these obligations will be issued to the Board shortly. Kenya maintains one exchange measure subject to Fund jurisdiction--that is, a multiple currency practice arising from the Exchange Risk Assumption Fund (ERAF). The staff will be recommending Board approval of this exchange measure, as no new commitments will be entered into under the ERAF, and the ERAF will be dissolved immediately after the existing obligations are paid, or at the latest by December 31, 2003.

Mr. Mwananshiku stated that he welcomed the statement of the staff representative from the African Department, which presented accurately the situation in Kenya at present. He wished to underline the authorities' commitment to the reform process, a commitment that had recently been endorsed by the ruling party in Kenya, thus providing a sound foundation of support for the reform. On fiscal policy, the Treasury and the Central Bank had established a mechanism enabling the Central Bank to monitor closely expenditures by ministries, with a view to preventing overexpenditure. In that connection, the introduction of monthly and quarterly ceilings on recurrent and capital expenditure, respectively, would be important in avoiding overexpenditures. The Central Bank had also strengthened its supervisory role over commercial banks following the revision of the Banking Act, and was continuing to recover money owed to it, thus strengthening its balance sheet. Preliminary figures on inflation for end-June 1994 suggested that there had also been a significant reduction in inflation. The authorities wished to express their appreciation to the Fund for its support of Kenya's reform process, and for the exercise of flexibility in the implementation of the program.

2. STAND-BY AND EXTENDED ARRANGEMENTS APPROVED DURING 1988-91 - REVIEW OF EXPERIENCE

The Executive Directors considered a staff paper reviewing experience in countries with stand-by and extended arrangements approved during 1988-91 (EBS/94/104, 5/19/94; and Cor. 1, 6/9/94). They also had before them background papers containing studies by the staff (EBS/94/84, 4/15/94; and Sup. 1, 6/8/94).

Mr. Kiekens made the following statement:

> The staff analyzes much interesting country experience with Fund stand-by and extended arrangements. Each of these topics deserves in-depth treatment. For the sake of brevity, however, we will concern ourselves mainly with the Central European countries as a group, for which many of the issues analyzed stand out with special clarity, and we will give a more detailed treatment only to the issues of nominal anchors, wage controls, and fiscal adjustment.

On the issue of nominal anchors and wage policy, I agree with the staff's main conclusions about the usefulness of nominal anchors for countries implementing strong programs of stabilization and liberalization. Even though nominal anchors are neither necessary nor sufficient for successful and durable disinflation, their effect has been, on balance, positive. In countries in which nominal anchors have been combined with sufficiently strong financial policies, the costs of establishing confidence in macroeconomic stability have been relatively small.

Notwithstanding this generalization, the experiences of individual countries with nominal anchors and wage control vary widely, so that nominal anchors should be recommended to countries with Fund-supported programs only after a careful reflection on their potential costs and benefits. Let me make a few comments on the staff's discussion of the costs and benefits of nominal anchors.

First, the role of nominal anchor in the countries analyzed was mostly performed by exchange rates. The staff has identified lost competitiveness, leading to a temporary decline in export performance and growth, as a possible cost of such a nominal anchor, but we regard this cost as generally more theoretical than actual. In the Central European countries, especially, stabilization programs applying nominal anchors were usually combined with structural reforms that contained large reallocations of production factors, which notoriously cause measured output to fall. To whatever extent an output decline results from termination of nonviable activities or discontinuation of subsidized exports, it seems questionable to regard it as a real cost of using a nominal anchor.

Second, it is noteworthy that the level at which the exchange rate was initially fixed had little effect on the sustainability of the exchange rate anchor strategy. In other words, it was found that quite a wide range of initial adjustments of exchange rates is compatible with the sustainability of a fixed rate regime. It may be true that the size of the initial devaluation preceding the fixing of the exchange rate predetermines the subsequent path of inflation and real appreciation, but this is not a satisfactory explanation. The answer may lie instead in the behavior of exporting firms. The initial devaluation gives them a certain competitive edge, which acts for many as a cushion of comfort, allowing them to postpone real adjustment measures such as cutting costs and raising productivity. The thinner this cushion, the sooner they were forced to begin boosting productivity and competitiveness; the thicker the cushion, the longer they could postpone the adjustment. The behavior of many Central European exporters bears out this hypothesis: they often tried to maximize export sales at low prices as long as they enjoyed the short-run benefits of a competitive exchange rate.

Third, a word about the desirability of exchange rate flexibility. It is well established that the level of Central European productivity is lagging the level of productivity of the Western market economies, and that in order for them to catch up, there will have to be a long period during which the rate of productivity growth in the Central European countries surpasses the rate of productivity growth in their trading partners. For this reason, we do not agree that it is inevitable, as suggested in paragraph 9 of the staff's concluding observations, that competitiveness will inexorably worsen and call for greater exchange rate flexibility. Under a fixed rate, of course, it is necessary to reduce the inflation differential between a country and its trading partners to a level that can be offset by differences in productivity growth.

Finally, it should also be noted that tight fiscal policies can be quite effective in reducing inflation if they are supported by nominal anchors. Perhaps the willingness of the authorities to accept the discipline imposed by a nominal anchor reinforces the credibility of their fiscal policies as a weapon against inflation. This synergy clearly demonstrates the importance of packaging together mutually supportive policies.

It should be stressed that, at least in some Central European countries, the reason for the existence of wage controls was to prevent asset stripping and excessive wage increases threatening inflation targets, owing to the absence of enterprise control by outsiders interested in long-term prosperity. However, the experience of countries that have already abandoned wage controls without having made outstanding progress toward establishing ownership rights does not lend strong support to these concerns. It is interesting in this connection to compare the experiences of the Czech and Slovak Republics: even though the Slovaks have already abandoned wage control, wages and prices have not increased faster than in the Czech Republic, where controls still exist. As we make this comparison, however, we must not overlook the fact that the Slovak Republic has an unemployment rate three times that of the Czech Republic to discipline wage behavior.

The staff argues that wage control can cause distortions by preventing the adjustment of relative real wages that would otherwise be caused by different rates of growth of nominal wages. This observation is generally true, but let me note that, in the Central European countries, there still exist large obstacles to labor force mobility, both because the housing market is still quite underdeveloped, and for historical and social reasons. The actual costs of wage regulation in terms of impeding labor reallocation may therefore be smaller in these countries than they would be if wage regulation were the only thing preventing the labor market from responding flexibly to supply and demand conditions. However, we agree with the staff that wage control can play only a temporary and limited role in the overall anti-inflation strategy.

The staff acknowledges the difficulty of assessing the progress made under the programs analyzed toward achieving long-term fiscal sustainability. Notwithstanding this difficulty, we would have liked to see a somewhat more systematic analysis of the factors that contribute to the diversion of actual fiscal results from the objectives of programs. The staff's assessment of the experience of the Central European countries notes that the ratios of both fiscal revenues and fiscal expenditures significantly exceeded targets, and that the excess was mostly due to unexpected declines in production, but also to lower nominal revenues.

This conclusion does not help much, however, in assessing the extent to which this difference between targets and actual outcomes resulted from wrong policies, as opposed to exogenous shocks. Even though much of the output decline in the Central European countries resulted from structural adjustment, rather than from the classical cause of weakness in total demand ascribable to the business cycle, it had just as much of an impact on the fiscal position. The unexpected output declines that contributed to unexpected declines in fiscal revenues probably also affected budgetary spending. It would be interesting to know more about the effect on the fiscal outcomes of incorrect program assumptions.

It would be even more interesting to know how the authorities in different countries responded to these unexpected economic developments. It is not unusual for Fund-supported programs to contain contingency provisions, especially with respect to possible cuts in budgetary spending and to revenue-enhancing measures. It would also be interesting to know how frequently the authorities have invoked these contingency measures, and what was their success, if any, in heading off a still more severe deterioration of the fiscal accounts.

Although useful from the standpoint of assessing the authorities' compliance with program objectives, such an analysis would be less useful for assessing the impact of the public sector on the economy. In the Central European countries undergoing important structural changes, comparisons in time and across countries of the quantity of funds flowing through the broadly defined public budget must be treated very carefully. While some expenditures--subsidies, for example--have disappeared from the public budget, new expenditures have appeared, and others have been transferred to the budget from the enterprise sector. For this reason, the bald observation that the ratio of public expenditures to GDP was higher than programmed cannot by itself provide a basis for strong judgments about the underlying change in fiscal stance. Only a more detailed analysis, along the lines indicated above, could hope to provide more authoritative conclusions. As it is intended to publish these studies, we would strongly recommend including in the section on fiscal adjustment a more detailed analysis of the factors affecting fiscal outcomes.

This review of the experience of countries with stand-by and extended arrangements covers only a limited sample of countries and a rather short time interval. Nevertheless, it offers many interesting, and in some cases surprising and nontrivial, conclusions. One very interesting observation was that savings have responded relatively weakly to factors that are usually considered to be their main determinants. Another is that the program countries have strongly succeeded in improving their external performances even when they have lagged behind their targets in terms of labor market reforms, inflation reduction, and fiscal balance improvement. In this area, expectations, government credibility, and the part played by the political process in the implementation of economic policies have certainly been major factors.

Despite the broad range of issues covered by the studies, we missed seeing any analysis of the impact of Fund-supported programs on employment and social spending. Even though these issues are not traditionally a major focus of operational targets, they are always prominent concerns of the media and of public opinion, and the Fund should not neglect them in the review.

Not covered by the present review were the many countries that, during 1993, entered into new Fund arrangements, not only stand-by and extended arrangements, but also arrangements under the newly established systemic transformation facility. In the future, the experience of these countries will help our understanding of many questions that cannot be answered satisfactorily today, and we are already eagerly looking forward to the next review.

Mr. Kiekens added that he hoped the staff paper would be published.

Ms. Lissakers made the following statement:

When undertaking a comprehensive review of longstanding policies on complex issues, there is always a danger of falling into the complacent view of the doctor who claimed that the operation was a success, even though the patient died. I was pleased that the staff papers for today's discussion, especially the annexes, largely avoid this pitfall. They provide a wealth of analytical material on the policy choices facing countries with Fund-supported programs and the lessons that have been learned from the decisions that have been made.

At a minimum, the Fund, like the doctor, is enjoined to do no harm. However, both have a higher goal, and must be prepared to adapt the course of treatment to the needs of the patient in order to enhance the prospects of full recovery. Our discussion today will help us in assessing future programs and our approach to adjustment and reform.

The staff's analysis suggests that Fund-supported programs have been generally successful in addressing the immediate financial difficulties and beginning the process of adjustment, particularly on fiscal and external imbalances. However, there has been less success in reducing inflation and, most important, in promoting the savings and investment necessary for sustained growth. In these circumstances, there is a clear need to look anew at the Fund's approach to stabilization and adjustment to see how we might achieve greater success in the future. The staff papers raise a broad range of issues, but I will focus my remarks today on just two: improving savings, investment and growth; and the role of nominal exchange rate anchors.

The ultimate objective of a Fund-supported program is to achieve the increased national savings and investment necessary for sustained growth and improved living standards over the medium term. The Fund's track record in this area has been disappointing, although the reasons may have nothing to do with the Fund's efforts. The difficulties facing the country and the magnitude of the needed adjustment and reform may be so great that they cannot be accomplished within the framework of traditional Fund-supported programs. The failure may be self-inflicted because the patient did not take the full dose of the Fund's medicine over a long enough period. Or, an adverse external environment may derail even the strongest program.

I was struck, however, by the fact that national savings rose only modestly despite the Fund's success in strengthening the financial position of the public sector in program countries. Clearly, the Ricardian equivalence appears to be alive and functioning in many countries, with increases in public savings being offset largely by declines in private savings. A case might be made that the failure to increase national savings is a nonproblem, provided that a country pursues sound policies that will enable it to attract the foreign resources to finance a current account deficit. However, this argument is based on the tenuous assumption that foreign savings will be used for productive investments in order to avoid excessive debt burdens and future debt-servicing problems. Our experience suggests, however, that a large portion of the funds will finance public and private consumption, and a growing external debt burden will make the economy highly vulnerable to changes in sentiment.

In these circumstances, it is important that Fund-supported programs devote greater attention to promoting private savings and investment. The staff's analysis, however, has failed to turn up any causal link between a range of policy instruments and private savings, including the mix of spending restraint and taxes, the level of interest rates, exchange rate adjustments, or financial reforms. The only sure means of increasing private savings appears to be increased output, accompanied by higher incomes.

This conclusion highlights the fact that savings, investment, and growth involve a dynamic process in which there is an important simultaneity between the three. We need to recognize the synergism involved in this process, rather than rely on partial equilibrium analysis of individual components, or an excessive focus on one phase of the adjustment process. It is therefore essential that Fund-supported programs be framed in a medium-term context. Thus, we must be careful to ensure that actions taken to stabilize the economy do not compromise success in subsequent phases. In particular, we need to avoid excessively draconian measures that remove all incentives for the future investments necessary to restore growth. You cannot expect investors to undertake risks unless there is some reasonable assurance of a growing demand, at home or abroad, to provide the necessary market.

Therefore, the staff's suggestion that an effort be made to determine a sustainable fiscal balance over the medium term is reasonable, and preferable to the blind assumption that all deficits must be eliminated regardless of the cost. Similarly, we might want to extend such an analysis to include the current account, particularly as the resource transfers involved in current account deficits are an essential part of the development process in many countries. I do not, however, exaggerate the difficulty of ascertaining in advance what may be sustainable, just as our predecessors found it impossible to define a fundamental disequilibrium, or the normal level of capital flows.

The lack of progress on savings and investment highlights the importance of structural reforms to mobilize the available savings and to ensure that they are invested productively. In this regard, financial reforms are especially relevant to provide new investment opportunities for savers, to channel savings to productive use, and to facilitate monetary management. The development of new savings vehicles, such as pension funds, is an area in which the private market may be able to make an important contribution. I understand that Chile has undertaken some impressive reforms in this area, and I would welcome staff comments on their impact.

Our experience in recent years also highlights the fact that private markets provide the most effective means of allocating scarce resources. Consequently, the Fund has encouraged countries to pursue privatization of state-owned companies to both reduce the drain on the budget and to encourage more efficient resource use. I believe that there is more that can be accomplished in this area, and I would urge the staff to intensify its efforts.

Given the importance of structural reforms in the adjustment process, we need to consider how structural measures can be incorporated more effectively into Fund-supported programs. I recognize the difficulty of developing appropriate performance objectives, but I remain skeptical that reviews alone provide the same information value as performance tests in encouraging countries to take the necessary action.

A key message to be drawn from the staff's analysis of savings and growth is the need to complete the stabilization phase of the adjustment process as quickly as possible in order to move into the virtuous cycle of low inflation, increased savings and investment, and sustained growth. There is growing recognition in program countries of the importance of tight financial policies to the success of any economic adjustment and reform effort. Excessive budget deficits financed through inflationary monetary policies lead to less savings, investment, and growth, not more.

However, I am concerned about the frequency with which programs go off track, and the need for repeated waivers. It is difficult to sustain the adjustment effort unless tangible benefits can be realized quickly to offset the palpable costs of changing the status quo. Promises of a better tomorrow ring hollow to those struggling to keep up today. I was struck, therefore, by the staff's analysis that nominal exchange rate anchors can be an effective complement to sound financial policies in accelerating the stabilization process through their positive impact on inflation expectations. Needless to say, care must be taken in how such anchors are utilized in order to avoid the serious downside risks.

A nominal exchange rate anchor is not right for all countries, and the conditions necessary for its successful implementation are rigorous. First and foremost, sound financial policies are critical in order to provide the necessary back-stopping and credibility for the anchor to be sustainable. At the same time, however, the anchor must be seen as an integral part of the stabilization effort, rather than a negotiating chip to induce countries to implement sound policies. Moreover, care must be taken to avoid making the anchor such a political symbol that it cannot be changed until long after it has outlived its usefulness. The Mexican model provides some useful lessons, which might have broader application.

In the right circumstances, an exchange rate anchor can become part of a dynamic process in getting inflation under control quickly, and thus minimizing the downside risks and costs of an overvalued currency. These risks can also be reduced by choosing an anchor that will limit the potential for external shocks throwing the program off course, and by choosing an initial rate that reflects both competitive realities and the policy mix. In this context, the staff has highlighted the problems for monetary management arising from large capital inflows attracted by high real interest rates following a decline of inflation. High interest rates also appear to be a common feature among "successful adjusters" experiencing slow growth and low fixed capital investment. High rates drive investors toward financial instruments and away from real investment. These problems could be addressed by pursuing more flexible interest rate policies in which nominal rates are reduced as inflation declines. This would help to moderate the capital inflows and the high real rates that can stifle investment and growth.

I want to congratulate the staff on an excellent set of papers, which focus on key issues in the design and implementation of Fund-supported programs. I would like to see the policy approach that has been taken in these papers carried forward in the material that the Board reviews in the context of programs or Article IV consultations. In particular, it would be useful if the staff were to highlight the policy trade-offs each country faces, why a particular approach was taken, and the implications of those decisions for other aspects of the adjustment effort.

The development, negotiation, and implementation of a Fund-supported adjustment program is more an exercise in political economy than in the application of a particular economic model. Moreover, Fund-supported programs must remain works in progress, which can be, and are, adapted to changing circumstances. There is no single solution that is right for all countries. Thus, we must be willing to experiment with new approaches rather than rely on past practices simply because they are familiar.

I would also urge that the next comprehensive performance review include countries that have not followed Fund-supported programs but have undergone successful adjustment and stabilization on their own.

Ms. Lissakers, adding to her statement, said that it was clear from the staff's interesting and candid study that the Fund was better at fixing the outside than fixing the inside, and in particular, that it had not yet found the key to sustained growth and increased private savings and investment.

She agreed with Mr. Autheman that the Fund had to face the fact that it would be involved for the medium term in most cases, and that a short-term balance of payments fix would not put most countries on a path to sustainable growth. While the staff paper was candid and straightforward, there was still some reason to consider more seriously the possibility of establishing an evaluation unit in the Fund.

Mr. Mirakhor made the following statement:

We welcome today's review of developments in countries with Fund arrangements approved during the period 1988-91, and we commend the staff for the extensive information and analysis provided in the set of papers.

A more transparent justification for the choice of the methodology used and the limitations and biases implicit in any given approach would have been desirable. The paper should set out clearly the drawbacks of the before and after, target versus actual, approach, especially its inability to distinguish between program and nonprogram determinants of policies and outcomes.

While we appreciate and commend the staff for its candor and the forthrightness of its analysis and conclusions, ideally, a backward-looking evaluation of Fund-supported programs should not be conducted by those responsible for the design and negotiation of those programs. In his statement to the Board during the meeting on the establishment of an evaluation office, the Managing Director recognized the importance of this concern, and suggested that "evaluations of Fund activities will always involve a significant element of judgment and, to carry conviction, must be--and must be seen to be--independent and disinterested. The best response to this concern is the creation of a separate body responsible for evaluating the work of the institution." A progress report on the status of the evaluation office project seems to be in order.

We believe that the evaluation of Fund-supported programs could be enhanced if, in the review process, the staff were to seek the authorities' own views about their assessment of their experience with program design and implementation. The authorities could take this opportunity to share with the staff some of the lessons they learned regarding, for example, the formation and maintenance of a political and social consensus, the trade-offs, the sequencing of reforms, and the sustainability of adjustment.

The evaluation of experience with Fund-supported programs should pay due consideration to the impact of the international environment, in particular when the guiding principle of the strategy is external openness. Unfortunately, the section on the global setting for adjustment is only 12 lines in a 270 page paper, and with no reference, for example, to the Middle East war, which had major direct or indirect implications for many countries under review.

Any program review should include an evaluation of the program design. The assumption that there has not been a program design failure does not seem reasonable.

It was our hope that the papers before us would provide answers to the question that has been posed by a number of Executive Directors, namely, why, despite notable success in stabilizing their economies and implementing far-reaching structural reforms, it has proved so difficult for some countries to shift to a path of high growth in output and employment? While the staff addresses the issue, the subject does not occupy the primacy that it clearly deserves. The record continues to be disappointing. Substantial progress was made toward meeting external goals, but this was not matched by progress in reaching domestic objectives: growth, on average, increased slightly, but virtually nothing is known about how employment has responded during the adjustment phase. The lesson seems to be that it is relatively easier to reduce macroeconomic imbalances and address the external problem quickly than generate the conditions needed to place countries onto a distinctly higher, and sustainable, growth path, with low inflation. Unfortunately, none of this is very new. We therefore strongly hope that the staff will continue to explore this vital area in its future work agenda, with a view to putting together a comprehensive paper for the consideration of the Board. In this context, we support the call for a longer-term analytical approach, which might help capture the lags in the effects of programs and outcomes.

Closely related to the above point, we can endorse the view that greater attention needs to be given in programs to employment and labor market issues, which are critical to the "employment-creating and growth potential of economies."

With respect to exchange rate policy, we broadly support the staff's analysis and conclusions on the use of exchange rate anchors, and the risks associated with explicit real exchange rate rules. We also concur with the suggestion that programs must address the trade-off between inflation and competitiveness in designing exchange rate policy, and the policy response that is required in the event the country is faced with an adverse exogenous shock or an extended loss of external competitiveness.

With regard to structural reforms, we are not sure whether the "second best strategy," which accords a lesser role to sequencing considerations, is the best way to spur reform. While there is some merit in the staff's view that it may be better to move as rapidly as possible in areas that are technically and politically feasible, and not worry too much about adhering to an optimal sequence, there is always the risk that the resulting tensions, instead of creating a consensus for further change, might instead derail the reform effort altogether. Programs should clearly spell out the risks associated with "different sequencings of removing distortions," including greater attention to the notorious cases of excessively high interest rates. In this context, we agree with the view that programs should be more "aggressive in ensuring that supporting policies are in place before pressing ahead with financial liberalization."

The papers contain an interesting analysis of savings--considered rightly to be a critical element of any Fund-supported program. In addition to the finding that private savings fell when Fund-supported programs were in place, quantifiable factors such as real interest rates, the real exchange rate, the stance of credit policy, and the liberalization of the trade and financial systems appear to have weak and unpredictable effects. It is interesting here to refer to the experience of East Asian countries, where high rates of growth were achieved owing, among other things, to the rapid accumulation of savings and investment. Studies of these countries and other experiences show that specific and nontraditional approaches were frequently used with satisfactory results. These measures include the regulation of spreads on financial institutions, control of transactions costs, the creation of public institutions to attract small savings or to finance specific projects like housing, and even protecting banks from competition to increase the financial strength of the banking system.

The finding that targets for broad money growth were overshot by wide margins in two thirds of the program years owing to larger than expected movements in net foreign assets, and the associated finding of the absence of a correspondence between the growth of net domestic assets and inflation because of offsetting movements in net foreign assets, again bring to the fore the problem of surges in capital inflows and the dilemma this poses for the authorities. The staff proposes the use of "more explicit benchmarks" that would be used as signals of possible dangers for inflation targets, with policy responses being guided by short-term "trade-offs between accumulating reserves, controlling money, and maintaining competitiveness." Perhaps the staff could elaborate on this point. In any event, we very much look forward to revisiting this issue again in the forthcoming staff update paper.

We can agree that the sustainability of fiscal positions should be given greater attention in the design of programs, and that the authorities should be closely involved in developing medium-term scenarios of the interrelationship between fiscal and other macroeconomic developments.

On the monitoring of programs, the only point we would like to emphasize is the staff's conclusion that there is no strong evidence that structural performance criteria accelerate the process of structural reform, and that the best way to monitor structural reforms is through reviews, and not through the use of performance criteria.

Mr. Sirat made the following statement on behalf of Mr. Autheman:

I commend the staff for this very clear, dense, and candid paper on the assessment of our adjustment policy. Needless to say, some caution is certainly required in analyzing heterogenous data on a set of countries, but the main conclusions of the staff seem relatively robust.

The main question raised by the paper is whether the Fund could better take into account the fact that, in practice, its involvement in countries' economic policy goes beyond a short adjustment period, and extends into the medium term.

This general question leads to two main subjects: the sustainability of the benefits of our intervention over the medium term, and the consistency of the policies we recommend and support, both internally--such as the sequencing of our agenda of reforms--and externally--such as in conjunction with private sector response, capital inflows, and the interventions of other institutions such as the World Bank.

The medium-term sustainability of our programs' results should be more clearly taken into account in analyzing the program conditionality. Acute and urgent balance of payments problems remain the origin of the Fund's involvement. In an ideal world, one might hope that the Fund would be involved earlier, but the political difficulties of such early involvement are clear enough. Moreover, the initial stages of adjustment might be postponed under the illusion of continued market financing in countries benefiting from a greater openness of the current and capital accounts, leading to late intervention by the Fund, and implying more painful adjustment.

Besides the short-term balance of payments problem, it appears that the Fund has in fact remained involved over a rather long period of time. Our experience shows that cases in which the Fund is involved for only one stand-by arrangement are extremely rare. Indeed, it may be argued that, paradoxically, a greater openness to external trade and external capital inflows have made the adjustment process more protracted and complicated, as gaps can become extremely large very rapidly in the face of the high volatility of capital inflows.

Altogether, a greater medium-term perspective should be introduced in our programs, in order to prevent short-term adjustments being followed rapidly by renewed imbalances. This medium-term perspective is central to the debate over nominal anchor policies, which is eloquently addressed by the paper, and to the related issued of sustained low inflation. Another example is the issue of fiscal sustainability.

In a sense, it is relatively easy to build a short-term, successful, standard program, allowing for a quick adjustment of the balance of payments through adequately tight demand management, an exchange rate policy aimed at balance of payments objectives, and appropriate debt relief. As an aside, the paper illustrates clearly that debt relief is a strong incentive for a Fund-supported program and, accordingly, that some caution is required in relaxing the link between debt relief and a Fund-supported program.

However, this "quick adjustment" strategy, using the exchange rate as a safety valve against any slippage, is not satisfactory, as it is a clear recipe for recurrent Fund involvement, given the inflationary bias of using the exchange rate for strict balance of payments purposes--that is, of a real exchange rate targeting. The paper shows clearly that a simple limitation of public dissaving does not suffice to limit inflationary pressures over the medium term.

The paper is rather supportive of nominal anchor policies. It goes to the point of making relative the short-term trade-off between the balance of payments objective and the inflation objective, as, within the sample used, it is not clear that current account deficits were larger in countries with a nominal anchor.

Clearly, however, a nominal anchor policy is viable only in a very strong program and, accordingly, in correspondence with a very high degree of conditionality. It is in those countries with the most credible anti-inflationary policy that a nominal anchor policy can be chosen: there is an element of circularity involved here.

This being said, it should be recognized that a nominal anchor policy relying on the exchange rate need not be a fixed anchor policy. Various schemes of nominal anchor policy can be derived: a currency board, a fixed exchange rate, a crawling peg, and other adjustable arrangements, so that some flexibility can be included in this policy without undermining its credibility.

More generally, the point is certainly not to enter into some kind of theological debate about the right exchange rate policy, but rather to look for the necessary conditions to move to an external nominal anchor policy.

Indeed, the staff's distinction between a first-best world, in which a nominal anchor policy would be fully appropriate, and the real world, in which it cannot be implemented, may appear to fall short of what is practically needed in program design, namely, a clear-cut rule allowing one to decide whether or not it is worthwhile to implement, or to prepare the implementation of, a nominal anchor policy. I would suggest the following four criteria.

First, credibility on the part of the authorities in their struggle against inflation and, accordingly, a good policy mix. Second, the possibility of effectively ending the indexation process, possibly through the implementation of an incomes policy, which is generally helpful in fostering a social pact and globally limiting wage increases. Incidentally, such an incomes policy can be rather more subtle than the crude wage controls mentioned in the paper. Several options can be considered, depending on local circumstances. Third, a satisfactory competitive situation at the outset, and the capacity to maintain it in the face of exogenous shocks affecting the terms of trade. Fourth, the possibility of implementing strong structural reforms that would enhance competitiveness during the initial period, during which the nominal anchor leads to a real exchange rate appreciation.

It is obvious that such strong conditions cannot always be met. The risk of failure of a nominal anchor, with the associated credibility loss, needs to be assessed carefully.

Consequently, the Fund must remain ready to support second-best programs and to make use of the flexibility inherent in its access policies to vary the relative strength of its conditionality. Of course, if and when these conditions are met, they may imply large financing needs in the initial stages of the adjustment process--and sometimes to a greater degree than the international community has been ready to provide in the past.

I would thus support a greater use of nominal anchors in order to improve the quality and the sustainability of our programs. Such pressure for stronger programs seems to be consistent with our intention to consider a higher level of access to Fund resources.

The quality and sustainability of the fiscal adjustment implemented in Fund-supported programs should be clearly taken into account in the assessment of our conditionality. Indeed, we should beware of fiscal targets attainable through various means, some of which hamper growth.

In particular, too much attention is clearly given to measures on the expenditure side--and within those, to cuts in capital expenditures--as opposed to measures on the revenue side.

As explained in Annex II, measures on the expenditure side are generally considered first; measures on the revenue side are generally considered only if all the possible cuts in outlays have been implemented, and generally only in subsequent programs. Moreover, measures on the expenditure side are generally implemented better than measures on the revenue side.

Such an approach is not sustainable over the medium term, as cuts are often politically easier in areas that are in fact essential for growth, such as infrastructure, education, and health.

On the question of a fiscal surplus, the Fund tends to consider that more is better. A small--and even an increasing--surplus may be comfortable, but it may have some negative impact on investment and growth.

Altogether, we should broaden the notion of fiscal sustainability. The staff's views in this regard are generally based only on a strict financial perspective--for example, looking at the inflationary impact of the deficit, or the stability of the debt/GDP ratio--often without explicitly taking into account the importance of the composition and level of expenditures, such as the positive externalities of budgetary outlays on the productivity of the private sector. The Fund should be involved not only in the assessment of the appropriate overall fiscal deficit, but also in the precise definition of the fields in which actions are required, both on the revenue and the expenditure sides. I would welcome closer cooperation with the World Bank in this area.

Our policy advice, tackling as it does wide-ranging issues in a more complex environment in which private inflows play a key role, should clearly take into account the possible overlapping of actions and the potential for agenda inconsistencies if it is to be consistent. As our involvement takes place in a medium-term framework, it leads to demands from program countries to address issues in the real economy, such as growth, investment, and savings. Such demands are by nature extremely complex to tackle, as they may imply an appreciation of both domestic and foreign private sector responses, of possible overlapping with the intervention of others, and of possible inconsistencies in the sequencing of our agenda for reforms. Financial sector reform is a case in point here.

A more complex analysis of the overall impact of our policy advice shows slow private sector response and capital inflows. It is not surprising to find some lack of growth during, or right after, an arrangement, as the bulk of adjustment should be on the demand side in the short term, given the severe existing balance of payments disequilibria at the outset of Fund-supported programs. This factor should be--perhaps more clearly than today--taken into account in our program design, which should preferably err on the conservative side as regards growth and private savings projections.

Naturally, there is a major question of the lags involved here: how long would growth be hampered by the adjustment process? Clearly, a stop-and-go approach to reforms and adjustment blurs the picture for the private sector, and therefore impedes growth. However, it might well be that our adjustment programs take more time to see results than contemplated in the paper. Accordingly, I would suggest that the staff's next study on the matter devote some attention to taking the same sample as used in our 1991 or 1994 review, and seeing what happens after a long period of time.

I would also suggest that there is some need to study further the role of private inflows in the design of the programs, in particular with respect to the variables that might explain why inflows return more rapidly in certain countries than in others, and how the effectiveness of monetary policy to curb inflation can be maintained in the face of large foreign inflows.

With regard to the question of sequencing our agenda and relationship with the World Bank, slow private sector responses should not lead the Fund to delve into every possible reform--for example, labor market reform--and to multiply the list of structural reforms needed to agree on a program. We should not blur further the border between our adjustment work and that of the World Bank in our search for theoretical maximization of private responses. On the contrary, we should ask the World Bank to use its own instruments, such as adjustment lending, to address the issues that we can identify as crucial, but with which the Fund itself cannot deal.

Naturally, the issue of the sequencing of our actions, the issue of pragmatism versus normatism in the agenda for reforms, is also at stake. I have some sympathy for the notion that creative disequilibrium in the reform process can enhance the reform process overall and that, accordingly, some pragmatism is called for in the definition of the agenda for reforms. We already use a great deal of pragmatism in our adjustment programs, and it obviously makes some sense to promote a policy that will be implemented effectively.

This being said, it must be recognized and clearly taken into account in program design that pragmatism has its limits, as some policy sequencing is clearly inappropriate. For example, liberalizing the financial sector without appropriate supervision of prudential policy can lead very easily to a major bank crisis.

Also, liberalizing external trade without having in place first an appropriate tax reform to make up for the shortfall in fiscal receipts can lead to major fiscal constraints and adjustment difficulties.

Financial sector reform is at the core of the Fund's mandate because it is at the heart of many other reform processes, such as private enterprise financing, privatization, fiscal reform, and savings enhancement. Financial sector reform is clearly a cornerstone of the adjustment process.

The staff papers show that financial sector reform, as it is implemented today, can have significant detrimental side effects, such as high real interest rates and large spreads between borrowing and lending rates. In order to develop efficient financial sectors, we favor the deregulation of strictly controlled financial markets and a shift from a monetary policy based on direct instruments to one based on indirect instruments.

We accept, in theory, that for such reforms to be successful, they must be accompanied by improvements in banking supervision. They also require certain preconditions, such as a sufficient degree of competition in the banking sector, adequate administrative capacities, and a reasonably stable macroeconomic environment.

Yet, in our zeal to go forward with reform, it seems that we sometimes forget these preconditions and these accompanying measures. This can have drastic consequences, in the form of the reinforcement of existing cartels, the inaccessibility--or very high cost--of financing for small- and medium-sized firms, and excessive risk-taking by the banking system.

There is then a very substantial scope for refining and diversifying our policy recommendations on financial sector reform to fit the specific circumstances of individual countries. For example, a recent working paper (WP/94/51) shows that refinance instruments might be preferred to outright open market operations in many developing countries or economies in transition.

Our conditionality should be analyzed in a medium-term perspective. This medium-term perspective might take us further and further away from macroeconomic adjustment, and into detailed structural reforms. We should resist such a drift, and concentrate our action on three main topics, but considered in a medium-term perspective: exchange rate policy; financial reform; and the fiscal situation.

This is not to say that, over the medium term, other structural reforms are not necessary, but such reforms, and the microeconomic analysis of private sector responses, might be placed more properly on the World Bank's agenda. We could offer to work on these matters in closer cooperation with the World Bank, as we already do in the case of ESAF-eligible countries.

Mr. Smee made the following statement:

Because stand-by and extended arrangements represent the core of the Fund's operations, this review is both necessary and useful. The longitudinal case study approach that the staff has developed in this document is interesting and revealing. We must note, however, that the short horizon of the analysis, with much of the focus on the first year of the program and the medium term defined as three years, limits the value of the study in light of the variable and sometimes lengthy policy response lags in most economies. Nevertheless, the staff is able to draw a number of insightful observations from the analysis, and offers several suggestions for improving the design of future stand-by and extended arrangements. I would like to concentrate my remarks today on the Fund's programs and the economic performance of borrowing countries.

Success in programs, as I read it, was most notable in meeting external objectives. To me, this is not surprising. After all, we are the "International" Monetary Fund, and member countries come to us because they cannot finance their balance of payments; it is only by improving in this area that recourse to Fund resources will become unnecessary. In that sense, we are a lender of last resort, and whether inflation is going one way and growth another way, the main thing a country should do to get out of our clutches is to get its external balance of payments into better equilibrium. Then, it is not a borrowing member, and not subject to all the criteria and stringent conditionality of the Fund. Neither is it surprising to me that the review confirms the pre-eminent role of sound fiscal policy in the success of Fund-supported programs. This experience reinforces the fact that fiscal performance is correlated with the achievement of other important macroeconomic objectives.

The preference for the exchange rate as a nominal anchor, which is apparently due largely to its simplicity and transparency, is less compelling when the potential for future misalignment, with its consequences for inflation and external imbalance, is more fully appreciated. As a short-term anchor, fixing the nominal exchange rate to the currency of a low inflation trading partner or basket of trading partners may, of course, be useful, as it provides a fast track approach, one hopes, to credible policies that a flexible exchange rate and internal nominal anchors, such as zero price inflation targets, may not immediately provide. But as monetary and fiscal policies gain credibility of their own, the requirement for an external anchor such as a fixed nominal exchange rate diminishes. For example, those countries with nominal exchange rate targets that eventually experienced a sharp acceleration in net capital inflows, leading to an acceleration in monetary growth, which slowed progress on inflation reduction, might have benefited from a more flexible exchange rate regime and an internal nominal anchor.

This leads me to one of the more troubling conclusions of the review that my colleagues have mentioned in their statements, which is that few, if any, countries shifted to a rapid pace of development led by higher investment and savings ratios. It almost comes to the question why many countries without Fund-supported programs have succeeded in having strong growth led by investment, whereas there is such failure to have strong growth in investment in countries with Fund-supported programs. Is there something wrong with the programs or the way we are going about it, or something else? The explanation seems to be, in the study of many cases, that it takes time to turn around private sector confidence. We see that ourselves in the industrial world, but is there more to this? Perhaps.

The staff paper indicates that the policy channels for influencing savings are limited, that investment ratios are falling, that there is little correspondence between the degree of credit restraint and the reduction of inflation, and that a large part of any external improvement seems to come from debt relief that comes after approval of the Fund-supported program, rather than as a result of underlying developments in the trade account. Could it be that sizable fiscal adjustment, which seems to be a sine qua non for success in a program, accompanied by removal of wage indexation--for which a good case can be made in order to reduce inflation--but in the absence of a nominal exchange rate anchor, could secure the gain in reducing domestic demand, without the loss in competitiveness, and without the loss of confidence that comes from ultimately going off the exchange rate peg one or two years later? In other words, are the short-term gains of having a nominal anchor in the beginning worth the costs that come when the rate is ultimately knocked off it?

Perhaps monetary policy is tightened too much. This seems to be borne out as well by the incredibly high level of real interest rates in many countries. On the one hand, if a nominal exchange rate anchor does not work, it is because the policies behind the exchange rate do not validate it. My European colleagues will no doubt want to recount some of their experiences on this. Thus, monetary policy is usually made even tighter when there is a failure to preserve the exchange rate, so real interest rates go even higher, and investment goes to financial assets rather than real capital formation--and growth turns out even lower. The policy mix is all wrong, and the economic cost becomes too high. On the other hand, if a nominal exchange rate anchor does work, it means that the policies behind it are correct, but now the problem is surges of capital inflows, usually dealt with by allowing real appreciation to take place through higher inflation rather than more deficit reduction and/or nominal exchange rate appreciation.

In other words, perhaps we need the following mix of policies: sizable fiscal adjustment, as suggested in the report; removal of wage indexation and other aspects which keep inflation inertia at a high level, just waiting for the next shock to come along to raise it even higher; the proper degree of credit restraint, where monetary policy should not try to make up for policy failures elsewhere, or to maintain an increasingly inappropriate exchange rate; more open-mindedness on the appropriateness of different exchange rate regimes; and, of course, structural reform to help the supply side.

Regarding structural reform elements, the Fund should stay close to areas that are the Fund's responsibilities. On page 29, we see a reference to a second-best strategy, which seizes opportunities for reform on as broad a front as possible. I believe that this is wrong. It does not correctly place structural reform efforts in the policy framework that is being developed. It is to resign oneself to doing what one can, when one can, and to hope for the best, in the knowledge that it has got to be better than doing nothing. Such an approach could involve the Fund in overlapping areas of responsibilities with the World Bank and the regional development banks, leading to questions of who should be responsible for helping a country. In my own constituency, I found that such an approach can put the country in the middle, between the Fund demanding things, on one side, and the other international financial institutions demanding other, sometimes conflicting, things, on the other side. The international financial institutions end up seeing the Fund as meddling in areas where the institutions are providing technical assistance or program or project assistance.

I compliment the staff on the skillful way in which the experience of recent years has been synthesized. Its work has led to a number of interesting and, in some cases, puzzling conclusions, and to my mind has provoked some questions regarding Fund prescriptions. That having been said, I hope that this is the last time that the staff will do this type of work. This is the work of an evaluation unit, which is yet to see the light of day. Program shortcomings can result from a number of factors, including, on occasion, faulty program design. An independent assessment of Fund-supported programs should provide additional objective information that could be integrated into subsequent operations and promote more effective use of Fund resources. An independent examination would also promote Fund accountability and credibility. Like Mr. Mirakhor and Ms. Lissakers, I would appreciate a progress report on the status of this unit, which seems to have disappeared off the face of the earth.

Finally, on page 33, there is a box entitled "Countries that Graduated from the Use of Fund Resources." It is one thing to graduate from prolonged use of Fund resources, but are we starting on a new concept now? Such an idea indicates a different purpose for this institution than I thought is embodied in the Articles of Agreement. Is not the Fund supposed to be an institution the resources of which are used in a revolving way by its members? Or are we becoming a development institution? Will the Fund, like the librarian who was happiest when all the books were back in the library, be happiest when no member is using its resources? I would appreciate some comments from the staff about that.

Mr. Sirat commented that, if the Fund were considered to be involved in some countries in the medium term, then the concept of graduation to which Mr. Smee had referred could be appropriate. When the Fund ceased to be involved in the medium term, then the country could be said to have graduated.

The question had been raised whether a nominal anchor policy had short-term benefits, but long-term losses, Mr. Sirat recalled, either through a loss of growth or a loss of credibility. The staff paper seemed to have shown exactly the opposite--that short-term losses occurred from targeting the real exchange rate, and long-term benefits accrued to a nominal anchor policy.

Mr. Geethakrishnan stated that what he had to say would be broadly along the lines of what Ms. Lissakers, Mr. Mirakhor, and Mr. Smee had said, although his conclusions would be rather different. He would start with a series of observations, which, while they might appear somewhat disconnected, would be connected later on.

The most striking successes of Fund-supported programs had been in meeting pressing external goals, Mr. Geethakrishnan reiterated. For most of the repeated users of Fund resources, debt-service ratios had been reduced to broadly manageable levels and, in several, large increases in capital flows during or immediately after the programs were completed had significantly eased the external financing constraint. The chart on growth, savings, and investment clearly demonstrated that output growth had declined in countries with previous arrangements. The record revealed few, if any, countries shifting to a distinctly rapid pace of development backed by higher investment and savings ratios. Developments in investments were perhaps the most disappointing aspect of the programs. The record of achieving and sustaining low inflation was at best mixed. Targets for broad money growth rate were overshot by wide margins in about two thirds of the program years. Where financial programs often failed to produce planned results, money creation and inflation were introduced. In the preceding five years, there had been 97 waivers, 40 percent of them on the fiscal side alone.

Those were not his views or assessments, but the staff paper's, Mr. Geethakrishnan observed. The result could therefore be summed up by what Ms. Lissakers had said: obviously, the Fund was very good at dealing with the external, and not so good at dealing with the internal. Or, the Fund's operation was a success, but the patient died.

Countries came to the Fund when they had serious balance of payments difficulties, Mr. Geethakrishnan went on. It was to the credit of the Fund that that problem had been addressed exceedingly well, and in most of the program countries, in fact, within a period of two to three years, they had managed to bring some order in their external payments position. At the same time, however, investment, savings, and growth had not performed so well. The unemployment situation had worsened, the money supply and inflation had not been gotten under control, and the chances were that those very countries could soon go into a tailspin on the external side, which would affect not only the countries concerned, but the financial integrity of the Fund itself, because the chances were that under those circumstances those countries would be unable to repay the Fund. The fact that the Fund had addressed its primary task of an imbalance on the external side, therefore, did not give him a great deal of satisfaction.

The Fund remained involved in program countries, as Mr. Autheman had said, on a medium-term basis, Mr. Geethakrishnan agreed. From that perspective, the Fund could not limit its advice to how to rectify the external position. The Fund's policy advice needed to encompass not only the exchange rate, the money supply, and fiscal correction, but the interrelated issues of the private sector, public sector utilities, social expenditures, and the social safety net. Technically, those question were not part of the Fund's mandate, but the Fund had to speak about them, because of their links with medium-term fiscal and monetary policies. From that perspective, the Fund needed to consider how savings, investment, and growth could be improved under Fund-supported programs.

It was as much in the interest of the countries concerned as of the Fund's financial integrity to address those and similar issues, Mr. Geethakrishnan pointed out. The Fund's policy prescriptions tended to go into the details of the letters of intent, covering--in fact--all aspects of governance and the domestic economy in a country; they were not limited only to setting the external sector right. To recognize that might imply, on the part of the Fund, any of three results. First, that the problems that were thus uncovered had no solutions; second, that, while the Fund could find solutions to some of the problems, it should nevertheless allow the World Bank to pursue them; and third, because the Fund would be involved in any case into the medium term, it should give appropriate advice to the countries concerned that took that fact into account.

That approach did not signify that an evaluation or a review would be required, Mr. Geethakrishnan commented. It was there that he differed with his colleagues whom he had mentioned earlier. Rather, the basic issue of whether or not the Fund was capable of finding solutions to problems needed to be addressed. In that regard, he would strongly urge that a study along those lines be undertaken. In fact, he had raised that issue with the Managing Director in September 1993. At that time, he had told the Managing Director that while he agreed that the conditionality package was fine, and its elements appropriate, perhaps at the end of two or three years, once the initial balance of payments problem had been taken care of, the Fund should look at the sequencing of the implementation of the elements in the package to see how to address the negative aspects to which he had called attention. The Managing Director had told him that the management and the staff were also concerned about those issues, and that he would come back to him in the fall. Later on, the Managing Director had said that a group of economists was examining the question, and that a paper that might be considered in a seminar would be ready in about six months' time--that is, ready for a discussion in June or July 1994. He had been disturbed to find that no such discussion had been planned in the most recent work program paper. The Secretary had explained that, as the work load was very heavy and the Annual Meeting in Madrid was coming up, it might be better to hold a discussion on that issue later, perhaps in the spring of 1995. To postpone discussion of an issue that all considered to be of importance for such a long time seemed strange.

It would not be necessary to return to the program countries covered in the present paper to review program implementation, because an evaluation of program implementation was not what was required, Mr. Geethakrishnan stressed. Rather, what was needed was the application of the Fund's own expertise to analyze in an objective manner the advantages and disadvantages of Fund-supported programs. On the one hand, if some enlightenment that could be applied to Fund and Bank-supported programs were to emerge from that, so much the better. On the other hand, if no answers were found, then at least the Fund would be aware of it; in such a situation, it should be clear that every loan the Fund made would increase the risk to the Fund itself.

The fact that, during the period under review, 97 waivers had been required showed clearly that, when the occasion arose, the staff had been only too willing to go along with the countries concerned in recommending necessary changes, Mr. Geethakrishnan concluded. The question that could not be avoided was whether following the policy prescriptions was the rule, and the need for waivers the deviation, or whether it was the other way around. Perhaps the Fund's policy prescription was what was wrong. In any case, whenever a country had come back to the Fund repeatedly for modification of the programs, the staff had been flexible in diluting or reducing the stringency of the conditionalities in the original program, which he welcomed. Perhaps, unbeknownst to the management and the Board, the necessary flexibility was already being introduced into programs. At the same time, the Board should examine the issues that arose in that connection in some detail, on the basis of a more complete staff paper.

Ms. Srejber made the following statement:

> I am not sure that the paper is organized in a way that best promotes analysis and provides the reader with a good basis for

reflection. The paper could have given a more clear-cut message about the role of the programs in economic developments, and the likely reasons for the different developments in the countries under study.

When categorizing the study material for analytical purposes, the staff has decided to put the countries into four different groups: first, countries that have several previous arrangements; second, countries with one previous arrangement; third, Central European countries; and, fourth, other new users of Fund arrangements (see page 2a). Within this framework, the staff approaches macroeconomic results and policy outcomes from different aspects, such as fiscal policy, exchange rates, inflation, and growth. Then the staff picks up every country belonging to the different categories and analyzes them in the light of the different aspects. Still, I am not fully certain that this categorizing is sufficient for understanding why different countries have developed in the way they have.

I wonder if it might not have been fruitful to take one further step and compare policy results and outcomes between groups of countries with different initial conditions regarding various macroeconomic, structural, and political situations--as said on page 3, "a focus of the review is to examine the success in tailoring programs to these varying conditions." A systematic analysis against the background of the question of what were the factors that the successful countries had in common might have increased our understanding. Similarly, we have to ask what common factors were behind the failures. Furthermore, we could ask what role the world economic trends have played. This kind of reasoning can be found here and there in the paper, but I would have appreciated a more systematic approach. For instance, perhaps using some matrices would have made the results clearer.

Furthermore, in order to label a program a success, it is necessary to go beyond looking at the mere observance of specified macroeconomic performance criteria. Like other speakers, I think that the analysis also would have benefited from a greater focus on assessing to a closer degree the extent to which Fund-supported programs contribute to the attainment of the fundamental macroeconomic goals that a Fund-supported program is aimed at helping a country to achieve in the medium term.

Let me now present some of my further reactions regarding more detailed questions and problems in the study. The Fund's important catalytic role can best be achieved through implementation of strong programs securing external viability in the medium term. Therefore, I support the idea of encouraging countries, in cooperation with the Fund, to develop medium-term strategies in general and, in particular, a fiscal policy strategy; and also, sufficiently firm plans on structural reforms.

The experience reviewed does not reveal clear channels for raising private saving rates in the short term during a macroeconomic adjustment, but longer-term experiences with stable financial policies and market-oriented reforms point to the likelihood of such policies resulting in rising private saving over the medium term. I would encourage the Fund to undertake further studies on this issue, keeping the long-term perspective in mind.

I would like to emphasize that the Fund should keep a restrictive stance in its policy on granting waivers. Only if moderate deviations from performance criteria owing to temporary factors occur should a waiver be granted. Some modifications of economic policies would be necessary if permanent changes in underlying factors occur. I would like to stress the importance of including contingency elements into arrangements in order to seek protection for the programs against external shocks.

We note from the staff paper that, somewhat contrary to what could be expected, there is no strong evidence that structural performance criteria speed up the process of structural reform. Perhaps reviews might be better suited for monitoring structural reform, as the quantifying of structural benchmarks or performance criteria is a quite challenging task. It would be helpful if the staff could examine further the use of structural performance criteria, and if the Executive Board could have a general discussion on that topic.

I agree that, to be effective, use of the exchange rate as a nominal anchor has to be supported by credible strong fiscal adjustment and the removal of indexation schemes. However, whether or not to use an exchange rate anchor depends very much on the initial state of the economy. A relatively rigid anchor might be needed in some countries at the initial stages to impose discipline in the behavior pattern, while in others, competitiveness considerations could be more important. Generally, in order to secure full employment and economic growth on a sustainable basis, monetary policy would make the best contribution if it were geared to a long-term objective of maintaining low price and wage inflation.

Mr. Jiménez de Lucio made the following statement:

Like previous speakers, we welcome today's discussion of the Fund's experience with stand-by and extended arrangements during 1988-91. The papers prepared by the staff provided a useful basis for our own reflections on the subject. A number of valuable conclusions and recommendations for the future design and monitoring of Fund-supported programs are presented in the reports; we are in broad agreement with them. Therefore, we will concentrate our remarks on a few aspects briefly mentioned or not discussed in the papers that we consider merit greater attention given their critical importance to the success of reform programs.

The unusual severity of the external financing constraints faced by member countries is highlighted as the first common characteristic of the programs under review. Another common characteristic identified is that substantial progress was made toward meeting external goals, but often less in reaching domestic goals. These two findings are obviously closely related; if a country's most pressing problem is external, it makes sense to concentrate efforts on resolving that problem. But why do countries wait until they find themselves faced with a major external financing problem before coming to the Fund? What can the Fund do to encourage members to seek its support earlier? More important, how can adequate attention to domestic goals be ensured?

A distinction is made throughout the papers between countries that are repeat users of Fund resources and those that are newer to the adjustment process, but the reasons for the large number of repeat users are not much discussed, nor are recommendations made to overcome this situation. The papers refer to the "time-honored view that countries' ownership and commitment to reform programs is fundamental to success," but there is no attempt to evaluate this relationship. How can ownership and commitment be evaluated? Under what conditions is the implementation of reform programs successful? What is a successful reform program? None of these questions are fully addressed.

An analogy might be useful to illustrate our previous comments. We can think of the Fund as the emergency ward of a hospital, a specialized emergency ward for patients suffering from acute anemia, an anemia of reserves. Anemic patients naturally are predisposed to a variety of other illnesses, and are often also afflicted by several of these when they check in. All patients that arrive require, by definition, urgent attention, focused of course on the most severe problem. Some of these patients come of their own free will, while others have to be induced, and in some instances even forced to come. Moreover, many of these patients have been anemic before and are making repeat visits to the emergency ward.

As could be expected, the emergency ward has acquired a great deal of expertise in treating anemic patients. It has developed and tested extensively a general recovery program, which has proved successful and can be adjusted to meet each patient's individual requirements. It has also established criteria for determining when a patient can be moved to the convalescence room and when the patient is well enough to leave the ward. However, full recovery is only achieved some time after leaving the hospital. In addition, doctors know how to prevent anemia, through a well-balanced diet, but they are also fully aware that unless the patient has the necessary commitment to follow such a diet, he is likely to become anemic again.

Like the emergency ward, the Fund has become adept at helping members deal with their external financing problems. Once members request Fund support, the institution is very effective at helping them design and, to a lesser extent, implement the necessary adjustment program. In our view, the conclusions and recommendations of the papers are geared mainly toward further enhancing the Fund's effectiveness in playing that very important role. Again, like the hospital, the Fund is less adept at preventing and avoiding the recurrence of illnesses. In this regard, we believe that much more attention needs to be given to reducing the number of members requiring Fund support, persuading those in need of support to request it earlier, and ensuring that the necessary corrective measures are introduced and that sound macroeconomic policies are followed so as to minimize repeat requests. We turn now to these issues.

The main instrument at the Fund's disposal for anticipating external financing problems of member countries is the annual Article IV consultation. To the extent possible, even greater emphasis should be placed by the staff during their country visits on attempting to identify potential balance of payments difficulties, and on explaining to the authorities the advantages of addressing them at an early stage. In addition, this matter should be highlighted in the reports to the Board. Briefly stated, the most effective preventive measure is to strengthen surveillance.

We must acknowledge, however, that for the foreseeable future, many member countries will continue to require and request Fund support only in times of crisis. Therefore, we must find a way of evaluating the Fund's performance in helping members under those conditions. The first step in evaluating the effectiveness of Fund-supported programs is, in our view, to define success and, by implication, failure. We do not need to arrive at an absolute definition; success can be expressed in terms of degree and will always be arbitrary--and therefore a matter of judgment--but a working definition is required nonetheless.

One possible definition of success could be related to a country achieving a high level of sustainable growth, and the degree of success could be associated with the achievement of other partial targets, such as fiscal balance, a certain level of reserves, certain ratios of savings and investment, and low inflation. These partial, shorter-term targets must be consistent among themselves and with the ultimate longer-term goal. It is evident that much more specificity is required before having a usable definition of success, and it is equally obvious that the task is difficult. In relation to this definition, we should point out that the main paper states on page 42 that "the record reveals few, if any, countries shifting to a distinctly rapid pace of development backed by higher investment and savings ratios." Another possible definition of success could be graduation from regular use of Fund resources. In practice, we use implicit definitions to determine whether or not a given program has been successful, often based on whether or not certain performance criteria were met, or whether or not certain specific results were attained. Therefore, it should be possible to come up with an explicit definition of success.

A point related to the above definition is the time frame and requirements associated with achieving the various degrees of success. How long will it take for a given country to attain high rates of self-sustained growth, as well as lesser degrees of success? What are the key elements for attaining success? What stabilization measures and structural reforms need to be undertaken and how long will it take to implement them fully? What role can and should the Fund play in ensuring that such conditions for success are met? What role should the World Bank and other institutions play in the process? At present, our focus is rightly on quarterly targets for certain key variables, such as net domestic assets and reserves. Meeting those targets implies in itself a certain degree of success, but that level of success seems insufficient to avoid cases of recurrence. Moreover, as stated in the papers, the use of waivers has increased sharply in recent years. Is the Fund setting targets that often cannot be met in the expected time? Is it better to show flexibility in meeting targets than to allow additional time from the start? Should greater emphasis be placed on medium-term scenarios? How long should the Fund remain closely involved in reform programs?

Concerning the elements for success of a reform program, we have already mentioned, for example, ownership and commitment as key elements. But how can one ascertain the degree of commitment to a reform program by a particular government? One way, of course, is by requiring prior actions. However, these might be undertaken because of need, and not because of conviction. Related to this aspect, the main paper states on page 2 that the design of programs reflects the enormous frictions in a second-best world in which political and administrative constraints are a fact of life. Limited effort has been spent to date in identifying these constraints and in dealing with them systematically. The increasing concern about social safety nets comes to mind. However, as the same paper states, the staff's attention has focused on improving the actuarial soundness of social programs and the targeting of assistance--that is, on the fiscal aspects of social programs--more than on their role in gaining popular acceptance for reform programs. It is our opinion that social safety nets will become an increasingly important element in a program's success, and that their full integration into such programs should become a priority.

Considering the increasing prevalence of democratic forms of government among member countries, the political implications and repercussions of reform programs are becoming critical. It is unrealistic to expect governments to undertake an adjustment program likely to lead to electoral defeat, even if they accept the need for such a program and understand the consequences of delaying its implementation. Clearly, much more work is needed in this area. In the meantime, we have a practical suggestion in terms of the program papers brought for Board consideration: to add a short section that provides basic information on the political context. Information such as the timing of elections, whether or not a majority government is in power and how strong its popular support is, whether or not the congress has to ratify the program or enact key legislation included in the program, and whether there is political consensus in favor of the program, should be assessed. This suggestion is aimed at better Board understanding of the political reality of a given country, and thereby at judging better the likelihood of success of a particular program.

We believe that the exchange rate can play a most effective role as a nominal anchor, in terms of helping lower inflation and generating confidence in reform programs. However, to perform these functions effectively, it must be complemented by a strong, credible fiscal adjustment, and a comprehensive set of structural reforms. Otherwise, speculative pressures against the currency might become overwhelming, and the loss of competitiveness caused by a fixed exchange rate in a context of higher inflation than the levels prevailing in trading partners would not be offset. In general, we share the comments on the subject made by Mr. Kiekens.

We would like to join other Directors in their concern about the lack of progress in establishing the already agreed-upon evaluation unit.

Mr. Waterman made the following statement:

We welcome the opportunity to assess developments in countries with stand-by and extended arrangements. The staff papers are both important and rich in insights, but if they are to be published--which we would support--I would make them shorter and bring out the main conclusions more sharply. The Fund should communicate effectively with outside readers and commentators.

I generally agree with the answers implicit in the questions posed by the staff for today's discussion. There are, however, a few issues I would like to touch on. In doing so, I might be straying a little from Fund orthodoxy, but as Ms. Lissakers and others have argued, we need to have an open mind as to the preferred approach to adjustment and reform, and the papers seem to have been prepared in that spirit.

The basic approach of programs under stand-by and extended arrangements has been to address pressing external problems, and there has been some element of success at that. There has been less success, however, in reducing inflation and getting other elements of sustainable growth in place. A particularly telling point is that investment ratios tend to be lower after a Fund-supported program than before one. In our view, there would appear to be some room to shift the focus of programs more toward the generation of sustainable economic growth. This point has been picked up by Mr. Mirakhor and Ms. Lissakers, among others. Reducing financial imbalances needs to remain an important goal, but it should be seen as the means to an end, rather than an end in itself. One gets the impression that sometimes that point is forgotten.

Generating higher rates of saving and investment is one particular area that deserves greater attention. There may be little that can be done to improve private saving through macroeconomic policy, but the public sector can play an important role in reducing its own dissaving and in providing for public infrastructure.

On the latter point, it needs to be recognized that accepting lower rates of public investment in the interest of fiscal consolidation may come at the expense of longer-term growth potential, particularly where that investment is necessary and can be expected to yield a good economic return. In that regard, I recall a point made by the Director of the Fiscal Affairs Department during the Board discussion on the fiscal policies of countries in transition: a somewhat higher fiscal deficit may be acceptable if it is in support of good structural measures. The Director may have had tax reform in mind, but the point has more general application, and bears on the issue of being more explicit about the required fiscal adjustment.

The program recently agreed with the Philippines is a good example of a case in which restoring economic growth is a central feature, and the program is better for it. While it has taken some time to reach that stage, for a variety of reasons, I would like to think that we could come up with growth-oriented programs for other countries somewhat earlier.

In addition to a greater focus on growth, I believe that programs could be enhanced and made more transparent by making them more general. When I arrived, I was struck by the level of detail that programs get into. At one level, I can understand the need for precise benchmarks, but at another, I know we cannot be overly precise about the settings required to achieve a broad improvement in macroeconomic variables. In terms of program monitoring, this argues for keeping performance criteria as broad and as simple as possible. In that regard, it may be better to have ranges rather than point-estimates. For fiscal policy, for example, the most direct concept is arguably the overall public sector deficit or financing requirement. A general performance criterion could aim broadly at reducing that. In any case, there is a general issue to be mulled over here.

Wherever possible, providing the authorities with a clear indication of what might be expected of them if the general direction of the economy turned out to be different from that expected because, for example, of external shocks, would be very useful. I know that this has been down in some cases.

Structural reforms are very important for enhancing long-term growth rates, but it is not clear to me that the Fund needs to get involved in detailed monitoring. I am comfortable with having structural performance criteria that focus on the exchange system, not because they are necessarily easier to implement, but because it is an area of the Fund's direct responsibility. In other areas, closer coordination with the World Bank, rather than closer monitoring by the Fund, is the preferred path. In that regard, the policy framework paper process, in the context of ESAF programs, seems to work quite well.

I was impressed by the evidence that in some countries, the exchange rate seems to have been an effective nominal anchor. However, we need to be careful not to overstate the point. One can imagine how targeting the nominal exchange rate could be helpful in breaking the back of inflationary expectations in countries with very high rates of inflation, but it is also clear that fixed or pegged nominal exchange rates must be backed by appropriate macroeconomic and structural policies. We also need to keep in mind the trade-offs involved in nominal exchange rate targets. While they might, in some circumstances, help in reducing inflation, they will also reduce international competitiveness, to the detriment of export industries--which we know are vital for sustainable economic growth. At least in some cases, a required real depreciation is likely to be more effective and timely, by having some adjustment in the nominal rate, or letting the rate respond to market forces. I recognize that using the exchange rate as a nominal anchor for inflation control is not inconsistent with some adjustment from time to time, but, in practice, there can often be a reluctance to move the rate where it performs an anchor role.

Direct wage controls have also been used as nominal anchors in a few countries, particularly in Eastern Europe. I am skeptical of the efficacy of such controls. The staff papers seem to reinforce that skepticism. I would hope that we would only recommend such direct wage controls in very exceptional circumstances.

I recognize the importance of trying to allow for the points that have been made about Fund-supported programs, without making the overall terms of reference against which performance is judged too elastic or ambiguous.

Mr. Kafka made the following statement:

This important paper would merit careful consideration of its methodology, as well as its conclusions, but, for reasons of time, we shall limit ourselves mostly to the latter. On the methodology, the staff presents various options other than the one adopted, and gives reasons why they were rejected. It is, nevertheless, still not clear to me why attempts would not have been worthwhile to revisit the type of study undertaken by Mohsin Khan in 1981--an econometric study with estimates of counter-factuals to determine the influence on performance of Fund-supported programs. Perhaps such a study would not have yielded meaningful results--but it might have been worth the effort.

Turning to the conclusions, the paper finds that a three-pronged approach of fiscal adjustment, external finance, and structural reform in program countries achieved significant success in improving the external position, but some success also in raising output. The latter apparently happened without strong responses of either saving or investment, a fact that might have merited more analysis. Other studies point to the importance of stable macroeconomic conditions and a viable balance of payments as conditions of success. This seems to justify the usual type of Fund recommendation. Nevertheless, it is not entirely reassuring. I would certainly have no better recipe, but what is probably needed is a more detailed analysis than the paper provides of why so many programs failed after the first purchase, and why 50 percent of purchases that were made involved waivers. I do not, of course, question the waiver technique, which is an important instrument of flexibility, but it should not be forgotten that the need to ask for waivers can be embarrassing to program countries, and even damaging to their progress. Other techniques to increase flexibility, such as a greater use of "adjusters," might be contemplated, but the more important question may be whether the program design was deficient. In particular, did the programs involve a major, even if presumably temporary, deterioration of living standards and employment, or a reduction in the availability of resources for important groups of society, or did they produce temporarily other socially damaging effects? Were there enough social safety nets in place? To learn something from the outcome of our programs, the Fund should perhaps intensify its use of the expertise of other social sciences beyond economics. Possibly, such investigations would teach us to shy away from programs that are inadequately financed externally to be socially bearable, even if they represented a first-best solution, provided they could be implemented. The old question--an attempt at a quick fix versus slow progress--appears here once again. In this connection, the paper notes correctly that there was no systematic analysis of sustainable fiscal deficits.

The paper itself raises doubt whether the programs had an appropriate medium-term focus, which in turn emphasizes the question posed above: did the Fund have and make available enough resources quickly enough, or was it able to mobilize enough resources from other cooperators? This is, of course, particularly relevant at a time when we are considering a possible establishment of cooperative trust accounts. This question of sufficiency of external resources, which cannot simply be determined on the basis of a comparison between exports--or even GDP--and financing, does not apply only to Central and Eastern Europe and to the countries of the former Soviet Union, but to other program countries. Even very large financing increases may be entirely eaten up by debt service and by the payment of arrears. Furthermore, while the importance of fiscal adjustment cannot be overrated, it is also true that more emphasis could have been placed on the importance of the control of credit policy and on means other than fiscal to deal with excessive capital movements. Moreover, the paper correctly states that more analysis is needed on how to effect private saving and investment, and also the attitudes of labor. We also find useful the paper's findings on the effectiveness and risks of nominal exchange rate anchors in reducing inflation.

Several questions are raised about the sequence of reforms, for instance, between financial sector reforms and the adoption of supporting policies. I agree with the conclusions regarding structural reforms and the need for countries to avail themselves of political opportunities as they arise, although trying to adopt medium-term perspectives on reform.

On the question of monitoring, there are a number of points that definitely suggest a need for a new, or at least another, look. Thus, the prevailing use of quarterly performance clauses establishes an enormous burden on the Executive Board and the staff, and we should consider whether we cannot get by with a general rule of semiannual performance criteria and semiannual reviews, or even annual reviews in multiyear programs. The whole question of the relationship between reviews and performance criteria perhaps also requires a review. It is also a pity that there was no discussion in the paper of the effectiveness of prior actions, difficult as these may sometimes be to define.

I join my colleagues who have reiterated their support for the establishment of an evaluation unit.

Mr. Blome made the following statement:

Like previous speakers, I commend the staff on its comprehensive empirical studies and its thorough analysis, which provide a good basis for today's discussion. I can also support the draft decision, including the proposal not to change the conditionality guidelines, which remain broadly appropriate.

I was a bit surprised to read that Fund-supported adjustment strategies consist mainly of three elements, namely, fiscal adjustment, mobilization of external financing, and structural reform. Concerning the first element of this so-called three-pronged approach, I would like to underscore that Fund-supported programs do not aim only at fiscal consolidation, but also at a rapid stabilization of monetary policy indicators, which are of particular interest for a monetary institution like the Fund. Therefore, the staff should have called the first element "macroeconomic stabilization" instead of "fiscal adjustment."

On the second element, I gained the impression that the staff has sometimes put too much emphasis on the mobilization of external financing in the program design. I would thus underscore that a Fund arrangement should rather aim at reducing the external financing needs than at creating new ones. This holds true, in particular, for the financing needs of the public sector, while the external indebtedness of the private sector can be neglected in our modern world given floating exchange rates, free capital movements, and efficient bankruptcy procedures for inefficient companies. Therefore, if private savings cannot be increased sufficiently and rapidly enough to cover the ubiquitous fiscal deficits, Fund-supported programs should strive for an early reduction of these deficits, rather than for a mobilization of additional external resources. Contrary to this view, quite a number of Fund-supported programs have aimed only at a shift of budgetary resources to more productive uses, namely, a reduction in current spending in favor of an increase in investment outlays, while the overall fiscal deficit remained unchanged. Such an approach is often not sufficiently ambitious.

Achievement of early improvements in the external positions by some countries was partly a consequence of substantial debt relief and additional financing granted by donors at the beginning of programs. Contrary to front-loaded external financing, however, major internal adjustment measures aimed at raising savings and investments were often only implemented or initiated at a later stage of the program, after the adjustment process had gained some momentum. The unsatisfactory evolution of domestic savings and investment during the program period is therefore not surprising.

These experiences underscore the need to complement usually front-loaded external financing with more front-loaded adjustment strategies, aimed, inter alia, at early responses of savings and investment. Such strategies should include the establishment of adequate real interest rates, preferably as prior actions, a removal of barriers to foreign investment, an early initiation of public enterprise restructuring and privatization, and a rapid rehabilitation of weak financial sectors.

At the same time, however, I agree with the staff that the short-term relationship between the initiation of reform policies and private activity is a complex one, and that private savings and investment are probably influenced to a large extent by long-term prospects and expectations. It is thus very important to sustain reform policies over a longer period of time in order to improve, step by step, investors' confidence and the business climate. The likely period of the adjustment process in this area will be very long, however, and the question arises whether the country should not be supported by the World Bank rather than by the Fund.

I do not share the staff's view that the reactions of savings and investment require further study, because the basic mechanisms in this area are broadly understood, and there are probably quite a number of papers about this subject prepared by other institutions. In view of the Fund's limited resources, we should only do additional research if there is an urgent need for it, and if no other adequate material is available. For the same reason, I do not consider it necessary to collect more data on employment and labor market issues. If authorities need additional guidance for formulating policies in this area, they could orient themselves, for example, by referring to recently published OECD or EU labor market studies.

I fully support the views of Mr. Kiekens on the question of exchange rate anchors.

Regarding fiscal consolidation, I concur with previous speakers that the staff and the authorities should pay greater attention to the sustainability of fiscal positions in the design of Fund-supported programs, and should also make greater use of medium-term scenarios in the interplay between fiscal and other developments. However, I assume that it may be difficult in some cases to formulate a medium-term strategy owing to weak data bases and deficiencies in the institutional framework. Independently from that, I would like to underline that the desired stronger medium-term orientation of fiscal policies must not lead to a postponement of major consolidation measures, and must also not prolong unduly the Fund's financial support for adjustment policies.

With respect to labor market issues, I learn from the staff paper that only very limited progress has been achieved in increasing the responsiveness of wages to labor market conditions. We should therefore put greater emphasis on labor market reforms in Fund-supported programs, and the timely implementation of these reforms could be monitored by a more frequent use of qualitative performance criteria. I agree that wage control measures could play a useful role in transition countries in the early stages of the transformation process, when market mechanisms have not yet been established in the economy, and when corporate governance is still poor. It is self-evident, however, that these controls should be abolished as soon as possible, as they impede the necessary adjustment of wage relations to changing conditions.

I agree that the staff should continue to encourage the authorities to develop medium-term structural reform strategies, but it should also support less systematic approaches if they represent significant progress and do not lead to an inappropriate postponement of difficult adjustment measures, such as privatization and labor market deregulation. Unlike the staff, however, I feel that the timely implementation of these and other structural reforms should be monitored through specific performance criteria, and not through reviews. I support the staff's general conclusion that every effort should be made to simplify monitoring procedures, especially of the complex fiscal accounts.

Mr. Fukuyama made the following statement:

I commend the staff for its endeavors in preparing a set of comprehensive papers. These papers contain much useful information, and I generally appreciate the approach that focuses on the design of various programs. Comparisons of countries with and without Fund support would be very difficult in a strict sense, and studies focusing on specific policy issues or cases do not completely fulfill the requirements of the 1979 guidelines on conditionality.

Nevertheless, I have some reservations. To begin with, these three papers, which amount to 270 pages, are obviously too long, even though summaries are inserted here and there. I understand that papers of this kind are apt to be very much descriptive, but more streamlining seems to be possible.

Furthermore, I am not satisfied with the arrangement of descriptions. As these papers are for a review of programs, they should start by describing the macroeconomic objectives of the programs. In this regard, I think that it is difficult to conclude, as Ms. Lissakers does, that the ultimate objective of a Fund-supported program is to achieve increased national savings and investment, although that is an important point. Rather, a typical pattern seems to include a combination of objectives, such as improving the external position, raising output, and reducing inflation; and different emphasis is put on each objective, depending on the circumstances surrounding each program. In any case, the paper then could go on to what policy objectives were selected--such as a reduction in the fiscal deficit--as a means to accomplish the program objectives, whether these policy objectives were achieved, and whether their achievement led to the accomplishment of the program objectives. I have the impression that the staff papers mix up program objectives with policy objectives, which impedes a clear understanding of the issues.

I was impressed by the evident difference in progress in reducing inflation between countries with and without exchange rate anchors. Nevertheless, it remains a concern that, at least in the short run, an exchange rate anchor tends to bring about a deterioration in external competitiveness.

As the staff points out, for most countries that seek the financial support of the Fund, the most urgent problem is difficulties with external payments. It may also be noted that the Articles of Agreement stipulate that Fund resources be made available to provide an opportunity to correct maladjustments in the balance of payments. From these viewpoints, a loss of competitiveness bears a big cost. Of course, the financial support of the Fund has changed in character, and it is correct to argue that the containment of inflation will improve a country's growth potential in the medium term. Therefore, I am not against the use of exchange rate anchors to help reduce inflation. Nevertheless, I would like to stress the need to recognize that exchange rate anchors are useful as a kind of shock therapy mainly when inflation rates are very high, and that anchors should be revised flexibly in accordance with the developments in inflation and the external position.

On the fiscal policy front, it is in a sense a matter of course that fiscal adjustment was significant and as large as planned, considering that fiscal policy is under the direct control of a government that is committed to implementing an adjustment program. As the staff suggests, fiscal policy should be evaluated not only by the degree of deficit reduction achieved during a single year, but also by the sustainability of the fiscal position over the medium term. How far the latter viewpoint can be taken account of depends on the urgency of problems a country faces. In this respect, the staff should examine carefully each item of the budget and assess whether the need to reduce the overall deficit has not led to a cut in investment expenditures that are crucial to future growth.

Judging from the fact that many countries have repeatedly faced difficulties and sought the support of the Fund, it may be appropriate to put more emphasis on the medium-term sustainability of adjustment policies in general, not limited to fiscal policy. I certainly support the staff's study on this matter, including a further study on savings and investment.

Wage policies are effective in some cases in reducing inflation and maintaining external competitiveness. When wage policies are introduced, however, due consideration should be paid to the following. First, emphasis on a general reduction in wage increases should not lead to the maintenance of the status quo vis-à-vis wage differentials. Every effort must be made to allow differences in productivity to be reflected in wage differentials. Second, it should be noted that freezing or controlling only public sector wages, which looks like an attractive option owing to the relative ease of its implementation, may bring about the problem of "brain drain." Third, once the economy has regained stability, wage policies should be eliminated, as they carry a risk of resource misallocation.

Typical examples of very high interest rates were those experienced in CFA franc countries, and in these cases, the source of the problem was the inappropriate use of exchange rate anchors. However, the countries that observed very high interest rates are not limited to CFA franc countries, and this implies that financial liberalization requires various preconditions. For example, if the banking system is oligopolistic and borrowers have little choice as to sources of funds, very high interest rates tend to persist. Therefore, I share the staff's view that programs should be more aggressive in ensuring supporting policies of financial liberalization.

Appropriate sequencing of structural reforms based on a medium-term viewpoint is obviously important. However, if that is not politically feasible, the less systematic approach of starting on whatever is possible may be a second-best choice. In this case, it should be noted that, while some reforms are related but separable, such as reform of the tax system and reform of the unemployment insurance system, there are others that are closely interrelated, such as privatization and the preparation of a bankruptcy law and an accounting system.

Mr. Sirat commented that he supported what Mr. Fukuyama had said about the possible negative impact of financial liberalization in an oligopolistic framework. The question that might be raised from that observation was whether or not the Fund should pursue more aggressively increased competition within the financial sector.

Mr. Coumbis made the following statement:

This review of stand-by and extended arrangements during 1988-91 is a result of excellent work on the part of the staff, and is extremely informative and balanced. It indicates the strong and weak points of Fund-supported programs, the probable conflicts of recommended policies, and suggestions for further research. The description of these suggested policies and the results achieved during the program years is accurate and extensive.

Fund-supported programs were successful in the external sector. By the end of the review period, a substantial improvement had been achieved in most cases in the amount of reserves, in the elimination of arrears existing at the beginning of the program, in the amount of capital inflows, in the current account position, and in the reduction of debt service ratios. The results, however, in achieving and sustaining low inflation were mixed; the output growth record was moderate. Moreover, the results in the areas of saving and investment were disappointing. In most cases, during the program period, private saving and investment declined slightly. Finally, there was an immediate response in many countries to the demands of the program for structural reforms in certain areas, such as exchange and trade restrictions, financial sector pricing policies, and the reduction in public expenditures. In other areas, however, such as privatization, tax reform, and increased responsiveness of wages to labor market conditions, progress was much slower.

As the staff points out, it is not surprising that ambitious objectives for the external sector were met more readily than domestic objectives. Most countries entered Fund arrangements because their external sector was in acute crisis. The Fund had the obligation to give first priority to their urgent problems. In that respect, for policies with conflicting short-term objectives--for example, between policies aiming to reduce inflation and policies to improve the external sector--the choice at that time had to be made in favor of protecting the external sector. Also, between policies aiming to improve investment and growth versus policies to improve the external sector, the choice was again in favor of the external sector.

It was clear in this review that strong gains in the real sector were not evident in the short period of the review. Moreover, it seems that other key requirements that are conducive to growth, such as stable economic conditions, a normal political environment, and structural reforms, could be fulfilled only over time. It is necessary, therefore, to examine the growth mechanism from a longer-time perspective. In that respect, we should study the factors affecting savings, investment, growth, and employment in the medium term, their interrelation, and their interaction with fiscal adjustment during the same period. Fiscal adjustment is the main instrument used to restore equilibrium in the external sector, and we know that in short-run programs in almost all countries, fiscal deficits fell in relation to GDP, and net credit to the public sector stayed within program limits. However, the staff underscores the difficulties of predetermining the appropriate path of fiscal adjustment in the medium term, and the sustainability of the fiscal position over that period.

The scenarios covering the medium-term period are politically sensitive and subject to large revisions because of external shocks. The sustainability of fiscal adjustment in the medium term depends on the behavior of private investment and on the rates of income growth. Given the complexities and the uncertainties that underlie the investment function, much work has to be done in this area, most probably in cooperation with the World Bank. It seems also that an important constraint for that kind of analysis is the lack of necessary data.

Regarding savings, there is a chapter in the background paper with valuable information from the literature, from the staff findings from 52 program years, from two case studies for Mexico and Tunisia, and from cross-section regression analysis. Neither the theoretical analysis nor the empirical evidence supports the hypothesis that policy variables are affecting private savings in the short run. It seems that in this case as well, an improvement in the data used for the analysis of savings is badly needed.

The information provided by the report and the background paper on private investment is limited. In a few paragraphs, the report indicates that during the program period, only a few countries shifted to a rapid pace of development backed by higher investment and saving rates, while for the medium term, investment responds reasonably strongly to macroeconomic stabilization, but usually with a substantial time lag. Moreover, it is noted by the staff that "the stagnancy of the investment ratio underscores the difficulty of restoring investors' confidence. Generating the confidence needed to raise investment requires the establishment of a track record of stable financial policies and often profound structural changes." There is no doubt, I believe, that financial adjustment is a necessary condition to secure a sustained rate of increase of private investment and, thus, sustained growth; but it is not clear that it is a sufficient condition as well. From the phrases cited above, it is clear that considerable uncertainties surround the actual path of private investment to rates of increase compatible with sustainable growth. This means that much more work has to be done in this area. In that respect, I think that it would be useful to have case studies of countries that, at some period of time, had financial difficulties that were corrected either through Fund-supported programs or by the adjustment effort of the countries on their own, and that had a successful record in reviving private investment rates. It would be interesting to examine in these cases the factors that contributed to that revival, as well as general economic and political conditions prevailing in these countries.

With respect to the effects of adjustment efforts on employment and labor markets for program countries, the staff paper indicates that it is important to examine the responsiveness of wages to employment conditions. I would add, however, that the problem is relevant mainly to the industrial countries, where there are strong trade unions and a long history of social security and unemployment benefits. With regard to the unemployment problem, there are no indications in the staff paper as to the effects of the program on the employment situation. There are also no indications about the employment prospects in the medium term. With respect to the rates of growth of output, there are many references in the paper to the results of the arrangements on output growth--which were mixed: a substantial fall in the Central European countries, a clear increase for the countries just beginning their adjustment efforts, and, in between, a modest increase for countries that had previous arrangements. However, for countries with a substantial increase in the rate of growth of income, it is not clear that that rate is sustainable in the medium term. Output may increase in the short run without an increase in investment if there is excess capacity, or if the increase in output reflects an improvement in efficiency in response to better structural and financial policies. In the medium term, however, it is doubtful whether there can be a substantial increase in output without a corresponding increase in investment.

Programs and conditionality are the major instruments by which the Fund ensures that its resources are used effectively in promoting its major objectives, protecting its financial integrity, and assisting its members who need its support. This review of Fund-supported programs is a useful exercise that helps us to evaluate the work that has been done so far, and to discuss future work that will improve the design and effectiveness of Fund-supported programs.

Mr. Marino made the following statement:

As usual, the staff has done a very good job in reviewing the experience of countries with stand-by and extended arrangements during 1988-91. The lessons derived from this experience are important ones that should be taken into account in future program design. As is clearly the case, there is not a unique blueprint in designing an adjustment program; much depends on the initial conditions, on the institutional framework, and on the political commitment to the reform efforts. We certainly agree with the staff that the design of programs necessarily reflects the enormous frictions that prevail in the real world, where political and administrative constraints frequently imply a departure from first-best solutions. The general conclusion from this is that program design should be done in close consultation with member countries, as government officials have greater sensitivity about the most feasible measures, or about those that have a greater probability of success given the short-term trade-offs between macroeconomic objectives. This is substantiated by the finding that, in the arrangements in which structural reform was most extensive and deep, there were no structural performance criteria.

The topics for today's discussion are central to the working of the institution. All of them merit in-depth discussion, and several of them have indeed been the object of substantive discussion in the Board in the recent past. Recognizing this, I am sure that I will not do justice, with my few comments, to the many months of work that are distilled in the excellent papers prepared by the staff. These should constitute valuable reference material for the member countries involved in transforming and adjusting their economies and, of course, they should be required reading for all staff members who participate in the design of adjustment programs.

Let me address a few of the issues on which the staff suggests that we comment in Section 3 of the main document. The first question is to what extent programs have contributed to the ultimate goals of ensuring strong and sustainable growth. There is a large body of empirical evidence showing that those countries that have achieved high growth rates during a long period are those that have the basics right, by which I mean macroeconomic stability, low inflation, strong public finances, monetary discipline, and a competitive exchange rate. These are the necessary conditions that are considered important to promote confidence in the banking system and encourage firms to undertake long-term investment projects. Nevertheless, getting the basics right also involves heavy and sustained public investment in social infrastructure, particularly education. This is in line with the three-pronged approach that the Fund has been using in the design of adjustment programs. Therefore, we believe that the Fund has done its part in helping countries set the foundations on which strong and sustainable growth can be built.

Admittedly, this is a somewhat hands-off approach to fostering economic growth. Recently, there has been a re-emergence of the idea that there might be a special role for government intervention in the economy, based on the successful experience of countries like Japan, Taiwan, and Korea. By actively intervening in the development of specific industries, governments can promote more rapid growth and, thus, job creation. I mention this because the instruments typically used for intervention usually are counter to the measures advocated by the

Fund, such as restrictions on imports, the preferential allocation of foreign exchange, tax incentives, and subsidized loans. Given this re-emerging trend, we consider that the Fund should be careful to stress in its policy recommendations that its role is to ensure that governments pursue policies that give markets the preponderance in the allocation of resources.

The second issue is that of nominal anchors. On this topic, two important facts stand out. First, the countries that have had greater success in reducing inflation are those that have used the exchange rate as a nominal anchor. Second, the results in countries that have tried to use the exchange rate as a nominal anchor without the peak conditions that enhance its effectiveness, such as an adequate degree of financial restraint and a break with indexation practices, have been dismal. The lesson for policymakers is, therefore, crystal clear. If the country meets the preconditions for recovering financial stability, using a nominal anchor is probably the most cost-effective route to reducing inflation. If the preconditions are not there, the message to governments is to not erode credibility by trying a tactic with a low probability of success. The art in all of this, of course, lies first in identifying when the preconditions have been met, given the interaction between inflation indexation and fiscal deficits, and second, in assessing when all sectors of society desire a return to price stability. That is when a social consensus around price stability has developed. I would like to express a word of caution about the conclusion in this section of the staff paper, where it is said that an anchor introduced as part of a disinflation program may well have to give way to greater flexibility in the face of adverse terms of trade movements or a protracted loss of competitiveness. This is a valid ex post conclusion, but ex ante, in order for an anchor to be successful, economic agents need to be convinced that the country is fully committed to maintaining the anchor, and that there are not too many escape clauses on which the anchor would be abandoned. Therefore, in program design, no hint should be given that the anchor will be easily abandoned.

The third issue is fiscal adjustment during programs and the medium-term sustainability of the fiscal position. This takes me back to my comment about getting the basics right. Part of the basics is sustained public investment in social infrastructure, particularly education. Unfortunately, in many cases, meeting the fiscal targets has involved sizable reductions in capital outlays and in current expenditures with a high content of investment in human capital. For example, more schools usually mean more teachers and higher expenditures on teachers' salaries. Across the board, expenditure cutting is understandable in the initial stages of adjustment, when the overriding priority is to stabilize the economy. Once this phase is overcome, program designs should explore the issue of the composition of public expenditure and the issue of the sustainability of the fiscal position. Therefore, we agree that programs would benefit from a more explicit exploration of what constitutes a sustainable fiscal position. Nevertheless, this exploration has to take into account not only the three standards for fiscal sustainability mentioned in the staff paper, but also some indicators of the social demands that are going to be placed on governments in terms of health, education, social security, and infrastructure.

Regarding short-term developments in investment and growth during programs, we concur with the staff that the data for examining many questions about savings, investment, and growth, and their interaction with government finances, are sparse and weak. Therefore, efforts to improve the quality of data would have a big payoff in terms of improving program design. Even though developments in investment were perhaps the most disappointing aspect of the programs, we are encouraged to see some shift in the composition of investment, with private investment ratios rising while public investment ratios fell, showing an important crowding-in process. Over time, this will auger well for the growth prospects of countries adopting Fund-supported adjustment programs. Clearly, a longer-term perspective is needed when reviewing developments in this area.

It is clear from the extensive empirical research on private savings that an important basis for sustainable development is the generation of sufficient national savings to finance the investment opportunities of a country. External savings have played only a limited, complementary, role in countries' development processes. Unfortunately, as is highlighted in the excellent chapter on this topic in the paper, both the theoretical underpinnings and the empirical evidence on the effectiveness of policies to affect private savings are ambiguous. In this situation, where we recognize the importance of promoting private savings but are not quite sure how to do it, one is tempted to follow the recommendations of Adam Smith--having the government look carefully after its own savings behavior, on which it has a handle, and letting individuals determine their intertemporal consumption decisions in a distortion-free environment. Having said this, it seems worthwhile to explore the experience of different countries in the development of new saving vehicles, as Ms. Lissakers suggested, although we saw that financial savings and national account savings can move in opposite directions.

It is clear that there are many possibilities regarding the approach to review Fund-supported programs. We are attracted to the idea of comparisons of countries with and without Fund support in order to bring out the catalytic role of the Fund and its impact on the availability of external financing, although we are aware of the problems involved. Regarding various aspects of monitoring programs, we strongly support simplicity as a criterion for monitoring. In Fund-supported programs, it is not uncommon to find complex performance criteria that are not well understood by the authorities--or even, at times, by us.

I join Mr. Smee and others in the call for an evaluation unit.

Ms. Lissakers commented that, with regard to the vexing point about the inverse relationship between public savings and private savings, the supplement to the staff paper stated that "while this process operates as a somewhat vexing damper on external adjustment, the body of evidence on longer-term experiences with stable financial policies and market-oriented reforms points to the likelihood of such policies resulting in sustained growth and rising private saving over the medium term"--a point that Mr. Marino had also made. However, the Tunisian experience raised the question of whether an alternative--and perhaps less painful--path could also have the same positive result in the medium term, but with a somewhat more attractive nearer-term pattern, namely, higher total savings for the economy and higher growth during the adjustment period.

Mr. Sarr made the following statement:

I wish to join previous Directors in commending the staff for the interesting and comprehensive papers prepared for our review of developments in countries with stand-by and extended arrangements approved during the period 1988-91. The sample of countries provides a mix of interesting country cases at various stages in the adjustment and reform process, which enables the staff to analyze the range of policy choices and their effectiveness in achieving the objectives of the program supported by the Fund under stand-by and extended arrangements.

As with any undertaking of this sort, there are drawbacks and limitations, and the staff is right in sounding some words of caution on the significance to be attached to a number of common issues identified in this review, and also on areas where further analyses remain necessary. While the review reinforces our view that a key to the success of the adjustment process is the authorities' continued commitment and sustained implementation of key policies, it also raises a fundamental issue of whether program design can help achieve a more balanced outcome between external and domestic goals.

The review of experience revealed that, although most countries adjusted their policies as envisaged under the program, the outcome on the domestic front was generally disappointing in terms of private savings, investment, and growth performance. Moreover, with economic contraction over an extended period of time, the cost of achieving the programs' financial targets became generally unsustainable. Besides some of the explanatory factors discussed in the paper, we believe that the lack of further progress in addressing the issue of debt overhang facing a number of countries in the sample, and of timely availability of programmed external financing, played a critical role in constraining performance on the domestic front. These issues will have to be addressed more forcefully in Fund-supported programs; also, consideration should be given to how to reinforce the Fund's important catalytic role.

The increased structural reform orientation in recent Fund-supported programs, with a view to addressing long-term growth, is welcome. However, this is an area in which improved coordination, more committed ownership of programs, and better sequencing of structural reforms can substantially improve the success rate of programs. In this regard, we agree with the staff that more explicit analysis of the linkages between structural reform and growth in programs should be encouraged. While the relationship between positive real interest rates and financial deepening remains broadly valid, however, as the staff rightly points out, the presence of positive real interest rates may not lead in itself to higher financing or savings, and more attention will need to be devoted to improving the efficiency of financial intermediation. In this regard, we welcome the recent emphasis being put in Fund-supported programs on structural measures needed to improve prudential controls and bank supervision.

We can support the view that, in deciding on a major change in interest rate policy, consideration needs to be given to the impact of an excessive level of real interest rates on growth.

We are not certain whether more emphasis should be put on adapting medium-term fiscal scenarios in Fund-supported programs. When countries are experiencing a major economic shock, some lag and uncertainties in the working economic variables should be expected, and the general direction of the adjustment process should be given more weight than the strictly quantitative indicators. In addition to the institutional constraints in preparing such a medium-term fiscal scenario, we believe that the time would be better spent addressing the weaknesses in the budgetary procedures, the lack of control over public enterprises, the bottlenecks in fiscal organization, and other technical issues, which could be more useful in evaluating the quality and durability of fiscal adjustment in individual cases.

The issues of employment and the labor market have been addressed only partially in Fund-supported programs through public sector wage and civil service employment. It is, therefore, appropriate for the Fund to investigate further the impact of these policy measures on work incentives and the efficiency of the public sector, and their consistency with the role that the public sector is likely to continue to play in the economy of these countries, especially in view of the continued delay in raising private savings and investment. We agree that countries should be encouraged to collect employment data, and discuss the broader issues relating to employment and the labor market.

I share some of the concerns of previous speakers about sequencing. Technical assistance at an early stage and appropriate sequencing should ensure a more durable outcome. The observations of the statistical constraints faced in reviewing the experience of countries are extremely helpful. We agree that improving the timeliness, coverage, and quality of data--especially national accounts and fiscal data--will go a long way toward strengthening program design and providing the scope for more uniform treatment of members. We consider that work on data consistency across countries and data collection is critical for the continued improvement of program design.

We agree with the staff that, while the monitoring of programs remains broadly appropriate, every effort should be made to simplify the performance criteria found in Fund-supported programs and to make use of the reviews to monitor structural reforms. We found the present framework, under which corrective action is discussed and implemented, to be flexible and appropriate.

However, it is important that fiscal performance criteria continue to be well targeted and limited to key variables that will not affect the authorities' ability to continue to address domestic social and political concerns, or upset the consensus needed for the pursuit of the adjustment process. The focus on the overall fiscal deficit and its financing, rather than on specific revenue and expenditure targets, should be favored because of its comprehensiveness and broadly neutral effect. Moreover, as the staff indicates in the paper, there was no strong correlation between the use of multiyear specific criteria and the achievement of the program's fiscal target.

Mr. Al-Tuwaijri made the following statement:

I would like to welcome these comprehensive and informative papers. The limitations to the staff analysis are well presented in the first section of the main paper, and I do not need to elaborate on this point. I would add, however, that our understanding of developments in countries with stand-by or extended arrangements could have benefited from the input of an evaluation unit.

I agree with the papers' broad suggestion that there is little need for change in the Fund's basic approach to programs. Nevertheless, the papers point to several areas to which greater attention should be paid in designing programs under both facilities.

The role of the exchange rate as a nominal anchor in Fund-supported programs raises a number of interesting issues. While an exchange rate anchor has been successful in reducing inflation or holding it at a low level, it has also contributed to a loss of competitiveness in many cases. Here, I fully agree with the staff that the success of the exchange rate as a nominal anchor will depend to a large extent on the authorities' ability to maintain the required restraint in financial, as well as incomes, policies. In this connection, determined effort on the structural front to remove distortions, enhance efficiency, and boost productivity, would improve the policy mix by reducing pressures in the financial area, thus greatly improving the chances of success. Against this background, I wonder whether an aggressive use of the exchange rate to maintain or enhance competitiveness may delay the necessary structural adjustment measures in some cases. Staff comments on this issue would be welcome.

Financial market liberalization is clearly an important element in ensuring the long-term sustainability of growth. The papers before us point to a number of important issues that need to be addressed--in particular, the emergence of very high real interest rates following the adoption of a market-determined interest rate policy. A rudimentary or oligopolistic structure of the domestic financial market will no doubt contribute to interest rate levels that are well above what could be justified by the return to capital plus the risk premium. Ensuring the proper sequencing of financial liberalization measures, including paying due attention to issues involving prudential supervision, will be critical. In this regard, the papers we discussed last Wednesday on international capital markets are very relevant. We look forward to continued Fund involvement in this area.

Another theme that emerges clearly from the papers is the need to strike an appropriate balance between addressing short-term balance of payments needs--which is the heart of Fund operations--and ensuring that adjustment is sustainable--which requires an appropriate medium-term framework. Our experience has shown that sustainability of the reform effort would be greatly facilitated by a pickup in investment and growth. Unfortunately, as the staff rightly points out, these may not emerge quickly, as investors may require a track record before they embark on direct investments. Here, movement on the structural front will be crucial. This raises the issue of close cooperation with the World Bank in the preparation of a medium-term framework. I wonder if the staff could share some thoughts on ways to improve such coordination. For example, is it possible to prepare a policy framework paper-like document for some countries?

A medium-term approach, along with enhanced cooperation with the World Bank, may be particularly useful in the countries in transition, given the complexity of the problems and the impact of the public enterprise sector on the macroeconomic variables. Such an approach, coupled with our increased experience in the type of issues that arise in the context of economies in transition, should improve the design of programs, facilitate the transformation process, and preserve resources by eliminating duplication, especially in the technical assistance area. This experience is also critical for ensuring the appropriate formulation of programs under the systemic transformation facility, which, unfortunately, is too recent a facility for us to have reviewed in this paper.

I agree with the staff assessment that our current monitoring procedures appear to be appropriate. However, I feel that care needs to be exercised to avoid any possible perception of automaticity in granting waivers.

Mr. Jones made the following statement:

There is now a broad consensus that economic reform is the way of the future, and that conditional lending from institutions such as the Fund serves a useful purpose to ensure steady progress along that path. This leaves us to focus on drawing lessons that will make the adjustment process more effective and more relevant. The staff has done a commendable job in putting in context the myriad experiences of the countries covered during the period under review.

That context is a world of the second-best, a world where political and administrative constraints necessitate trade-offs between various objectives. The policymakers must deal with a situation in which economic optimality conflicts more often than not with what is socially and politically feasible, at least in the short run.

The realistic assessment of the adjustment process is a major step in the direction of making an attempt to draw conclusions on country experiences based on situations as they are. This cannot but help the Fund as it continues to make a valuable contribution to the functioning of the global economy. An important lesson drawn from this experience, and indeed from all Fund-supported programs, is that adjustment is a continuous process of prudential economic management. The prospect of successful adjustment is enhanced by policies that reinforce one another. For example, sustainable fiscal consolidation requires growth and supporting policies in other areas; fighting inflation requires more than monetary corrections; and banking liberalization must be underpinned by appropriate supervision. Attempts to break down the adjustment process into the short and medium term can only be for analytical purposes, and to provide a focus for a manageable planning horizon.

Another general lesson is that the adjustment paradigm must be less pedagogic, with more room for the use of judgment. In practical terms, two points need to be emphasized. One is that even as we uphold unequivocally the principle of conditionality, the Fund should be more flexible in program design and implementation. The other point is that we should be prepared to accommodate more the views of governments in the design of programs and the sequencing of policy implementation.

This pragmatic approach extends to the establishment of performance criteria and the granting of waivers. The review suggests that more performance criteria are not necessarily better than less; that sophistication in the use of performance criteria is not necessarily better than simplicity. It is observed that there is no clear correlation between the method of monitoring fiscal performance and the achievement of fiscal targets. Also, there is no strong evidence to suggest that performance criteria contributed to speeding up the process of structural reform. It is, therefore, logical to conclude that such reforms are best monitored through reviews rather than explicit performance criteria. In general, it would seem appropriate to keep performance criteria simple, easy to monitor, and aimed at the major problem areas. This is particularly relevant for monitoring fiscal performance in countries in which the financial system is not very sophisticated.

There is no evidence that the relatively high frequency of waivers has weakened conditionality. The situation reflects the responsiveness of the Fund to the noticeably difficult environment since the 1980s in which countries have had to implement adjustment programs. In so doing, waivers have helped to sustain the adjustment process and contribute to the broad success of programs. This is the standard by which Fund-supported programs must be judged, taking into account all of the constraints facing the countries undergoing reform.

The broad success of the programs should not, however, mask the need to continue to explore avenues for improvement. It has been observed that the performance of the domestic sector in critical areas such as savings, investment, growth and diversification has not been very satisfactory. This raises two key questions: first, to what extent is the progress on the external front self-sustaining? and second, to what extent can future programs be expected to deal with the problem of slow growth and widespread poverty, which is now the scourge of a large number of member countries?

The present evidence seems to suggest that the relationship between policy instruments and objectives at the macroeconomic level, which defines the internal dynamics of the adjustment model, is not as predictable as is often assumed. Progress seems faster in the external sector, where some of the key variables by which progress is measured are not intrinsic to the assumed relationships between policies and goals. There is a need to explore ways of internalizing growth, employment, and poverty reduction in the adjustment model, by looking at ways of increasing productivity and the level of productive investment, which, in the staff's own words, was the most disappointing aspect of the programs. It would appear that these do not necessarily flow from just having a rational set of macroeconomic policies. The staff paper notes that private investment responds with a substantial lag to macroeconomic stabilization. The lag might be longer in developing economies, where public investment has been falling in successive short-run periods. Very tough demand management measures aimed at achieving rapid stabilization may also be a deterrent to investment. Issues such as these must be part of the future work of the staff as it goes to the heart of our endeavors to make the adjustment process more effective and relevant.

How to wage a successful fight against inflation is another matter that deserves further attention. It is apparent that there are limitations to the use of financial programming to control inflation. In fact, the staff paper notes that financial programs often failed to produce the desired results. The use of an exchange rate anchor, however, has proved to be helpful in reining in inflation, especially in high inflation countries. Without being unreasonably rigid, future programs could benefit from this experience, considering that large and frequent devaluations to achieve competitiveness have often been self-defeating. Perhaps competitiveness could best be enhanced by taking steps to improve productivity and keep wages in check. Of course, supporting fiscal and structural policies are necessary to take pressure off the exchange rate in order to have a credible anchor. As for targeting monetary aggregates in the absence of an exchange rate anchor, an option raised in the staff paper, it might suffice to note the difficulty in doing so, even in advanced economies.

The evidence on the relationship between interest rates and savings is not surprising. We have always cautioned that the link between the two was weak, especially in low-income countries, and that high interest rates could discourage productive investment. This situation indicates that while it is imperative that low-income countries make every effort to raise the level of domestic savings for investment, foreign assistance from the donor community and multilateral financial institutions would continue to be the main source of financing to support their reform effort. Increased investment should ultimately strengthen growth performance and raise the level of domestic savings, thereby reducing reliance on foreign resources.

Concerning fiscal adjustment, this review shows that fiscal consolidation is a crucial aspect of the adjustment process, and it is to be noted that many countries made significant progress during the period. I agree with the staff that it is difficult to tell how far these countries have moved toward sustainable fiscal positions. While this may be an avenue to explore in designing future programs, establishing the path of a sustainable fiscal position over the medium term might be time-consuming, both in terms of acquiring data and molding political consensus, and could well introduce unnecessary rigidities in programs, without much improvement in the final outcome.

Mr. Wei made the following statement:

Like other speakers, I commend the staff for the comprehensive and useful study of countries' experience with stand-by and extended arrangements. I welcome today's opportunity to review the experience from 1988-91. Many questions and issues that have emerged from this review still need to be addressed in the recently adopted programs. I would like to comment on a few selected issues raised in the staff paper.

The Fund's mandate stipulates that the nature of financial assistance is to correct short-term impediments which, however, result in many cases from medium- and long-term institutional and structural weaknesses. On the one hand, while Fund-supported programs that are basically demand-management oriented have been relatively successful in some countries in restoring macroeconomic stability and improving external viability, on the other hand, I share the impression that less focus has been placed on the measures to stimulate domestic saving and investment. It is these issues that we have to resolve by moderating or reorienting our policy design.

It is fundamental that the program should be designed to resume quickly and maintain financial equilibrium, with a view to creating a favorable environment conducive to implementing reform measures and sustaining growth momentum.

However, this does not mean that the Fund-supported program would disregard those more fundamental, long-term issues. Traditionally, the savings and investment objectives have not been given priority on the policy agenda. The successful experience reveals that only when macroeconomic financial stabilization is secured can sustained growth be obtained. A pragmatic reform and adjustment strategy, including the removal of the long- and medium-term bottlenecks and constraints, must be undertaken concomitantly. In this sense, I would agree that the longer-term investment and growth perspectives should be given increased weight in the program design. For those countries where there has been protracted use of Fund resources under extended arrangements, more attention should be given to addressing those longer-term problems in a consistent and durable manner as long as financial stabilization needs to be secured.

We note that the inflation performance was mixed. In all cases, the major cause of inflation was the persistent high fiscal deficit. Reducing inflation should always rely on restrained credit and fiscal policies, accompanied by a prudent and responsive exchange rate as a nominal anchor, rather than resorting to indexation. Meanwhile, we are aware of the dual function of exchange rate policy in abating inflationary pressures and safeguarding external competitiveness.

In assessing the roles of the exchange rate in the disinflation program, attention should be given to two particular issues: first, whether the central bank can maintain a positive real interest rate to curb inflation and encourage investment; and second, whether, for those countries confronting large capital inflows, corresponding domestic policies can be effectively introduced.

The latter question has been deliberated in detail in previous discussions. However, as many adjusting countries face this problem, I would encourage the staff to elaborate on this issue in the next program review.

With respect to the short-term trade-off between inflation and competitiveness, we share the staff's conclusion that anchoring inflation and maintaining or improving competitiveness cannot be achieved simultaneously in every program country. In this respect, it cannot be overemphasized that the authorities are encouraged to make every effort in persevering with the fiscal consolidation measures, so that the above objective can be better achieved.

We note with satisfaction that steady and broad structural reforms have been undertaken in almost all program countries, including far-reaching financial sector reforms. An underdeveloped financial market and lack of indirect monetary instruments are common phenomena in many developing countries. How to address this issue should be included and given more emphasis in the program design.

Furthermore, one has to recognize that financial liberalization has been restrained by excessive fiscal overruns and negative interest rates, which have curbed the effectiveness of monetary policy in reining in inflation. We share the view that further financial liberalization measures are needed. Nevertheless, the Fund should be cautious and avoid a harsh approach to financial liberalization, in particular, in the countries in which institutional capacity in program implementation is weak. In this connection, China, in pursuing its financial sector reforms, has benefited greatly from the Fund's technical assistance. It is crucial and very important that the Fund provide assistance in this area.

In almost all cases, the fiscal deficit was the main cause of imbalances, adding to inflationary pressure, complicating monetary policy, and hampering the role of the exchange rate as a nominal anchor. Top priority should be given to controlling the deficit. In our view, it would be preferable to monitor the overall criteria on the ratio of the deficit to GDP, in particular for reasons of simplicity and transparency in monitoring the overall fiscal performance. In any case, we would emphasize the importance and necessity of continuing to focus on fiscal performance under all the programs.

It is obvious that expediting structural reform greatly raises the chance of earlier success. One area which is crucial not only in facilitating the attainment of fiscal performance criteria, but also in strengthening growth potential--and which therefore needs particular mention--is public sector reform. In a number of programs, the excessive number of nonperforming loans in the public sector was one of the main reasons for the weaker fiscal position. I therefore generally agree with the staff that the authorities should be encouraged to take a more active medium-term perspective on structural reform, especially public sector reform. Monitoring should be in the form of periodic reviews, rather than quantitative performance criteria.

I am concerned about the frequency of missing specific performance criteria. Given the complexity of factors causing the missed criteria, I agree with the staff view that employing existing ways of dealing with the missed criteria, rather than canceling or reinitiating the program, would be more cost-effective and appropriate.

We note that several countries were willing to invite the Fund to continue monitoring their economic and policy development after completion of Fund-supported programs. This will enable countries to augment their hard-won performance and avoid repetition of previous failures. In this regard, we recommend that the staff develop in advance, in close consultation with the authorities, a possible follow-up monitoring framework in the program design process. This will certainly help to address the critical issue of whether programs have been designed with the medium-term goals in mind.

Experience with countries adopting stand-by and extended arrangements varies. It is very difficult to draw universal conclusions from the experience of the 36 countries using the Fund's two basic financial assistance vehicles. However, quite markedly, although programs have been tailored to countries' specific circumstances, some common program weaknesses need to be dealt with, especially taking into account the varying initial conditions when programs were introduced, as well as unexpected exogenous external developments.

Many of the issues raised in these papers need to be studied further and analyzed. We encourage the staff to continue to work on these issues. Like Mr. Kiekens, I hope the future review will include the arrangements under the newly established systemic transformation facility. I join Mr. Mirakhor and other Directors in supporting the early establishment of an evaluation unit. I can go along with the proposed decision.

Mrs. Hetrakul made the following statement:

The world's economic landscape has changed dramatically since the stand-by and extended arrangements were established more than forty years ago. These two facilities exemplify the monetary and temporary nature of the Fund's assistance. Although this overview focused primarily on country experience, a fundamental question remains how the modalities can be enhanced in the light of the drastic changes that have occurred.

I would like to comment on the discussion topics suggested by the staff in the context of several very interesting trade-offs inherent in this overview. The first is between short- and long-term objectives. In general, a program addresses short-term balance of payments problems, but aspires to solve long-term positions on which leverage is normally insufficient. This is manifested in the wide success of the programs in restoring external balance, but their falling well short of the achievement of medium- to long-term targets, such as employment, investment, savings, and fiscal deficits. Should programs continue to aim at these medium-term goals? It is very important that they do. But care should be taken in using such yardsticks to judge the effectiveness of the Fund's assistance under such short-term facilities.

Another conflict is between economic and noneconomic factors, and this is classically illustrated in the wages issue. In the discussion on off-track programs, high wage increases were cited in many instances as the major reason why the programs went off track. On the one hand, there is a strong economic rationale for the removal of subsidies, reduction in price controls, and alignment of utility prices with marginal costs. On the other hand, wages are a sensitive social issue, and the price burden of these policies on wage earners can be enormous. This translates into weak public and political support for wage moderation and the removal of indexation. Can the staff elaborate on how this wage pressure can be handled without reverting to controls? Can sequencing help? One way is for the program to pay equal attention to less sensitive measures aimed at easing structural supply restrictions which can offset, to some extent, the impact of any wage increase on inflation and competitiveness.

This brings me to the interesting trade-off between inflation and competitiveness, which tends to limit the effectiveness of an exchange rate anchor when inflation is very high. The anchor appears to be useful in protecting disinflationary gains and improving credibility. This implies that the onus of disinflation must be on tight financial policies, with some flexibility in the use of the nominal anchor to correct adverse movements in competitiveness. This flexibility can be progressively restricted as inflation falls. In any disinflation program, the most effective weapon is a package that includes, in addition to tight financial policies and a nominal anchor, structural measures to help ameliorate any decline in competitiveness.

We all know that political considerations play a critical role in the success of program implementation. While I fully agree with the staff that fiscal issues should be more closely integrated into programs, this is an area in which a very pragmatic approach is required, as policy choices have to constantly circumvent political pressures. A medium-term fiscal plan will provide an extremely useful policy guide. It will also help if the country's sense of program ownership is actively cultivated during the preparatory phase.

With regard to the ongoing conflict between theory and empirical studies, which concludes that saving is not responsive to interest rates, without any improvement in data, there will be diminishing returns from further studies on this relationship. What does this imply for program design and for the Fund's advice in general? Should programs reorient the focus of interest rate policy to investment from savings? One should keep in mind that the promotion of real interest rates under the savings rationale is not without cost in terms of higher debt servicing, lower investment, and, perhaps, less employment and growth. At the same time, with the integration of financial markets, the binding constraint on investment is not domestic savings, but the country's ability to access foreign savings on reasonable terms. In addition, with the reduction in public investment likely in many programs, higher interest rates can prevent the private sector from taking up the slack. Perhaps the best advice is to integrate the proper sequencing of interest rate reforms into the reforms of the entire financial system and, once appropriate conditions are met, leave the market to find its own interest rate level.

Mr. Evans stated that the staff had prepared a good and thoughtful set of papers. At the same time, the discussion in the papers revealed that the

Fund was not very clear as to the objectives of stand-by arrangements, notwithstanding the guidance given by the Articles of Agreement on that score. Most of the objectives were on the external side--improving the external position and raising output in a sustainable way. Ms. Lissakers had referred to the ultimate objective as an increase in output. In evaluating programs, it was important to establish clearly what the programs were intended to achieve. He would be interested in staff comments on that.

Experience during the period under review revealed that some nominal anchors had been successful, some had been unsuccessful, that some countries managed successfully without them, and that some countries managed unsuccessfully without them, Mr. Evans observed. As Mr. Smee had mentioned, there were a great variety of nominal anchors: fixed exchange rates, crawling pegs, nominal income targets, inflation targets, and the money supply, for example. Credibility and commitment on macroeconomic policy was probably more important than the form of the nominal anchor.

Fiscal policy under the programs had turned out close to the targets, Mr. Evans recalled. That was impressive, and perhaps surprising. He strongly supported using comprehensive measures of fiscal policy, as argued by the Director of the Fiscal Affairs Department, rather than narrow ones. It would be better to be approximately right than precisely wrong.

Sustainability was certainly the heart of fiscal policy, Mr. Evans continued. That concept included, inter alia, the content of fiscal deficits, the balance between expenditure and revenue, and the type--as well as the level--of expenditures. It was surprising and perhaps disappointing that it had not been possible to judge how far programs had moved countries toward sustainable fiscal positions. He would like to see more work in that area, especially in a medium-term context. At the same time, he would caution against putting a great deal of Fund resources or country resources into developing large-scale comprehensive models for that purpose. Such models ran into sharply diminishing returns, especially in the context of the medium term, for which most of them were not designed.

Structural policies were ultimately more important for sustainable growth even than macroeconomic policies, Mr. Evans averred. There was an inherent tension between the time scale of the implementation of structural measures and short-term programs. In that connection, he wondered whether there should be more structural performance criteria or benchmarks in programs. He would not be averse to that were such criteria to originate with the authorities of the countries concerned, as part of greater ownership of the program by the authorities. However, he wondered whether structural criteria were within the purview of the Bank rather than the Fund; at the same time, it was hard to see a clear line of demarcation between the two institutions in that sphere. It was certainly clear, however, that they needed to collaborate closely--probably more closely than in the past. When in doubt, the responsibility should probably be left to the World Bank. He supported Mr. Autheman's proposal for more explicit cooperation with the World Bank so that clear messages were given to the country concerned about which institution was in the lead.

The performance and flexibility of labor markets were absolutely crucial to adjustment and to longer-term sustainable growth, Mr. Evans continued. On a recent visit to West Africa, he had been struck to see the widespread extent of labor market rigidities and distortions, many of which emanated from the public sector, which was in many countries the single biggest employer. That was an area that could not be neglected by the Fund.

With regard to incomes policies, any organization--whether the central government, local government, public enterprise, or private companies--had to have control over its own wage bill, Mr. Evans pointed out. Wages policy, however, often in the form of government controls over the private sector, seemed to create rigidities and distortions in many countries, and it seemed to have been part of the problem rather than part of the solution.

The main qualification for success, as shown by the four countries that had graduated from use of Fund resources, was a decisive commitment to tight financial policies, and to maintaining stabilization and structural reform efforts even in the face of sizable adverse shocks, Mr. Evans commented. The concept of graduation from medium-term Fund involvement was on the whole helpful, but the Fund had not yet gone far enough toward encouraging the extent of borrower ownership of programs necessary for the sort of commitment that would ensure a follow-through. In practice, there was a wide spectrum of borrower involvement in program design and ownership, ranging between the programs designed by the country concerned and subsequently endorsed by the Fund, and the opposite--in which programs were designed by the Fund and sold to one or two key people in the country. It was particularly difficult for the Board to judge the gestation of programs and efforts toward consensus building among various constituencies, but it would have been helpful if there could have been a more explicit discussion of those topics in the current review. While the Board often looked at them implicitly or obliquely, through the prism of the track record, prior actions, social safety net measures set in place, and--occasionally--administrative capacity, a more direct approach would be advisable. The World Bank might have some useful lessons on possible indicators of ownership in that regard.

It was his understanding that the Board had approved in principle the idea of establishing an independent evaluation unit in the Fund, Mr. Evans remarked. Since then, as Mr. Marino, Mr. Mirakhor, Mr. Smee, and others had noted, no progress at all seemed to have been made in translating that principle into action. He attached a high priority to doing so. He had no doubt that the staff would be able to find a way to accommodate the unit adequately within the budget constraints faced by the Fund. Such a unit would be of great value to the Fund in providing systematic and independent assessments of its programs. He would like an explanation of the delay, and a progress report on what was being done.

The staff papers for the review should be published if good summaries of them could be added and if they could be shortened, Mr. Evans concluded. He supported the proposed decision.

Mr. Sirat said that his chair was against the creation of an evaluation unit, at least until the real need for that unit was studied in more detail. An independent assessment of programs should be made by the Board, and not by an outside unit. The paper before the Board at the current juncture showed well that the assessment of Fund-supported programs could be handled effectively by the staff.

He was not certain that incomes policy basically boiled down to government control of the private sector, or that it was merely control of wages, Mr. Sirat observed. Rather, it could be the negotiations and bargaining between unions and the private sector. It could be done at a regional level, or centrally. Incomes policies had worked well in many countries, including in Western Europe. Further study of incomes policy was needed in order to avoid oversimplification.

Mr. Evans added that not only had the Board agreed 17 months before to establish an evaluation unit, but all Directors, including those who were opposed to the decision, said that they would be prepared to go along with it when the decision was taken. Directors should bear that in mind.

Perhaps he had oversimplified the question of incomes policy, Mr. Evans acknowledged. Where incomes policy was a matter of negotiations between employers and trade unions, then putting the responsibility for the outcome onto both sides--as opposed to putting it solely on the government--had been an important element in the United Kingdom in recent years, in comparison with the experience of the 1970s. That was true of many other countries as well.

Mr. Mirakhor said that he agreed with Mr. Evans's comments about an evaluation unit. With regard to the relationship between external and domestic performance, he recalled that in the review of programs supported by the structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF), there was a positive correlation between domestic and external performance. The present study suggested that there was either no correlation or, at least, a negative one. Therefore, apparently the time element to which Mr. Evans had referred played an important role in the programs.

Four Directors had recommended that the staff papers be published, but Mr. Waterman had suggested that the paper be shortened, and both Mr. Evans and Mr. Fukuyama had said that there should be some streamlining, and perhaps the addition of a summary, Mr. Mirakhor recalled. At the same time, attention needed to be paid to the language, content, and presentation of the papers. He had received a discouraging picture of Fund-supported programs from the papers. For example, upon his return from the Islamic Republic of Iran upon the conclusion of the Article IV consultation discussions, one of his colleagues had asked him how the situation was there. He had responded that it was very depressing, because there were so many economic problems, which he had then outlined. His colleague had commented that it seemed that all the country needed was a Fund-supported program. He was glad that the current staff paper had not yet been prepared at the time of the Board discussion of the Article IV consultation with the Islamic Republic of Iran, because if it had been, a few Directors would probably have had to argue in favor of a Fund-supported program for the country, rather than against it. The tone of the staff papers should be examined carefully, in his view.

Mr. Geethakrishnan said that the question of an evaluation unit did not arise from the staff paper. Normally, an evaluation was thought of by an outside agency, or within the Fund, but external to the particular group of staff members who had been involved in the initial program design. The only reason to follow that route would be in the event the Board believed that the staff could not do an objective analysis, as it was engrossed in its day-to-day work above which it would be unable to rise. In contrast, the paper showed clearly that the staff had been both comprehensive and extremely objective. As a model of the kind of evaluation the staff could perform, the current paper put paid to the notion that an independent evaluation unit either inside or outside the Fund was needed.

The staff paper was depressing because the situation was depressing, Mr. Geethakrishnan added. The staff should be commended for not trying to paper over that fact.

Mr. Mirakhor stated that the Board had already taken the decision to establish an evaluation unit. Whether or not that decision should be reviewed in the light of the cost implications of such a unit was another matter. It was too late, and not useful, to reassess whether or not the initial decision was correct. With regard to Mr. Geethakrishnan's observation about the tone of the staff paper, the facts of the paper were less depressing than the language of the paper, in his view. Fund-supported programs were intended to achieve external balance in the first instance, and they had done a good job in that direction. The problem was that expectations had been raised that the programs were supposed to do more than that--to address growth, investment, and savings, for example. The staff had been candid, had raised the right questions and had found the right answers, but the language of the paper did not reflect that.

Ms. Lissakers commented that while the Fund had been created to deal primarily with short-term external imbalances, the series of programs that countries undertook with the Fund suggested that the Fund's involvement was, in practice, over the medium term. That was how the institution, and the relationship between the institution and its member countries, had evolved. The scope of programs was clearly much greater than dealing only with external imbalances. That was most obvious when the countries in transition were considered. Even if a narrow definition of the Fund's mission were accepted, the lack of success of Fund-supported programs in stimulating growth and savings, in particular, was troubling. While improving the external balance would be an important factor in improving, eventually, the internal situation, a clear progression was not seen in many programs, even where the Fund had been involved over an extended period.

Her chair had supported the creation of an evaluation unit in the past, Ms. Lissakers continued. She had some sympathy for Mr. Sirat's view that the Board should act, in some sense, as an evaluation unit. There was also a trade-off between an internal evaluation unit and an independent evaluation unit, on the one hand, and greater disclosure of program information and more extensive publication of internal Fund documents, on the other hand. To the extent that the Fund made public more of its operations, then the outside world could act effectively as an independent check on the organization, also strengthening the ability of the Board to do its job. The two questions of disclosure and an evaluation unit needed to be considered together. She would favor publication of the interesting and valuable staff papers in an expurgated form.

She would not support the proposed decision if paragraphs 2 and 3 meant that the Board was going to drop the interesting questions that had been raised in the staff paper about, for example, the utility of nominal anchors, or the impact of large public savings on private savings, Ms. Lissakers concluded. She had noted that one of the paragraphs stated: "The Fund decides to postpone until an appropriate time the review of the provisions of the extended Fund facility." She would like to know what was the appropriate time. Paragraph 3 stated: "The Fund will again review the experience with programs supported by stand-by and extended arrangements at an appropriate time pursuant to paragraph 12 of the guidelines on conditionality." She wondered whether that implied that the Board would have to wait until the next review of conditionality before answers to the intriguing questions that had been raised would be provided. Rather, she would like to see a speedy follow-up study focusing on two or three of the issues that Executive Directors had focused on as being of particular interest and importance to the design of Fund-supported programs, and for improving the design of Fund-supported programs.

Mr. Marino commented that he was satisfied with the staff analysis, which was objective, clear, and contained elements of valuable self-criticism. Unfortunately, at times, that was not sufficient. An independent analysis was needed to have a detached view, and to convey the impression that the evaluation was indeed objective to the outside world; neither the Board nor the staff could do that adequately. An independent evaluation unit would strengthen the lessons and policy recommendations of the institution. The current budgetary stringency was an obstacle to the creation of the unit, but he would support a redeployment of resources, if needed, to ensure that it was set up.

Mr. Evans observed that he was not persuaded that the issues of disclosure and an independent evaluation unit were inextricably linked. He was not convinced that the Board was capable of acting as its own evaluation unit. Indeed, he would not feel capable, without a great deal of support of the type that had been provided in the staff papers, of making the necessary judgments and assessments. There was not necessarily a dichotomy between good staff papers and the need for an independent evaluation unit. The independent evaluation unit would ensure that evaluations would be conducted on an ongoing and long-term basis, and independent of, and not subject to, Fund staff pressures of any kind.

Mr. Mirakhor said that he shared Mr. Evans's views on disclosure and an evaluation unit. For the public to judge whether or not performance had been as promised, a transparent set of objectives needed to be shown. He was not certain that was the case at present. An evaluation unit could promote that. While it was unlikely that an evaluation unit would draw very different conclusions from those in the staff papers, it would confirm to the outside world that the programs were doing the best job possible, and strengthen the position of the staff and of the Fund.

Mr. Sirat stated that he agreed with Ms. Lissakers about the proposed decision. The questions that she had mentioned were major factors in the Fund-supported programs that needed to be answered relatively quickly.

He wondered who would do the independent evaluation were an evaluation unit to be set up, Mr. Sirat noted. Also, he wondered about the notion of independent evaluation in the field of economics, and about the basis of such an evaluation. If the evaluation unit were expected to do what the staff had just done, he would be extremely unwilling to go along with it, especially as almost all speakers had commended the staff for its work.

The Acting Chairman said that the Board had reached an agreement in principle on an evaluation unit, but the details of its establishment were complex and bedeviling. For example, a decision needed to be made about who the unit would be responsible to, who would appoint its members, and what the relationship would be between the evaluation unit and ongoing work of the staff. Also, whether or not the evaluation unit would replace the kind of review papers that had been traditionally produced needed to be agreed. As the Managing Director had said in the context of the work program, given the Board's expectations about what the unit would accomplish, he was not certain whether an evaluation unit of 11 staff would be adequate, and even a unit of that size would have significant costs. The question of an evaluation unit might be pursued in more depth once the Managing Director returned.

After adjourning at 1:00 p.m., the meeting reconvened at 2:30 p.m.

Mr. Havrylyshyn made the following statement:

> I welcome this review, and its focus on the effects of policy choices in Fund-supported programs and on the question whether sustained progress in improving macroeconomic performance has been made under these programs. This is a more useful approach than reviewing the record of meeting--or not--year-by-year program targets, as it can contribute to our understanding of how programs influence the longer-term economic developments in the countries involved, and will help to use Fund resources more efficiently. A consequence of the chosen focus of this review is--as the staff put it--that the presentation of the experiences reviewed is

comprehensive. I think that this is unavoidable, and I do not regret it, for I expect that the results of this review will help focus on more specific issues, both in future reviews and in the implementation of policy design in the Fund.

A good starting point for a review of Fund-supported programs is to remind oneself of the purpose of such programs according to the Fund's Articles of Agreement. Two key concepts are highlighted: balance of payments support should be temporary and should be used to correct maladjustments. Proposed decisions and the Guidelines on Conditionality suggest that "temporary" is about one year for stand-by arrangements. From these statutory statements, one infers an early "model" of Fund support, wherein a quick injection of balance of payments support provides the time to make corrections of the financial imbalances that caused a balance of payments crisis. Chart 1 in the main staff paper gives an overview of arrangements approved during the period mid-1988 to mid-1991 and subsequent and contemporaneous arrangements, and shows that there were only a few countries that had only one short program in the period specified--and most of them because political difficulties led to failure of the program. The bulk of cases were extensive in time and repeated programs. This simple look at the facts suggests a simple question. If Fund support has been repetitive and long-term, what is the reason? Why does it not fit the simple model of the Articles? I need only refer to Ms. Lissakers's statement and concur with the three answers given: the time frame may be too short, not all policies were implemented in some cases, or external shocks derailed the program.

Whatever the reason or combination of reasons, the implication of the empirical evidence is clear: the simple quick financial fix model is not in practice very relevant to Fund-supported programs in the recent past. Instead, we see a reality of more complex situations requiring both financial stabilization and a correction of structural distortions. As deep-seated structural distortions are part of the problem in most cases, the achievement of sustainable stabilization requires sustainable adjustment--inevitably a medium-term process. It would help if the staff were more explicit that the model implicit in the original Articles is not what it seemed to have in mind in this review, but rather, the model implicit in Decision No. 4377-(74/114) of September 13, 1974, and I cite Article I, 2(a): "(ii) The Executive Directors have noted the studies prepared by the staff, including SM/74/58 ("Extended Fund Facility," March 8, 1974), and especially paragraphs 12 to 16 of that memorandum, in which certain situations to which an extended facility could apply, are described as follows: (a) an economy suffering serious payments imbalance relating to structural maladjustments in production and trade and where prices and cost distortions have been widespread."

The inadequacy of structural adjustment implementation may be the main reason for the observed slow progress made on the domestic side of the program.

The staff paper highlights the major indicator of lagged adjustment, that savings and investment performances under Fund-supported programs during the period under review are, at the least, disappointing. This leads us to a few observations. The first is that we have to take this evidence into account when designing future Fund-supported programs. As an example, how can we reconcile the findings of this review on savings and investment with the fact that so many recent programs assumed a considerable increase in domestic savings within a very short time period? The second observation is that the review now being undertaken covers too short a period to show possible improvements in savings and investment. One has the impression that the staff chose the time period 1988-91, then regretted it, inasmuch as all the conclusions seem to point to the importance of a longer time period needed for observing an adjustment process. Third, the review does show that despite low savings and declining investment ratios, growth has picked up, even if only marginally, implying an understated conclusion in the paper--a more efficient use of resources, or more formally, an increase of the incremental capital to output ratio.

If we change our perception of the implicit economic model behind Fund-supported programs from the short-term financial imbalance model of the Articles to the medium-term model of stabilization-cum-adjustment that the staff and most speakers implicitly seem to have in mind, this pattern might in fact be sensible and might be expected in the first stage of the adjustment process, when financial stabilization is under way and dominant. A decline in investment and savings occurs, but also some improvement in efficiency, which gives some stabilization and pickup in growth. Only in the second stage, the time lag of which may not be clear as yet, when structural adjustment is achieved, should the incremental capital to output ratio stabilize, whereas investment and savings should pick up, implying a stronger growth of the economy. Does this pickup of savings and investment and, consequently, of growth, really happen, as many of us around the table have wondered today, and is it going to happen in many of these programs? The staff says tantalizingly on page 22 of the background paper of staff studies--Vol. II-- that "a body of evidence on longer-term experiences points to the likelihood of sustained growth and rising private saving over the medium term." Most of what I read in the staff paper seemed to be a body of evidence showing it is not happening in the medium term. Could we hear more about this evidence?

The most important implication of this review's findings is, as several speakers had noted, that sustained stabilization is necessarily a medium-term process, requiring correction of structural distortions, and not just of financial imbalances. Had the staff been more transparent about the implicit medium-term model that it has in mind, this implication could have been more clearly drawn, and the distinction vis-à-vis the "simple financial imbalances" model of the Articles would be clear. The most important question this raises is the one already debated by Mr. Geethakrishnan, Mr. Sirat, and Mr. Smee, among others--that is, how far should the Fund go in its involvement with correction of structural distortions? I might note that the Fund has recognized the need to be involved in medium-term adjustment in several new instruments, such as the extended Fund facility, the enhanced structural adjustment facility, and the systemic transformation facility. I have already cited the reference from the 1974 decision on the kind of thinking that underlies the kind of economic rationale that underlies the extended facility in which one speaks explicitly of structural maladjustments of prices and cost distortions. Therefore, given this recognition, both de facto and de jure, as in the decision, to stick to the narrow version of the Fund's role in financial stabilization only, is too late--a point Mr. Geethakrishnan made earlier.

I do not know what the best solution is for the future, but before we go to the other extreme--not mentioned here, but by some outside observers such as Peter Kenen of Princeton--that the Fund and Bank merge because they are both concerned with medium-term structural adjustment--we need to think much more about intermediate solutions. These recognize that even without going to complete specialization of effort between the Fund and the Bank, the comparative advantage of the Fund remains financial stabilization, and that of the Bank, structural corrections. For the present time, I agree most closely with the view of Mr. Geethakrishnan: there is no question that corrections of structural distortions must be made--we must determine who should best do it--the country, the Fund, the Bank, or, perhaps all three in collaboration. Besides, if the merger were to succeed in its objective of correcting structural distortions in all countries, then where would we be? We would be back to the simple model of the Articles of the 1940s and 1950s--that is, with the possibility that financial shocks and unexpected events would cause financial imbalances that had nothing to do with underlying structural distortions, and we would need to reinvent the Fund. We could then call it either "The Fund II, or The Fund: The Movie."

Mr. Lvin made the following statement:

I appreciate this opportunity to discuss the Fund's extensive experience in assisting its members to restore imbalances, improve fiscal performance, and accomplish structural reforms. I would like to praise the staff for preparing quite comprehensive studies on this issue. These studies not only provide us with well-grounded evidence of the general rightness of the Fund's policy and practices, but they have also their own research value, and add to our understanding of transformation and adjustment.

The staff expresses its conclusions in the papers in exceptionally cautious language. This is understandable, given the very sensitive issue of dealing with a wide range of very different programs in one paper. However, most of these conclusions are quite transparent, and I can agree with them, as well as with the proposed decision.

If we agree that programs "significantly contributed to the ultimate goals of ensuring strong and sustainable growth," it is necessary to examine some of the particular issues so thoroughly presented by the staff. While considering questions that the staff proposed for discussion one can, perhaps, see them as different aspects of one more general question, namely, how rather short-term programs may contribute to long-term adjustment.

That question is, or rather should be, a central issue in the Fund's discussions with the authorities. For example, it is obvious today that the spectacular termination of inflation is by all means feasible. Moreover, success on this front, related often to bringing a country's interest rates to prevailing world levels, may give rise to significant short-term capital inflows. However, it is the long-term level of domestic saving that matters in the pursuit of long-term growth. The staff admits that it is difficult to establish a direct link between domestic savings behavior and numerical outcomes of the programs. Moreover, these links seem to be weaker with respect to private savings, which are more likely to be translated into efficient and growth-oriented investment. However, one can assume that these savings tend to reflect deeper systemic solutions, aimed at creating long-term policy credibility and predictability among agents. These solutions can be found in dealing with just about every aspect of programs' fiscal adjustment.

Here we come to an important point of discussions about disinflation efforts--the nominal anchor policy. The nominal anchor is often suggested as a reliable way to alter public expectations. I can agree with the cautious, but rather positive, staff assessment of this instrument. The main problem with any preannounced exchange rate--be it pegging, crawling, or any mix of two--is the very limited credibility of the authorities' commitment to maintain it. A lack of credibility is quite understandable given the lack of a reliable track record. Such a discretional exchange rate policy is inevitably subject to various political pressures. In this regard, a surge in public interest toward exchange arrangements with 100 percent foreign exchange backing of high-powered money appears quite justified.

Therefore, institutionalized rules of money creation may prove even more important in curbing fiscal pressure than the formal independence of the central bank. When the monetary authorities effectively cease to be a ready-to-help lender, domestic banks are induced to improve their soundness sharply. One cannot overestimate the importance of such prudent behavior, as the underdevelopment of financial intermediation has proved to be a critical bottleneck in establishing market relationships among enterprises. I take note of the helpful observation in the staff paper about the negative effects of credit auctions held by central banks. This mechanism, so frequently included in programs, tends to entail adverse selection among participating banks, and, therefore, raises interest rates to inappropriate levels and leaves the central bank exposed to future losses.

Lithuania's recent switch to a full-fledged currency board, along with the excellent performance of Estonia under a similar arrangement, Hong Kong's experience under a more traditional currency board regime, and Argentina's under the quasi-currency board arrangement, all provide us with ample proof of the currency board's effectiveness. Dealing with this issue should not be limited to some working papers; a special Executive Board seminar may prove to be justified.

The most serious case against a fixed exchange rate is concern about competitiveness. The labor market rigidities and wage inelasticity have been, along with fiscal imbalances, the main reasons to abandon a commitment to pegging. The staff analysis of the economic complications of wage controls is quite comprehensive. I concur with the staff's view that "in general, the record thus far does not provide strong evidence that wage controls made a significant contribution to either improving corporate governance or encouraging labor shedding in the state sector." It is certainly the choice of the authorities whether or not to embark on centralized wage setting. Nevertheless, the Fund should send a clear message with respect to wage elasticity, which is so needed. Because traditions of centralized wage bargaining are still not deeply rooted in transition economies, this may appear as a permanent advantage over major developed economies with their built-in rigidity. In this respect, one could point to recent developments in Poland. It is remarkable that, in some ways, the incidental termination of wage controls in Poland did not have any significant implications in terms of inflation or loss of competitiveness.

Ensuring long-term budget viability is the most important one issue in the fiscal area. Too often, short-term fiscal adjustment, bringing about a termination of unchecked inflation, causes some future imbalances, such as rising interest outlays of the state budget, soaring social expenditures--particularly pensions--and quasi-fiscal expenditures of the central bank. Only systemic reforms can help countries to avoid future trouble. These reforms are: changes in pension schemes aimed at the creation of a clearer link between contributions and benefits, and sometimes, at a complete divestiture of this domain; improved bank regulations, aimed at giving holders of commercial bank equity the sole responsibility for these banks' financial outcomes; and privatization, aimed at relieving the state from incurring the losses of the public sector. I agree that it may not be appropriate to build in these measures as performance criteria directly; however, this point of view should be presented every time the staff discusses program design with the authorities.

Issues of a nominal anchor, wage controls, the behavior of private savings, fiscal and monetary policies, and the modalities of Fund arrangements with countries in transition, are of particular importance for transition economies and should be examined thoroughly. The staff paper addresses the issue of fiscal performance criteria, and I can agree that the existing menu of these is rather well designed to furnish adequate monitoring in different circumstances. However, what monetary indicators should be targeted and chosen as benchmarks and performance criteria is currently left to the staff's discretion. This issue seems to be quite important given the still-wide scope of quasi-fiscal operations performed by central banks in these countries. For example, this chair has raised at some Board discussions--for example, that on Moldova--the question of the appropriateness of net domestic assets of the banking system, instead of base money or net domestic assets of the monetary authorities, as a major targeted indicator. Indeed, when unanticipated--albeit perhaps relatively small--capital inflows have occurred in some transition economies, inflationary surges in base money were not matched by expectable behavior of the net domestic assets subject to Fund monitoring. I may recall in that regard the case of the Russian Federation just a year ago, as well as that of Latvia and Moldova. Perhaps the staff might elaborate on this and related issues highlighted by Mr. Mirakhor, as the last discussion of performance criteria took place in 1986--well before assistance to transition economies had gained its present place in the Fund's agenda.

I would like to underscore the appropriateness of using some boxes in the main text to emphasize some aspects of the conduct of Fund-supported programs. Box 2 (pages 25-27 of the main paper) seems to be particularly well written. It presents the structural reform in the Central European transition economies in a very concise and transparent manner. However, this transparency leads me to express some regret that the experience of some countries of the former Soviet Union is not covered in this review. Certainly, they were not able to command Fund support for their transition efforts until 1992 and, thus, happened to be beyond the scope of the review, but it seems unnatural to limit the overall, unified, process of transformation of former centrally planned economies, which posed such a critical challenge to the Fund's knowledge and experience, only in order to comply with a formal time period for the review. It is my hope that we will return to this issue some time, perhaps in several months, and that the staff will give us comprehensive and updated information on developments in the transition economies. I hope also that this information will be based on the experience of a broader group of countries, and not just on those with a lengthy track record of cooperation with the Fund. What is particularly needed is strong emphasis on looking forward, on something less obvious and less predictable. Therefore, I am looking forward to obtaining new, valuable staff research, in order to organize new Board discussions, and to deepen our understanding of the dramatic shifts that are taking place in transition economies.

Mr. Shaalan made the following statement:

I welcome today's discussion of developments in countries with stand-by and extended arrangements. In particular, I wish to commend the staff for its most extensive documentation provided in the three papers before us. I may come to the defense of the staff on the matter of the length of the papers; it needs to be borne in mind that the Board is in part responsible for the length of such papers, as it asks for the inclusion of more aspects for analysis. The staff's exposition on the use of nominal exchange rate anchors--the anchor most commonly used--is premised on the proposition that sustainable growth over the medium term can best be promoted in an environment of low inflation. This is a proposition that is documented in the literature. The success in reducing inflation is noteworthy in many of the nominal anchor countries that have pursued strong adjustment programs. The gains on the inflation front in many cases came at a significant cost to export and economic growth. What we need to know more about on the exchange rate issue, however, is how and when a country pursuing a nominal anchor policy is to change its exchange system to effect a depreciation in order to resume export growth. It should be realized that the weak growth performance could have resulted from the tight fiscal and monetary policy, and not necessarily from the exchange rate. Among the pertinent questions that need to be addressed would be whether or not the country in question has the institutional infrastructure to manage a new exchange system, or whether the system should remain unchanged, merely establishing a new peg at a more depreciated level, as in the case of the CFA franc countries recently.

The issue of how a sudden change in the exchange system of a country that has liberalized its exchange and monetary policies would affect capital movements--the magnitude of which could be so large as to jeopardize the whole financial system, and reverse the financial stability gained over the previous period--needs more attention. This risk could be serious, to the extent that the capital inflows into that country may still be in the form of sizable liquid financial assets, rather than real assets. I would appreciate the staff's views on that.

Too mechanical a link is assumed between the deterioration in external performance and what is perceived to be the real appreciation of the exchange rate. This link is not altogether supported in several of the Fund's program countries. The paper on this subject rightly notes that there are other factors affecting export performance besides the exchange rate, but only an obvious one was mentioned in the paper--namely, the collapse of trade relationships between the Central European countries. I would appreciate it if the staff could elaborate on other factors besides the exchange rate that can have an impact on export performance. In this connection, the recent discussion on the exchange rate and economic fundamentals clearly points to the serious deficiencies in the calculations of real effective rates. I believe that a margin of error of 30 percent was mentioned in that paper. In view of these considerations, it would appear that the staff needs to exercise a degree of caution in its policy advice.

Regarding the reasons programs went off track, lack of success in programs is almost invariably attributed to exogenous factors, presumably not foreseen when the program was formulated, or to shortfalls in implementation. Undoubtedly these are important factors, but it is too presumptuous of the Fund to assume that these are the sole reason. Could it be that the program design was inappropriate in terms of policies and their sequencing; or that the program was overambitious to the extent of making it politically unacceptable; or that the assessment of a country's ability to implement the proposed measures was mistaken?

The research carried out in the Fund has increasingly become more relevant to the work of the Fund in recent years. This has been a most welcome development. I find rather disturbing the fact that insufficient attention has been given to this valuable research, where relevant, in the Fund's program design and policy advice. I do not intend to be critical of the staff, but rather I wish to point out that the staff is overworked, and in many instances, it does not have the time to accord these studies the importance they deserve. In a way, we are running down our human capital stock. This is an area we need to address.

Social safety nets are an integral part of any adjustment program. This means that they should be adequately provided for under Fund-supported programs. Financing for social safety nets could provide a justification for excluding nonrecurrent revenue items, such as privatization proceeds, from the fiscal targets. On a related point, nonrecurrent revenues should be regarded as an alternative to a front-loading of fiscal adjustment in situations in which the need for stabilization is urgent, but the scope for front-loading is limited by weak growth conditions.

Like Ms. Lissakers and Mr. Mirakhor, I would urge the staff to present us with an analysis of nonprogram countries that have successfully pursued sound adjustment policies.

I would like to associate myself with Directors who have emphasized the need to establish an evaluation unit.

Mr. Link made the following statement:

The staff prepared a very interesting review of the Fund's stand-by and extended arrangements during the period 1988-91. This review was needed, and it is welcomed, as it assesses the successes and failures of the Fund's policy recommendations. This chair, like many others, reiterates the suggestion of establishing an evaluation unit.

Countries turning to the Fund generally had unusual external financing difficulties. The priority was therefore put on improvement of the external balances and the rebuilding of foreign exchange reserves. In this respect, experience tends to show that Fund-supported programs have been successful. Mixed results were achieved in reaching domestic goals. The weak response of private investment to macroeconomic stabilization polices was particularly disappointing, but, as the study points out, savings and investment require time to react. Thus, this response is not unusual considering that most of these economies lacked--and still lack--well-functioning financial markets, and that privatization took place in only a few countries. Building the credibility and stability--both essential ingredients to spur investment--takes time, and it requires an appropriate financial environment. It brings me to the importance of structural reforms in the adjustment process. I fully agree with Ms. Lissakers that we need to consider how structural measures can be incorporated more effectively into Fund-supported programs.

Generally, I share the view expressed in the conclusions of the staff study that nominal exchange rate anchors--essentially an exchange rate peg--should be used prudently. In fact, success in reducing inflation depends much more on the strength of financial adjustment and wage restraint than on the adoption of such anchors.

The choice of an exchange rate policy depends critically on the country's initial position, on the political willingness to fight inflation, and on the strength of the macroeconomic adjustment policies. Fiscal and wage policies have to be compatible with the disinflation program. The staff paper shows that when wage indexation and fiscal imbalances are not strongly addressed, the lack of policy credibility renders a nominal anchor unstable, leads to a depletion of the central bank's international reserves, and to unsustainable, high interest rates. In addition, the use of the exchange rate as a nominal anchor comes at a real cost, namely, a temporary loss of external competitiveness, especially when inflation is high. This can translate into lower output growth in the short run. As the staff mentions, to restore external competitiveness, an exchange rate anchor should eventually give way to more flexibility once credibility has been established and inflation expectations have been broken--for example, as in the case of Mexico. A degree of flexibility is also necessary to offset the destabilizing effects of an excessive balance of payment movement. The CFA franc zone, where all countries recently had to devalue their currencies to increase competitiveness and reduce distortionary affects, is a clear example of how an overly fixed exchange rate can cause more harm than good to an economy. Exchange rate adjustment should, however, not replace strong, sustainable domestic policies, but rather should complement them.

Unsustainable fiscal imbalances have been the central problem in most adjusting countries. The staff acknowledges the difficulty of assessing the progress made under the programs toward achieving long-term fiscal sustainability. I therefore agree with the recommendation of Mr. Kiekens and some other Directors to include in the section on fiscal adjustment a more detailed analysis of the factors affecting fiscal outcomes.

Little sustainability analysis has been performed, however, to set fiscal performance criteria. This chair supports the staff's suggestion that the sustainability of fiscal positions be the focus of greater attention in the future design of programs. We would further suggest that sustainability should be understood in a broad sense. Attention should focus not only on the calculation of a primary deficit leading to a stable ratio of debt to GDP, but also on the probability that key measures will be maintained.

We encourage the staff to pursue its investigations into the issue of private savings and investment. Empirical evidence presented in the staff study tends to confirm that no conclusion can be drawn concerning the impact of adjustment programs on the evolution of the savings rate. Perhaps an alternative area of investigation could then be the efficient allocation of savings.

In this respect, the staff study on the behavior of nominal and real interest rates has focused too narrowly on interest rate liberalization and auction market developments. Freeing interest rates has been mainly an instrument to achieve improved capital allocation. The key point for success is therefore not whether countries have achieved positive real interest rates, or whether governments pay market rates for their borrowing, but rather whether profitable investment gets financed. What is the capital allocation pattern that has emerged after financial liberalization? What was the evolution of private investment? What role had the informal financial sector, and how was it affected by the liberalization? These are other questions that should be investigated further.

I fully agree that unemployment and labor market issues should receive much more attention in program analysis. The staff analysis shows that there is no clear empirical evidence supporting the idea that administrative wage controls are helpful in addressing the corporate governance problem. However, I agree with the staff that wage control can play a temporary and limited role in the overall anti-inflation strategy. For lack of clear conclusions, we would suggest being rather cautious in setting wage controls as a performance criteria in Fund-supported programs for transition economies.

Structural measures giving rapidly positive results could play an important role in building a momentum for reforms and establishing interest groups to defend them. Elements of an economic system are, however, highly interdependent. While supporting the view that governments should take advantage of political opportunities to push reforms through, we would suggest that a medium-term program should be followed, assuring that a minimum level of consistency is respected in sequencing the reforms.

Reviews are generally more suited for monitoring the progress of reforms. However, we would be in favor of including some structural criteria when these reforms have been delayed, or when they are key measures requiring increased attention.

I agree with other Directors that this review of the experience of countries with stand-by and extended arrangements was needed and is very comprehensive, but it does not provide an answer to many questions. Despite the broad range of issues covered by the study, it is still difficult to say whether certain strategies are more suited to certain initial conditions. For example, for a high-inflation country, are expenditure cuts or revenue increases more successful? What would be the best options for heavily indebted economies? Perhaps classifying countries according to their initial problems--such as a weakness in the tax base, high interest payments, or high noninterest expenditures--rather than according to the number of Fund arrangements previously concluded might have provided clearer answers to these questions.

I support the proposed decision, and look forward to the next comprehensive study that will cover other countries beyond the year 1992, as well as the countries with arrangements under the newly established systemic transformation facility.

Ms. Lissakers said that she agreed with Mr. Autheman and Mr. Link about the need for the staff to do further research into whether revenue measures or expenditure cuts were more useful in effecting structural adjustments and reforms. That issue should be covered more completely in a follow-up paper. The Fund tended to focus first on expenditure cuts in structural adjustment. In most cases, the countries that had requested Fund-supported programs had already eliminated capital expenditures from the public accounts, because they had heavy debt and debt-servicing burdens. Those countries had been financing their debt servicing out of the capital accounts. She wondered whether it made sense, in those circumstances, to request further cuts in capital expenditures, rather than to take quick measures on the revenue side.

The Director of the Policy Development and Review Department stated that the reactions of Directors seemed to indicate that the staff might need to give further thought to the best mechanisms to distill, for the benefit of the Executive Board, the meaning out of the wealth of analyses performed and conclusions reached, not only in the Fund, but also in the World Bank and academia, relating to the content and assessment of Fund-supported programs. Many of the questions that had been raised were addressed, perhaps in different fora, such as in the Fund's informal research papers, and more formal Board papers, but the necessary drawing together of those results had apparently not been accomplished. The staff would need to give some thought to those issues.

The question of the methodology used in the review of stand-by and extended arrangements was one of continuous discussion, and indeed of tension, within the staff, academia, and elsewhere, the Director remarked. Over the years, the staff had adopted various alternative approaches, such as case studies and cross-section analyses of performance narrowly defined within program periods. One previous conditionality review had presented case studies; the call had then been for a cross-section analysis. The study before that one, which had been done on a cross-section analysis basis, had elicited calls for case studies. At the same time, it appeared that the staff was getting closer to what the Board wanted, in that he had detected less dissatisfaction with the effort that had been made in the context of the current study. One of the objectives of the current study had been to identify and shed some light on the recurrent analytical issues that had come up in the context of specific cases--the questions about nominal anchors, savings performance, and wage controls in Eastern Europe, for example. The staff had chosen those issues that it believed to be the most important. The results of the studies appeared in the annexes, the conclusions from which had then been incorporated into the main paper.

The staff was constrained by the way in which those studies had traditionally been approached, the Director emphasized. The Board's decisions on conditionality called for a review of performance under Fund-supported programs, which was what the staff had set out to do, but much of the frustration in the current debate had been about the fact that the staff had not reviewed cases over a longer period of time, or in a broader context. That could be done, but the Board would need to agree on what approach it wished the staff to take.

Another objective had been to record what had gone on in the context of the performance of countries under Fund-supported programs in the period under review, the Director continued. The degree of success or failure in meeting certain policy targets, such as fiscal and credit targets, as well as the progress made more generally toward the ultimate objectives of programs to restore balance in the external sector, reduce inflation, and increase growth had then been assessed. In doing so, the staff had not set out to assess fundamentally the paradigm within which the institution was operating--and one Director appeared to suggest that the staff undertake that. It was his view that such an analysis should be undertaken elsewhere. The large body of empirical evidence had led the staff to conclude that countries performed better with respect to growth, investment, and efficiency when fiscal deficits were small and inflation low. That conclusion had not been challenged or fundamentally re-examined in the current set of papers.

A variety of methodologies had been used in the staff papers, the Director explained. In the savings annex, for example, there was a regression analysis of the factors driving private and overall savings. Comparisons of outcomes with targets had been made. The strengths and weaknesses of those various methodologies were generally well known. The methodology of employing counterfactuals had not been used explicitly; he was not fully convinced about some of the applications of counterfactuals, but perhaps the staff needed to explore those possibilities a bit more. In fact, some work was under way in that direction.

In the discussion, there appeared to have been a general frustration with the disappointing results regarding the behavior of savings and investment and the progress made toward the ultimate objectives of the programs on investment and growth, the Director observed. At the same time, the question might be raised whether the results were so surprising, taking into account the initial conditions of countries with Fund arrangements in comparison with other developing countries. The record of GDP growth, price inflation, debt, and reserves for countries with Fund arrangements had been dramatically worse than for the others. Moreover, their macroeconomic situations and, in many cases, institutional settings, had been out of control to a certain extent.

That went to the heart of the point made by Mr. Havrylyshyn about the difference between what the Fund was trying to accomplish under a stand-by arrangement and what might have been presumed in the Articles of Agreement, the Director stated. The Articles came close to the model in which countries would come to the Fund at an early stage of their problems. They might be threatened with external sector problems for which they might feel they would have to impose restrictions or take other equally undesirable measures; instead, they should come to the Fund for financial support. The fact was that most of the countries requesting Fund-supported programs had already taken those undesirable measures, with enormous distortions to their economies. Therefore, the idea of a stand-by arrangement as a preventive measure, which had been the presumption in the early years of the Fund, no longer obtained in fact at present. Rather, stand-by arrangements had to deal with long-entrenched, incorrect approaches to dealing with the problems that the countries confronted. That was even before addressing the question of the reforming economies of Eastern Europe or the transition economies in the former Soviet Union--the problems of which, or course, had not been in the minds of the drafters of the Articles, or the crafters of the Fund's original facilities.

Taking all of that into account, there could be no question that the first priority was to stabilize the external situation, the Director went on. In many of the program countries, arrears were developing, access to capital markets had been lost, and--in some cases--aid flows had failed. In such situations, immediate measures needed to be taken to reduce the need for resources, as well as to reduce the accumulating imbalances. In those circumstances, the fact that performance toward achievement of the ultimate program objectives had not been better did not strike him as surprising.

Clearly, the ultimate objectives of Fund-supported programs ought to be the ultimate objectives of an economy--growth, efficiency, and better living standards for the population, the Director acknowledged. A Fund-supported program ought to be a stepping-stone to that, but the first step was often taken in the context of a difficult situation in which the attention of policymakers needed to be focused on emergency issues, before the broader issues--those that affected the outcome of policies, such as the structure of the system and of institutions--could be addressed.

It was true that the Fund had gotten into the habit of anticipating that stand-by arrangements would be followed by a medium-term program under the extended Fund facility or ESAF, the Director noted. Frequently and unfortunately, if there were slippages and interruptions, a series of stand-by arrangements resulted, but that was a second-best solution.

The staff would look into the question why the information that was available was not being distilled better in order to shed more light on performance under programs, the Director stated. There was indeed an enormous body of literature on which to rely in that regard, produced both by the Fund's Research Department and the World Bank. Some was produced outside, but it was not collected in an efficient manner for distribution in the Fund.

The other frustration that had been evident in the discussion concerned whether or not the elements of program design themselves were harmful to the objectives, the Director continued. That frustration would probably be somewhat difficult to resolve. For example, with regard to fiscal adjustment, there were pressures to sustain, or put in place, social safety nets, and health and education expenditures in the budget. While those expenditures might represent good long-term capital investments--the World Bank's work showed that health and education expenditures were one of the most productive of capital investments--they did not pay off for a long period of time. Thus, if resources were devoted to those expenditures and cuts were being implemented elsewhere, it would not be surprising were the results not to be seen during the period of the adjustment process.

In the same context, of course, the staff encouraged a reduction of unproductive expenditures, including the control or reduction of military expenditures, but it needed to be borne in mind that the Fund dealt with sovereign entities, and that there might be differences of view regarding the scope for the Fund to move in that direction, the Director of the Policy Development and Review Department concluded. On a related point, the OECD's Development Center, in its work on the political aspects of adjustment, had found in a sample of five countries that the same measures tended to be the cause of disturbances under adjustment programs: an increase in the price of staples and of urban transportation; a reduction in student scholarships, and in wages in the public and parastatal sectors. Other measures, such as the reduction of public investment, were applied without trouble. Similarly, in 23 African countries examined over a period of 11 years, measures such as more rigorous monetary policy or reductions in operating or investment expenditure usually had not entailed any political risk. There was thus a clear indication that, when pressed to reduce expenditures, the authorities chose those items that were less socially sensitive. To that extent, they might help to sustain the immediate adjustment effort, but because they were cuts in--presumably--efficient capital expenditures, they carried the cost of limiting future growth and productive investment.

Ms. Lissakers said that it was fairly obvious that a cut in capital expenditures was politically more palatable than a cut in current expenditures, which was why governments did it. For example, all of Latin America's efforts to service its external debt had come out of the capital accounts expenditure in the budget. Another way to address the issue was on the revenue side; that might be both economically sound, in terms of the growth effects, and politically more manageable.

The Director of the Policy Development and Review Department stated that the staff had looked at that balance in the context of the current review, and it would certainly take it into account in the context of each country case. On average, targeted fiscal adjustment had fallen about equally on revenues and expenditures. On the expenditure side, the staff was working with the Bank on expenditure reviews. A task force had been established, including the Policy Development and Review Department, the Fiscal Affairs Department, and some of the area departments, to look at the extent to which the Fund utilized the material available in the Bank on public expenditure reviews, either in specific sectors or more generally, and how the Fund could collaborate better with the Bank staff.

With regard to the sequencing of structural reform, the staff had not meant to imply that the Fund had an intimate role and mandate in all of the structural issues that were confronting a country, the Director explained. The staff had not the knowledge or the information to establish an optimal schedule for the sequencing of structural reforms in many cases. Rather than setting out to do that, the staff focused on what could be done, while being aware of when the sequencing might not be optimal, and when the effect of the structural reforms might be counterproductive.

The connection between performance criteria and reviews should not be starkly drawn, the Director commented. It was not a matter of having measurable quantitative performance criteria, on the one hand, and a vague notion of what was to be achieved, on the other hand. Even if structural reforms were to be dealt with in the context of a review, there ought to be an understanding of precisely what was expected, even though that expectation, because it might not be measurable exactly, might not be subject to quantitative performance criteria.

The positive side of the term "graduation" was that it signaled that a country had succeeded in overcoming the problems for which it had requested Fund assistance in the first place, the Director of the Policy Development and Review Department observed. The negative side was directly related to that--in a sense, not to graduate from the use of Fund resources could indicate in a derogatory way that a country had not solved its problems, and to that extent, by attaching a negative slant to approaching the Fund, discourage countries from coming to the Fund at an early stage of their adjustment problems. It was for that reason that he had disliked the term.

Mr. Mirakhor said that the message that came across from the staff paper was that both stand-by and extended arrangements were designed, whether implicitly or explicitly, to address external imbalances. Policymakers' attention should, and needed to be, focused on emergency issues. If that were the case, perhaps it should be stated explicitly and transparently as the intention of such arrangements, in order to reduce expectations and make it clear that programs would not address all the issues. If it were within the Fund's mandate to address other issues in a medium-term context, then the Fund ought to design a program that would address those other issues--the structural adjustment, savings, investment, growth, and employment questions.

Mr. Sirat commented that there was broad recognition in the literature of the fact that protecting health and education expenditures and capital expenditures was good for growth. He wondered how that recognition could be reflected in a concrete way in program design. For example, would the Fund decide that the protection of health and education expenditures would be a performance criterion in programs?

The Director of the Policy Development and Review Department stated that, even in the initial program design, the need to work toward the ultimate aims should be recognized. From that perspective, the trade-offs on the revenue and expenditure sides needed to be taken into account. The initial effort needed to be sustained in order to move to a medium-term program. Real program failures, in his view, were those cases of constant interruptions and disruptions. While the Fund might appear to be involved over a long period of time, in fact, because of program disruptions, its effective engagement might be far shorter. The authorities needed constantly to start over again, overcoming inertia each time. He was not suggesting that conditionality should be applied to specific expenditure categories, notwithstanding the calls that had been made by critics of the Fund--including in the context of the Conference on the Fiftieth Anniversary of the Bretton Woods Institutions, held in Madrid--that the Fund and/or the Bank ought to insist that countries devote a certain percentage of government expenditures to health or other items. It was his view that that was not possible given the nature of the relationship between the Fund and its member countries. That was not to say that the Fund did not have a role to play in cooperating with the Bank in the context of its expenditure reviews to try to help the authorities by pointing out areas in which cuts might be made, or where efficient revenue savings might be secured, and what the trade-offs might be to bring about a better quality of adjustment than might be achieved otherwise.

Notwithstanding those efforts, it was unlikely that, in most situations, a high growth path would be attained quickly, the Director considered. World Bank studies of the East Asian experience, for example, showed that, for whatever reasons--perhaps the time needed to build investor confidence, political stability, to establish credibility, and set in place and pursue new policies in a sustained manner--foreign investment took time to flow in. That could be seen as well in the case of a country like Ghana, which had sustained adjustment over many years before private investors had come in, thus effectuating the move to a higher growth path.

Mr. Sirat commented that when the Fund set a fiscal deficit target, it seemed to be setting implicitly a target for expenditure cuts as well. In his view, to claim that the measures taken to reach the Fund's deficit target were not the Fund's responsibility was being a bit disingenuous. It was hard to detach responsibility for the deficit target from the ways the target was met. If it were accepted that the Fund-supported programs should be placed in a medium-term framework, and therefore that the sustainability of reform was a key component of conditionality, then the question might well be whether the Fund should provide an incentive for a sustainable program, such as by granting greater access to Fund resources for programs in which fiscal reforms included some protection of expenditures related to growth, health, education, and capital expenditures.

Mr. Mirakhor observed that a program designed with the aim of regaining external balance would probably be fundamentally different from one designed with the aim of achieving economic stability, low inflation, and growth over the medium term. The program's design, targets, and conditionality would all be different. If the two aims were mixed together, the result would be what the Fund had at present. The staff papers admitted for the first time that, in the initial approach to a country's problems, the Fund intended to restore external balance. For countries in which the Fund was involved over a long period of time, such as Bangladesh and Ghana, the question was why the Fund's long-term involvement had not resulted in the desired outcome for growth, savings, and investment. The answer, in his view, was that the Fund did not change its mind set. It continued to look for external viability as the primary target of programs whether or not the program was a short-term one or, de facto if not de jure, a long-term one. Perhaps the Fund should admit that, in the short term, under stand-by and extended arrangements, the establishment of external balance was the goal. In consequence, program design would be more focused and conditionality more straightforward. The Board and the Fund needed to distinguish between the objectives in the short term and those in the medium term, and design appropriate programs to achieve those objectives in each case.

Mr. Geethakrishnan said that he agreed with Mr. Mirakhor. While a country might come to the Fund because of a balance of payments crisis, the conditionality that the Fund imposed affected an area far wider than just that related to the balance of payments crisis. That left much to be desired, because the Fund was not sure that it knew how to respond to problems other than those related to the short-term balance of payments crisis. Before discussing the medium-term questions, the Fund would need to consider whether or not it was properly equipped to attempt to answer them. At present, the Fund knew definitely how to tackle only the balance of payments crisis; it was uncertain as to how to promote savings, investment, growth, and employment. The Fund should discuss, first, whether it should tackle those issues, and second, if it should, how it should go about it.

The Acting Chairman said that he wondered whether Mr. Mirakhor was challenging the notion of a growth-oriented adjustment program, and whether he would prefer to go back to the traditional balance of payments adjustment program.

Mr. Mirakhor explained that the staff needed to make clear the differences between programs that focused on short-term balance in the external sector and those that focused on medium-term, growth-oriented adjustment. The initial objective of programs under stand-by and extended arrangements was to restore external balance, which might not be the same objective as a program that focused on growth-oriented adjustment in the medium term.

The Acting Chairman commented that there was a short-run dimension to external adjustment, and a medium-term dimension. The short run focused on bringing the economy into line with the available external financing. The medium-term focus was to bring the economy into line with financing in a way that would enable the country to repay the Fund. The external constraint was a combination of those two--whether or not the program was financeable in the current year, and whether or not there was a prospect that the Fund would be repaid in the medium term. Over time, the Fund had moved toward growth-oriented adjustment programs because without growth, the prospects were poorer for attaining a sustainable external position, and thus, more significant questions arose as to whether or not the Fund would be repaid.

Mr. Mirakhor added that some countries were able to pay their creditors, but others had not had the growth that would enable them to pay their external creditors.

Ms. Lissakers said that she agreed with Mr. Sirat that when the Fund set a certain fiscal target, it was implicitly setting an expenditure reduction target as well. If the Fund did not take a more proactive stance with regard to the structure of those expenditure cuts and the timing and size of revenue measures, governments would take the path of least resistance--which would be to cut the budget expenditures that most supported private sector growth. The Fund needed to ask itself the question why growth was not seen at the end of the adjustment path that countries had followed so carefully. The characteristics of the expenditure cuts chosen and the policy approach might be part of the explanation.

Mr. Sarr said that, while he understood the concern of Ms. Lissakers about cuts in specific categories of expenditure and the issue of the quality of the fiscal adjustment, it was unlikely that the desired fiscal results would be secured only through a strengthening of conditionality. The staff paper clearly indicated that there was no relationship between the number of performance criteria and the achievement of the fiscal objectives. It would be better to try to achieve the fiscal objectives through enhanced technical assistance and training.

Mr. Waterman said that in a situation in which a country had come to the Fund only as a last resort, at a time when there was a risk that the country would be unable to make its external payments, the Fund would necessarily have to work hardest on the immediate problem--making revenues match expenditures. That would often require making tough choices that might not be consistent with the longer-term objectives of getting an economy growing again. In communicating the results of the review, it would be important to get across to the public the nature of the problems that the country and the Fund faced, and the difficulty of meeting the immediate objectives while at the same time taking into account the longer-term objective of returning the economy back to a sustainable path, reducing inflation, and lifting savings and investment.

Mr. Havrylyshyn remarked that it needed to be borne in mind that there could be situations in which a balance of payments crisis was caused by purely macroeconomic mistakes, such as profligacy in spending or the wrong exchange rate, but in which the underlying structural relationships, such as the incentives for export, were generally healthy. In that case, a simple, quick, short-term program could be effective, and it probably need not have much more behind it. In cases in which there were underlying structural distortions at the heart of the balance of payments crisis, of course, it was clear that they would have to be cured. The key was to be able to identify when the balance of payments crisis was caused by structural problems, and when it was not. If structural distortions needed to be corrected, the Fund would have to decide whether to go ahead and try quickly to provide short-term expedients to ameliorate the problem, while making it clear to the country that it would have only a temporary effect, and that to be truly successful, the program would have to take care of the underlying structural distortions. The empirical evidence from the staff papers suggested that most Fund-supported programs were of the second kind--that is, aiming to address balance of payments problems that had at their root structural distortions. It was therefore inevitable that the Fund would have to intervene in the structural corrections, perhaps in cooperation with the country itself and the World Bank. That should be acknowledged at an early stage of negotiations with the authorities.

Mr. Geethakrishnan observed that the Fund's policy prescriptions, even in the short term, covered the various structural adjustments. In the case of India's stand-by arrangement, for example, many domestic as well as external issues were addressed. This paper showed that, time and time again, the Fund was not very good at addressing all of the domestic issues, and the end result was that programs had not been very successful on the domestic side. That was why he raised the basic question of whether the Fund knew how to address the domestic issues. Perhaps there was a case for examining why the Fund was not successful, and what it should do to become so.

Ms. Lissakers remarked that it seemed odd to discuss the idea that short-term stand-by arrangements were meant to address the narrow issue of balance of payments imbalances, and that more comprehensive structural adjustments would follow in future programs, when the Russian Federation was not yet ready for a stand-by arrangement because the authorities were not prepared to undertake the comprehensive structural adjustments that the Fund would ask for under a one-year stand-by arrangement. There seemed to be some inconsistency in the Fund's approach.

What caused her the greatest uneasiness was not the Fund's reaction to the short-term emergencies, but rather its reaction to the longer-term problem, Ms. Lissakers stressed. For example, the adjustment process in Mexico had been under way since the early 1980s, yet domestic savings were down and growth was low. She wondered what would turn that situation around; the Fund appeared to have no answers. Another example was the case of Ghana.

Mr. Smee remarked that, historically, stand-by arrangements were crafted to deal with a short-term external liquidity crisis. The direction of causation in that case was from the external sector to the domestic sector of the economy. The Fund would attempt to lead the country out of the liquidity crisis by overseeing the implementation of reasonable policies. In that respect, it was necessary to find the relationship between the domestic economy and the balance of payments. A deterioration in the terms of trade would require adjustment on the domestic consumption side. If public expenditure was way above the revenue-generating capacity of the country, which was indeed often the case, it would have to be cut. After that, efforts to make the public sector more efficient could be undertaken, as well as measures to increase revenue, through, inter alia, value-added tax reform and changes in personal and corporate income taxation.

At times, however, the problem was not one of liquidity, but of external solvency, Mr. Smee went on. While growth was desired, problems with the balance of payments continued year after year. Debt and debt-service reduction were not enough. The Fund could not always deliver both an improved balance of payments and growth. In the case of Russia, for example, the Fund was trying to ensure that domestic policies were consistent with those put in place to solve the short-term balance of payments problem. Medium-term growth could not be the focus of a stand-by arrangement. That should be made clear to the Fund's members.

Ms. Lissakers noted that it was not always the case that expenditures were wildly out of line with reasonable levels of revenue. Rather, the taxation pattern of many countries that had requested Fund-supported programs demonstrated that it was the level of taxation that was wildly inadequate for the level of public service that the economy needed. Typically, income taxes were equivalent to about 3-4 percent of total GNP, and most revenues came from taxes on exports and/or imports, which caused structural distortions. Early attention to the revenue side would be very much in order in such cases. For example, in the case of Chile, an increase in income taxes had been one of the first acts of the democratic government. It had done so in order to increase government expenditure on primary health care and education. It had been a sound measure, even though it was not a standard part of the Fund's prescription to program countries.

Mr. Smee agreed with Ms. Lissakers that it was by no means the case that all countries had problems only on the expenditure side. In many cases, there were also problems with income distribution and the tax base. However, where the crisis was on the external side, a reduction in the absorption of the economy was needed. That was why the Fund tended to recommend a reduction in expenditures even though the level of taxation was inappropriately low. That was not to say that the system of taxation would be ignored, but tax reforms generally took time to implement and to have their full effect.

Mr. Sirat said that he agreed with Ms. Lissakers. The situation that Mr. Smee had described seemed to be one of an acute balance of payments crisis, in which it was decided to cut those items of expenditure that were the easiest to cut. While it was true that tax reforms took time to implement, that was precisely why they should be started immediately, rather than in the second, or third, or fourth stand-by arrangement.

Perhaps the Fund should accept the idea that it should create an incentive in the context of a short-term program to take into account medium-term objectives, such as fiscal sustainability and inflation, Mr. Sirat suggested. In the same vein, perhaps it should be agreed that, when the conditions for it were present, a nominal anchor policy could be appropriate to protect an inflation-fighting policy over the medium term, reinforced by greater access to Fund resources. Similarly, if it were accepted that some expenditures needed to be protected, then the protection could be provided by greater access to Fund resources.

Mr. Geethakrishnan commented that in a number of countries, tax rates were prohibitively high, and the tax system had a narrow base. In some of those countries, the initial decision had been to reduce tax rates drastically, because broadening the tax base required much political courage and more time. In India, for example, the peak customs duty rate was 500 percent, with the average rate at about 75 percent. The ultimate objective of the Government was to reduce the average rate to about 15 percent. For the first four years following such a change, the Government would encounter a severe revenue loss. Of necessity, therefore, the focus of fiscal correction would have to be on the expenditure side.

Mr. Mirakhor stated that when the Fund assisted a country in re-establishing payments balance or restoring its solvency, the program design needed to generate an immediate domestic surplus. That surplus could be generated most easily on the capital expenditure side, which was inconsistent with a growth-oriented adjustment program. That had been seen in the case of India.

The Director of the Policy Development and Review Department commented that Fund-supported programs were balanced on the fiscal correction side. In fact, about half of the adjustment of the deficit occurred on the expenditure side, and half on the revenue side. In the case of Peru, for example, revenue accruing to the public sector had been extraordinarily low, and the focus of attention in part of the program had been to try to rebuild the revenue base. Moreover, he wished to stress that it was not the case that there had been no growth under Fund-supported programs. Rather, the problem was that the kind of step-up that was desired onto a higher growth path was not being seen. In a good number of cases, as had been shown in the review of the ESAF, growth tended to be higher where the adjustment effort was sustained.

Even in those cases in which the focus of policy attention had been on correcting the external imbalances, the program had not been designed to fix the imbalance immediately, the Director pointed out. Rather, the programs had been framed with a view to making progress toward viability over a number of years. Moreover, it was not the case that it was necessary to generate a domestic surplus in order to deal with the imbalance. Rather, an enormous inflow of additional resources to sustain expenditures--including aid flows and debt relief--usually followed agreement on a Fund-supported program, especially for the lower-income countries. That was part of the design of the program, and part of the targeting of the extent to which domestic correction needed to take place to engender external correction.

The staff representative from the Policy Development and Review Department stated that one of the background papers had gone into detail on the structure of the targeted adjustments in the fiscal accounts. That reduction amounted, on average, to a bit over 3 percentage points of GDP over the average two-and-a-half years of a Fund arrangement, divided about equally between expenditure reduction and revenue increases. Within the category of expenditures, the reduction was targeted to be divided about evenly, as a percentage of GDP, between current and capital spending.

Obviously, that meant that more was falling on capital spending, because capital spending was a smaller percentage of GDP than current spending. In that sense, the staff had raised the concern that programs might tend to depend disproportionately on capital expenditures.

From the regression analysis, a strong relationship could be seen between the initial level of revenues or expenditures and the change that had been targeted under the program, the staff representative noted. Countries with the lowest ratios of revenue to GDP tended to target the largest revenue increases, and, conversely, the smallest expenditure cuts. Deviations from the targets frequently were with respect to the revenue targets, with compensating adjustments then made on capital spending, which was the easiest and fastest place to make cuts.

The staff had experimented with a number of ways of grouping countries for purposes of analysis in the papers, the staff representative observed, including on the basis of inflation performance and degree of financial market liberalization. For the overview, the staff believed that it was important to keep with one set of groupings of countries throughout the paper, because it would be difficult to understand the paper's conclusions if different groupings were referred to in different parts of it.

The staff had chosen the groupings in the paper in order to address the question of why countries approached the Fund, the staff representative from the Policy Development and Reveiw Department concluded. There were distinct differences between the countries coming to the Fund for the first time in many years, and those that had had a series of Fund-supported programs. The former countries typically had extraordinarily low levels of reserves and were facing an immediate liquidity crunch; the staff needed to design policies to take care of those problems quickly. Some countries in Central Europe had also come to the Fund for the first time, but their situation was completely different from those countries coming to the Fund for the first time because of simple--albeit serious--balance of payments problems. The principal difference was that those countries were undergoing systemic transformation. The largest group of countries--15, or almost half of the total sample--had had several programs with the Fund since 1980, and had started to adjust before the period under review. Sometimes they had faltered and had had to abandon their programs, but some continuity of the process could be perceived in their experience. Generally, those countries--among them, the countries with heavy debt burdens at the beginning of the 1980s--had achieved a significant amount of adjustment in their fiscal accounts and in their current account positions, and higher reserve levels. Such a categorization of countries seemed the most meaningful and informative for making comparisons and drawing conclusions about the appropriateness of the design of programs.

Ms. Srejber said that the problem was that the grouping did not help to explain why some of the countries had been successful and others not successful. Perhaps countries should have been grouped according to political situation, private market development, and the role of the public sector, instead. The Fund needed to try to understand why some countries did better than others, and unfortunately, the analysis provided little illumination in that respect. Perhaps another methodology would have been more helpful; for example, the treatment that had been given to the lessons that had been learned in Morocco, as reflected on pages 75-77 of the staff paper on a review of the adjustment experience of Morocco (SM/94/159, 6/27/94), was highly understandable and readily accessible, in her view. That paper explained well why things had happened the way they had.

The staff representative from the Policy Development and Review Department replied that it would have been satisfying to be able to explain the successes and failures, but often that was not possible in the two- to five-year periods reviewed for each of the countries. The policies that the Fund recommended reflected the results of studies that analyzed broad-based, comprehensive, and long-term data. To understand the successes and failures, econometric studies needed to be undertaken of the extent to which certain kinds of policies reached certain objectives. Those studies would need data over a fairly long period of time, so that the lags in the effect of policy could be better understood. The paper had not attempted to reinvestigate the Fund's basic policy paradigm.

With respect to savings and the experience of Chile, the staff representative continued, the pension funds in Chile had been introduced in 1979, and the rate of private savings during the ensuing two years had risen by about 1.5 percentage points, and over the ensuing decade, by about 3 percentage points. However, there was considerable disagreement about the degree to which the increase in savings was affected by the introduction of the pension scheme, as opposed to other variables. In fact, there was a view that the introduction of the pension scheme had had start-up costs, with initial negative effects. Moreover, there was the question whether the contributions to the pension scheme were simply offsetting voluntary savings that would have occurred anyway. That question had been raised in several Asian countries--in particular, Malaysia and Singapore. It was hard to imagine that the pension scheme in Singapore had not supplanted to a large extent private savings, although the authorities disputed that.

The experience of Tunisia might be useful in shedding some light on a way to improve private savings in the context of adjustment programs, but the evidence from that program also tended to confirm the negative relationship between private and government savings, the staff representative pointed out. Government savings had fallen, on average, and private savings had increased. The question then became whether the lower level of government savings was in fact sustainable, and whether lowering government savings could be considered a useful mechanism to raise private savings. In summary, short-term instruments that could be used to increase national savings were limited. The evidence suggested that increases in public savings were not completely offset by declines in private savings, although about half of the increases in national savings that originated in increases in government savings tended to be offset by a decline in private savings. Thus, while the net effect of an increase in public savings was an increase in overall savings, it was disappointing that a decline in private savings tended to offset to a fairly sizable extent the increase in public savings.

Fund policies in the programs under review had not had much effect on savings, the staff representative from the Policy Development and Review Department acknowledged. Nevertheless, a more useful result might be obtained over longer time periods. For example, the World Bank's study of the "Asian miracle" showed that increased growth over a long period of time eventually fed through to higher savings. There appeared to be a similar relationship in Chile. Most of the econometric literature on savings showed that there was a positive relationship between long-term growth and the level of savings, although that might not be seen over a period of four to six years.

Mr. Havrylyshyn stated that he hoped that, over a time horizon of ten years or longer, savings would be seen to rise after the conclusion of the period of the Fund-supported program. If evidence of that hope did not materialize, then he was left with the unfortunate and pessimistic main message: the long-run positive effect on savings of Fund-supported programs could not be proved. If that were so, then there was all the more reason to raise the themes of Ms. Lissakers, namely, that programs had to be put in a medium- or even a long-term context, and that the question of why savings were not increasing to the level conforming to the cases of East Asian countries had to be investigated thoroughly.

The staff representative from the Policy Development and Review Department remarked that the longest time horizon in the countries being reviewed in the staff paper was from two to five years--a period that was probably too short to observe long-term effects. The staff could only place its trust in the best econometric evidence of long-term relationships, and recommend policies in accordance with that. Unfortunately, in the period under review no countries had experienced a rebound in private savings of the sort that the staff had hoped would occur. Also, however, no countries under review had had uninterrupted Fund-supported programs over a period of 15-20 years, the staff representative pointed out. Some had had a program, say, in 1981, 1984, and 1987; some of those program had broken down; some had continued off and on; but there had not been a period of continuous Fund involvement. That being said, it was unlikely that long-term savings behavior could ever be linked directly to the influence of Fund programs. This suggested that it was more appropriate to look at the effect not of Fund-supported programs, but of policies whether supported by the Fund or not. In that regard, attention might be called to the case of Thailand, which had had a tremendous increase in savings after intermittent Fund-supported programs in the early and mid-1980s. A large increase in savings had occurred in the late 1980s reflecting policies that had been set in place during Fund-supported programs and independently of the Fund-supported program. Moreover, an entire transformation of trading arrangements in East Asia had occurred that had changed the environment in which savings and investment decisions were made. It would be difficult to differentiate those aspects of the changes that were the results of Fund-supported policies from those that were the results of other policies.

Ms. Lissakers commented that, from Chart 3 on page 14a of the overview paper, public savings in Mexico had risen sharply starting in 1988, and total national savings had declined sharply, because private savings had declined very sharply. In Tunisia, the exact opposite had occurred: public savings had begun to decline in late 1985 or 1986, and total national savings had increased steadily. Perhaps the time frame was too short, but the experience did not bear out the contention that an increase in public savings lead to a net increase in overall national savings; it had not done so in either Mexico or Tunisia.

The staff representative from the Policy Development and Review Department explained that the regression analysis showed that changes in public savings had a very strong systematic influence on private savings, and that subsequent changes in private savings offset about half of the effect of changes in public savings. When public savings rose by 3 percentage points of GDP, private savings tended to fall by 1 1/2 percentage points of GDP. Nevertheless, it had to be recognized that a large proportion of the changes in savings could not be explained in the savings equation. The hypothesis was that there were many nonquantifiable factors influencing savings. The reason the case studies were presented was to try to take some of those into account. In Mexico, there was a strong presumption that structural reforms had led to an expectation that wealth and income would increase in the future. People's expectations as to their permanent incomes were rising, and consequently, they started to smooth the path of their consumption with the expectation that income would be higher in the future. In Tunisia, the reforms had not been as dramatic as those in Mexico, and the regaining of access to foreign capital markets by Tunisia had been nothing like that by Mexico.

Mr. Evans commented that there was still some tension between short-term objectives and longer-term ones. He would want to look at future programs to see how clearly the objectives were being defined.

The quality of fiscal adjustment was important, but so was the quality of investment within public expenditure, Mr. Evans stressed. For example, often investment in new roads was much less productive than spending on maintenance. Therefore, he would be wary of any explicit recognition of the notion that the total amount of investment should be protected. There could be a trade-off, in practice, between the short term and the long term, in that lesser fiscal and external adjustment could be traded for protecting some elements of public expenditure, such as education and health.

He wondered whether the staff could explain how the authorities' idea of ownership of programs could be strengthened, and how the degree of ownership felt could be assessed in the context of program reviews, Mr. Evans concluded.

The staff representative from the Policy Development and Review Department stated that it was indeed difficult to measure the degree of ownership felt by the authorities in relation to Fund-supported programs. The staff could refer to the World Bank's measures of political commitment.

In a report of the Bank's Operations Evaluation Department, an index of political commitment had been created, which was essentially a subjective reading of the authorities' willingness to undertake reforms in specific areas. Of course, that judgment would vary enormously, depending on the person who was making it.

The Director of the Policy Development and Review Department added that the policy framework paper was a critical element of the authorities' ownership of a program. At the time of the invention of the policy framework paper in 1986 in the context of the structural adjustment facility, the middle-income, non-SAF eligible countries had been opposed to having that paper as a requirement for a Fund-supported program. There had been some long and somewhat heated discussions in the Board to make sure that the policy framework papers would be limited to SAF and, subsequently, ESAF arrangements.

The staff and a number of Directors believed that it might be useful to extend policy framework papers to other country cases at various times, the Director noted. Similar papers--although not referred to as policy framework papers--had been included in the context of requests for resources from several of the Eastern European countries, and in the context of medium-term policy documents for some other countries as well, but not as extensively as might be hoped. The purpose was to ensure that a common document, agreed to by at least all those policymakers whose areas were to be affected by elements of the program, was available to all, so that there would be no surprise later on. In his view, policy framework papers would be useful in the context of medium-term programs in particular, where many sectoral operations, including those of the Bank, would affect policies in many areas.

There had been cases of less ambitious adjustment in order to protect certain areas, the Director acknowledged, especially among the poorer countries, in which special efforts had been made to secure additional financing and/or grants to sustain expenditures in particular areas.

The Acting Chairman observed that the Fund had sometimes been criticized for not being precise enough about what it expected from a program, and that the authorities were therefore unclear about what needed to be done to secure the Fund's support. Against that needed to be contrasted the ideal that the program should originate in the authorities' own plans, thinking, and development.

Ms. Lissakers remarked that the fact that the magnitude of the fiscal adjustment in some programs was too great in the short run was implicit in the statistical evidence. Even though it was obvious that, in the absence of money, expenditures needed to be cut, to the extent that there was some discretion over the size and pace of adjustment financing, it might be worth taking another look at the trade-offs between immediate and sharp expenditure cutbacks and the longer-term growth path. In particular, perhaps more attention could be paid to the distribution of cutbacks, the timing of fiscal savings, and the magnitude of adjustment, taking into account the time horizon of the program.

The staff representative from the Policy Development and Review Department stated that the staff had not compared progress toward external viability and domestic performance under the ESAF as opposed to stand-by and extended arrangements. However, in ESAF countries, those that had made the greatest progress toward external viability had not suffered on the domestic side, in that growth had been at least as high as in countries that had not made progress toward external viability. Savings and investment outcomes in ESAF countries had been disappointing, however, as it had been in the countries under review.

At the same time, it needed to be borne in mind that the majority of the countries in the sample had improved growth, albeit by a very small amount, during the arrangements, the staff representative emphasized. Given the weakness of the data in those countries, the small increase in growth that was seen could not be interpreted as a significant development, but at least the countries were not adjusting in a way that was outright sacrificing their growth or domestic performance.

Regarding the question from a Director about the influences on exports, terms of trade developments, exchange rate movements, and structural rigidities--such as an antiexport bias in trade restrictions or the structure of tariffs--had been important influences on exports, in addition to the growth of external markets, the staff representative explained. A wide range of other exogenous and country-specific factors could affect export performance.

Of the 45 arrangements that the staff had examined, nine had gone off track after the initial purchase, the staff representative recalled. Three of those arrangements had been in countries in which other arrangements had remained on track: Costa Rica, Nigeria, and Poland. In six countries, no arrangements had stayed on track during the period under review. While there was no single explanation for why countries failed in following the programs, one feature that seemed to recur was relatively weak programmed fiscal adjustment. In four of the six countries with programs that had gone quickly off track, the fiscal deficit had actually been programmed to rise, in large part because the Fund arrangement was set in place relatively late in the fiscal year, when the deterioration had already set in. Measures had been planned in those cases to reverse the fiscal problem, but not within the course of the year. Countries that planned strong fiscal adjustments seldom had failed programs.

Some of the countries that were reviewed could be said to have failed overall, the staff representative continued. Their policies had gone off track and their performance had clearly deteriorated. Some countries had experienced temporary setbacks and had had difficulty reaching agreements on how to bring the program back on track, but had gone on subsequently with other Fund arrangements, some not reviewed in the current paper; for example, Madagascar had gone on to an ESAF arrangement.

Aggressive use of the exchange rate to maintain competitiveness could reduce incentives for structural reform, the staff representative acknowledged, although that had not been fully investigated in the paper. In the program for Czechoslovakia in 1992, during which the exchange rate was pegged, it was thought, on the one hand, that if the exchange rate were set at too low a level in relation to competitiveness, the pace of structural transformation of the economy would slow, because it would maintain the competitiveness of those enterprises that really would not be competitive at an exchange rate sustainable over the medium term. On the other hand, if it were set too high, structural change might be too rapid, and those industries that might possibly be competitive under a different exchange rate would be weakened or destroyed. Therefore, the level of the exchange rate had to be balanced against other policies that also affected competitiveness--such as structural policies, in particular.

Many factors, besides wages, could influence the profitability of production and investment, the staff representative from the Policy Development and Review Department concluded. Those factors needed to be borne in mind in deciding how to handle wage pressures, and whether or not structural measures could bear more of the burden at times when it became difficult to hold wages at an appropriate level. The programs under review had attempted to strike a balance between financial adjustment and structural reform, and they had not relied on any specific, unique instrument to obtain the desired result.

Mr. Jiménez de Lucio stated that the current Board discussion suggested that there was no consensus on the objectives and goals of Fund-supported programs. A multiplicity of views and interpretations had been advanced, of which the two main ones were, first, the focus on the lack of growth and the low savings and investment ratios, which had been viewed as a longer-term issue; and second, the focus on the shorter-term objective of restoring external viability. That multiplicity of views deserved urgent attention, because it had obvious implications for the design of programs. The Fund must have a clear view of what it wanted to accomplish if it was to design effective programs.

The ambiguity about short-term, as opposed to long-term, objectives was reflected in the staff papers, Mr. Jiménez de Lucio concluded. There was no clear framework for evaluating the success of Fund-supported programs, which was why he had emphasized the importance of coming up with a definition of success. The more precisely one could specify what one was trying to accomplish, the better one would be able to design a program to accomplish it, and the easier it would be to identify when the goal had been reached. Also, once one knew what one wanted to accomplish, the easier it would be to know what to do to accomplish it, how long it would take, and who should do what. The Fund should have a clearer view of the objectives of its programs.

The Acting Chairman observed that most Directors were comfortable with some of the basic principles of, and the basic approaches in, Fund-supported programs. There had been no disputes about the staff's broad conclusions, although one or two Directors had said that they could have been drawn more sharply. The paper and the general conclusions had allowed Directors to explore different subjects and to ask questions about whether the Fund had a clear view of objectives. Many issues had been raised, some with the purpose of stimulating further work on the part of the staff in the future, some to influence the positions that different chairs had taken in the context of discussions of individual Fund-supported programs. The findings of the staff paper did not suggest that a major change of direction was in order.

Ms. Lissakers said that she believed that the discussion had been extremely useful, but she would be interested in a follow-up discussion. While the staff paper might not suggest a radical, revolutionary change in Fund-supported programs, it would be worth asking the staff to do a shorter paper drawing the policy implications from the results that would present to the Board some possible modifications in the shaping of Fund-supported programs.

The Acting Chairman suggested that Directors agree that his summing up of the discussion should be made at the next Board meeting.1/ On other subjects, the Board would want to discuss again the evaluation unit. The details of such a unit would be laid out in that context, including some of the more difficult aspects, such as the budgetary implications, structure of the unit, and reporting requirements. The focus of its investigations would need to be clarified; in particular, whether it would focus on adjustment programs or broader surveillance issues.

If Fund-supported programs were the curative medicine, then surveillance was the preventive medicine, the Acting Chairman observed. In that context, more than 90 countries were being closely monitored. Some of them had just emerged from Fund-supported programs. The continuum of Fund involvement and support for its members needed to be recognized. Surveillance could be used to better identify countries before their problems became dire.

The Director of the Policy Development and Review Department, addressing the draft decisions, noted that the text of the draft did not preclude or foreclose the ongoing work that Ms. Lissakers and other members of the Board had said was needed in the realm of conditionality. The decision simply concluded formally the review that was called for in the guidelines on conditionality.

The Executive Board took the following decisions:

1. Pursuant to Decision No. 9790-(91/106), adopted July 31, 1991, the Fund has reviewed the experience with recent programs supported by the stand-by and extended arrangements and decides

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1/ The Acting Chairman's summing up of the discussion appears in the minutes of EBM/94/59 (7/6/94).

that the guidelines on conditionality will remain in force in the present circumstances.

2. The Fund decides to postpone until an appropriate time the review of the provisions of the extended Fund facility envisaged in Section 3 of Decision No. 9790-(91/106).

3. The Fund will again review the experience with programs supported by stand-by and extended arrangements at an appropriate time pursuant to paragraph 12 of the guidelines on conditionality.

Decision No. 10723-(94/58), adopted
June 30, 1994

3. JURISDICTIONAL IMPLICATIONS OF OFFICIAL CLEARING AND PAYMENTS ARRANGEMENTS - REPORT BY DEPUTY MANAGING DIRECTOR

The Acting Chairman stated that the staff was currently preparing a paper reviewing the jurisdictional implications of official clearing and payments arrangements. It was expected that that paper would be discussed by the Executive Board after the Annual Meetings. In the exercise of its jurisdiction over exchange restrictions under the Articles of Agreement, the Fund had found that official payments or clearing arrangements gave rise to exchange restrictions where they provided for the settlement of balances less frequently than every three months. Accordingly, the staff advised members that arrangements that provided for longer settlement periods were inconsistent with the Fund's Articles.

However, in the context of the preparation of the staff paper for the forthcoming review, it had become clear to the staff that adequate information on that question had not been provided to all members, and that some members were under the impression that arrangements providing for longer settlement periods, particularly in the case of regional arrangements, did not give rise to exchange restrictions, the Acting Chairman continued. In order to address those cases, and pending completion of the forthcoming review of the jurisdictional implications of official arrangements, management would shortly propose that the Executive Board temporarily exempt existing official arrangements from the application of the Fund three-month rule. The proposed exemption would only apply to such arrangements in force on July 1, 1994, and remain effective until completion of the forthcoming review.1/ The proposed exemption would not in any way affect or prejudice the outcome of the Board review of the jurisdictional implications of official clearing and payments arrangements, which he expected would reaffirm the Fund's traditionally strong stand against bilateralism.

1/ See "Official Clearing and Payments Arrangements - Temporary Exemption from the Three-Month Rule (SM/94/188, 7/14/94); and Decision No. 10749-(94/67), adopted July 20, 1994.

Those matters would have important implications for decisions that the Board would be taking in individual country cases with respect to approving or not approving certain restrictions, the Acting Chairman concluded. The staff would be presenting to the Board a broader policy paper, in order to eliminate any perceived or actual inconsistencies and avoid the perception in some countries that there was not uniform treatment on that matter on the part of the Fund.

4. RWANDA - REPORT BY DEPUTY MANAGING DIRECTOR

The Acting Chairman made the following statement on behalf of the Managing Director:

> The Fund has received a fax dated June 10, 1994 from Mr. Ntirugirimbabazi, signing as Governor of the National Bank of Rwanda, asking for a reserve tranche purchase by Rwanda in an amount of US$10 million.
>
> The above fax does not meet the formal conditions required to be considered a valid request for the use of the Fund's resources. In normal circumstances, the request would have to be reiterated in the proper form to be acted upon and the purchase, being a reserve tranche purchase, would be made without Executive Board involvement.
>
> However, the circumstances of Rwanda are not "normal". In fact, the legal, political and military situation in Rwanda is so confused that the Fund cannot at present determine with any certainty whether or not there is a government in Rwanda, which group of combatants constitutes the government, which group has effective control of the country, whether Mr. Ntirugirimbabazi is still Governor of the National Bank of Rwanda, or, if he is, whether the National Bank is still the fiscal agent of the government.
>
> In view of the exceptionally uncertain circumstances summarized above and, in particular, the fact that there is no government in Rwanda with which the Fund can conduct financial transactions at the present time, 1/ and also taking into account past Fund practice in similar circumstances, I have delayed sending any reply to the above-mentioned communication, pending clarification of the political situation in Rwanda. As this is an exceptional situation, I believe that you should be aware of the action that I have taken.

1/ It is noteworthy that the OAU, at its recent meeting of heads of state and government in Tunis, has avoided taking sides in the Rwandan conflict and allowed both political factions to attend the meeting.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/94/57 (6/24/94) and EBM/94/58 (6/30/94).

5. COMPENSATORY AND CONTINGENCY FINANCING FACILITY - COMPENSATORY FINANCING OF FLUCTUATIONS IN COST OF CEREAL IMPORTS - EXTENSION

Paragraph 23 of Section IV of the Decision on the Compensatory and Contingency Financing Facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended), shall be amended to read as follows:

> Until January 13, 1996, the Fund will be prepared to extend financial assistance subject to the provisions of this Decision to members that encounter a balance of payments difficulty produced by an excess in the cost of their cereal imports. (EBD/94/106, 6/22/94)

Decision No. 10725-(94/58), adopted
June 24, 1994

6. NEPAL - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from May 30, 1994, Nepal has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/94/108, 6/24/94)

Decision No. 10724-(94/58), adopted
June 28, 1994

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 94/2 and 94/3 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/94/106 (6/23/94), EBAM/94/106, Sup. 1 (6/24/94), and EBAM/94/107 (6/28/94) and by an Assistant to Executive Director as set forth in EBAM/94/96, Sup. 1 (6/22/94) is approved.

9. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/94/48 (6/24/94) and EBAP/94/49 (6/29/94) is approved.

APPROVAL: April 4, 1995

LEO VAN HOUTVEN
Secretary