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Minutes of Executive Board Meeting 85/10

3:00 p.m., January 23, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	M. K. Bush
	M. Lundsager, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
M. Finaish	T. Alhaimus
	M. Sugita
G. Grosche	D. Hammann, Temporary
	Z. b. Ismail, Temporary
	G. W. K. Pickering, Temporary
	J. R. N. Almeida, Temporary
	K. A. Hansen, Temporary
R. N. Malhotra	A. S. Jayawardena
E. I. M. Mtei	S. M. Hassan, Temporary
	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
	G. Ortiz
	J. de Beaufort Wijnholds
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	R. Msadek, Temporary
	T. A. Clark
S. Zecchini	N. Coumbis
Zhang Z.	Wang E.

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

Also Present

Asian Department: K. A. Al-Eyd, M. J. Fetherston, I. Otani, D. A. Scott, S. Takagi. European Department: R. P. Hicks. Exchange and Trade Relations Department: J. O. Bonvicini, E. H. Brau. External Relations Department: N. K. Humphreys. Fiscal Affairs Department: C. Schiller. IMF Institute: A. Hilmy, Participant. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder. Middle Eastern Department: S. von Post. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell, A. Chopra, M. C. Deppler, R. A. Franks. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: S. I. Fawzi. Bureau of Statistics: W. Dannemann, Director; J. B. McLenaghan, M. R. P. Salgado. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, G. Castellanos, M. Z. M. Qureshi, E. M. Taha, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: I. Angeloni, Chen J., J. de la Herrân, J. J. Dreizzen, G. Ercel, N. Haque, G. D. Hodgson, J. M. Jones, H. Kobayashi, K. Murakami, J. D. Robinson, J. E. Rodríguez, A. A. Scholten, A. J. Tregilgas, E. L. Walker, B. D. White, A. Yasseri.

1. MALDIVES - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/85/9, 1/23/85) their consideration of the staff report for the 1984 Article IV consultation with Maldives, together with a proposed decision concluding the 1984 Article XIV consultation (SM/85/4, 1/2/85; and Sup. 1, 1/18/85). They also had before them a report on recent economic developments in Maldives (SM/85/11, 1/9/85).

Mr. Msadek observed that the Maldivian economy was subject to the vagaries of international trade, on which it depended almost entirely. The fishing, tourism, and international shipping sectors represented 50 percent of both total employment and government revenue and accounted for the majority of exports. The authorities' public investment, monetary, and fiscal policies in the past five years had reflected the economy's dependence on the export sector. Economic performance had reflected the fluctuations of external demand for Maldives' products.

In the past five years two distinct economic periods could be identified in Maldives: between 1979 and 1982, when economic growth had accelerated to 15 percent of GDP; and between 1982 and 1984, when the rate of growth had reached a low of 4 percent reflecting the world's economic recession and a downward trend in the export sector, Mr. Msadek noted. During the first period, investment in the public and private sector had been financed from abroad with sizable inflows of grants, official loans, and private capital. Tourism had expanded, particularly as a result of the construction of the international airport. The public enterprise sector had contributed significantly to the revenues of the Central Government, for example, the State Trading Organization (STO) and the International Shipping Line had been responsible for more than one half of total nontax revenues. Furthermore, entrusted with the import and distribution of most essential commodities, the STO had prevented speculation on staple food products.

The overall budget deficit, including grants, had decreased from 25 percent of GDP in 1980 to 4.6 percent of GDP in 1982, reflecting increasing revenues, grants, and expenditure control by the authorities, Mr. Msadek noted. The dynamic performance of the three main export sectors had also contributed to the favorable fiscal position.

On the external side, the current account had declined from $22 million in 1980 to $19 million in 1982, Mr. Msadek observed. Imports had increased moderately, and tourism had expanded. The overall balance of payments deficit of $4.9 million had been the result primarily of lower export earnings owing to the collapse of the world market for tuna in 1982.

As for the second period, the Maldivian economy had deteriorated since 1982 reflecting the authorities' pursuit of an expansionary policy and unfavorable external developments, Mr. Msadek commented. The fiscal deficit had risen to 16.2 percent of GDP in 1983, following an increase in expenditure, decline in grants, and almost complete cessation of profit transfers from the shipping fleet, forcing the Government to increase domestic borrowing. Net credit to the public sector had grown by 27 percent and to the private sector by 36 percent.

Owing to a lack of experience and the limited effectiveness of monetary control in a small, open economy, the authorities had been unable to control monetary aggregates and to influence economic activity, Mr. Msadek noted. Foreign exchange earnings had declined because of the shipping fleet's difficulties and a 30 percent decline in fresh fish exports. The balance of payments had deteriorated from a deficit of $4.9 million in 1982 to a deficit of $11 million in 1983. Gross reserves had fallen from $9 million in 1982--2.4 months of imports--to $5.2 million in 1984--one month of imports. Maldives' external position had deteriorated with the expiration of the grace period on the foreign loans used to finance the Development Program embarked upon in the early 1980s. The debt service ratio had been relatively low in the 1980s, reflecting the concessionary nature of many loans but had risen substantially with increased payments of principal and interest of loans to cover the losses of the shipping sector and the balance of payments deficit. Debt service payments had increased to $10 million in 1983, 21 percent of exports of goods and services.

Favorable external developments and measures taken to strengthen the main economic sectors had improved the economic performance in 1984, Mr. Msadek observed. GDP was estimated to grow by 8-9 percent, and the balance of payments deficit was projected to be reduced to $4 million in 1984 as a result of the restructuring of the shipping line, a rebound in tourism following the recession, better fish exports, and the streamlining of grants reflecting increased efforts by the World Bank. A less expansionary financial policy had been adopted, and the fiscal deficit contained. Nevertheless, the balance of payments position--characterized by large trade account deficits, because all consumer goods except fish, were imported--remained weak, owing to the high level of external debt and low level of reserves. Those deficits, however, were offset partly by surpluses in the services and transfer accounts.

Despite a small increase in merchandise exports and better tourism receipts, the balance of payments registered a deficit of $4 million in 1984, financed primarily through short-term borrowing, Mr. Msadek noted. The authorities must learn from the postboom period, when expenditure had risen to cover increases in wages and recurrent costs of capital projects. The 1985-87 Development Plan should aim at a moderate rate of growth of about 5-6 percent, thereby lessening the burden on the external position, particularly as much of the investment on infrastructure would have to be financed from foreign sources. Imports should be restricted to the level required to meet projected rates of economic growth, and emphasis should be placed on improving exports and receipts from invisibles by improving fish production, tourism, and other exports. The balance of payments outlook was not bright given the high debt service burden. The pursuit of appropriate adjustment policies, particularly revenue-raising measures aimed at reducing the fiscal deficit, was therefore essential. Even though GDP growth in 1984 was estimated to be 13 percent rather than the 8-9 percent originally projected, cautious monetary and fiscal policies were necessary to limit the debt burden. In conclusion, his chair supported the proposed decision.

Mr. Jayawardena remarked that Maldives' economic performance in 1984 indicated that the economy had the potential to rebound from the slack of 1983, which had been the result of external factors. Developments had been generally favorable in 1984: real GDP had grown by about 13 percent; the rate of inflation had declined to 2 percent; the growth of broad money and domestic credit had decelerated; and the fiscal deficit, relative to GDP, had declined by 8 percentage points. Furthermore, the overall balance of payments deficit had been reduced to $4 million, an improvement of almost $11 million.

The staff regarded a 5 percent annual growth rate to be desirable in the medium term, as a higher rate of growth could lead to an unsustainable external position, Mr. Jayawardena noted. Based on experience in Maldives, however, an annual rate of growth of 8-9 percent appeared feasible. The staff estimated that if the authorities were to pursue development policies promoting a rate of growth of about 9 percent a year, the external current account deficit would double by 1989, and the overall balance would deteriorate significantly, indicating the need for an increase in external borrowing as concessionary capital flows declined. The differences of view between the staff and the authorities should have been spelled out in the staff paper so that the Board could make a more informed judgment. If foreign resources could be mobilized on concessional terms, strengthening the external current account, the growth target could be pitched higher than 5 percent, particularly given the need for infrastructural development.

Moreover, the staff projections did not indicate how the medium-term prospects would change if the growth rate were lowered to 5 percent, Mr. Jayawardena went on. The external position might, in fact, be weaker with a growth rate of 5 percent than if a growth of 9 percent were achieved. Details on the balance of payments position under different assumptions would throw light on the financial inflows that were expected and on their impact on the economic variables. Furthermore, a high current account deficit could be sustainable if the capital inflows strengthened export earnings or led to import savings and if the resulting debt service burden was manageable. Although the country's debt service burden was rising, its manageability was difficult to determine from the staff report. However, a high growth strategy might be difficult to sustain. The authorities might, in fact, share that view as evidenced by their reduction in public expenditure in 1983.

Some centralization of expenditure was desirable, and the fiscal deficit should be kept under control, in particular by requiring central government approval for foreign borrowing, Mr. Jayawardena considered. Additionally, steps should be taken to raise revenues, and projects should be assessed on the basis of the prioritites outlined by the Government in a medium-term development plan and on their potential to strengthen the external position.

The staff had urged that credit growth should be kept below 9 percent in 1985, based on a growth rate of about 5 percent and a rate of inflation of 4-6 percent, Mr. Jayawardena noted. Its suggestion to raise the cash reserve ratio, particularly for foreign liabilities of banks, was worthy of consideration. The staff feared that the authorities' issuance of treasury bills might weaken fiscal discipline, and it urged the monetary authorities to issue savings certificates with an interest rate set above the prevailing market rates on deposits in order to absorb excess liquidity. He wondered in what way one instrument was superior to the other. Were there special circumstances in Maldives that had caused the staff's apprehension with respect to treasury bills?

The authorities had been considering a reform of the tariff system, Mr. Jayawardena commented. How much progress had been made on that front? The rufiyaa had become overvalued because of the authorities' preoccupation with unifying the exchange system. They should consider the staff's suggestion to peg the rufiyaa to a currency basket rather than to the U.S. dollar.

Maldives had, until recently, been a single product exporter, but the development of the fisheries, tourism, industries, and shipping sectors had led to economic diversification, Mr. Jayawardena observed. The satisfactory growth and inflation record, under difficult external circumstances, demonstrated the resilience of the economy and reflected the authorities' sound management of the economy. The efficiency with which they had acted following the economic deterioration in 1983 augured well for the future. A pragmatic approach to economic development, leading to stable growth with a flexible exchange rate policy and sustainable external position, was the best strategy for Maldives.

Ms. Lundsager noted that Maldives, a small and open economy, was vulnerable to external developments. While fluctuations in economic activity might be beyond the authorities' control, the impact of exogenous developments could be softened. The authorities had maintained a high rate of growth at the cost of large imbalances in the economy. While adjustments had been made in 1983, stronger measures were necessary--such as pegging the rufiyaa to a trade-weighted basket of currencies or the SDR. Realistic prices would then be paid for imports, and the authorities might be forced to restrain their overambitious development program. Because Maldives' dependence on imports would remain high, a strong export base was needed; high local currency prices would stimulate increased production and diversification of exports. The impact of a currency adjustment on the supply of, and demand for, foreign exchange could reduce the large current account deficit, which had reached 35 percent of GDP in 1983 and had fallen to 26 percent of GDP in 1984. Those deficits had been financed by extensive borrowing. The growth in total outstanding external debt to more than 110 percent of GDP and short-term debt to 40 percent of GDP was clearly unsustainable, and the medium-term external debt scenario, based on the current development strategy, should indicate to the authorities the need for comprehensive policy changes.

The exchange rate adjustments that she had suggested would not be sufficient to reverse the projected trends, however, and she strongly urged the authorities to moderate their development plan, reduce government spending overall, and implement a restrictive credit policy, including the staff recommendations relating to reserve requirements on deposits and foreign liabilities, Ms. Lundsager stated. In that regard, she was discouraged to learn that the budget deficit was expected to increase rather than be reduced in 1984. The authorities should re-evaluate their budgetary policy. In conclusion, she supported the proposed decision.

Mr. Hammann indicated that he agreed with the staff appraisal and supported the proposed decision. The stance of policy adopted in a small, open economy would have more immediate repercussions than in larger economies. The reduction in the fiscal deficit and less expansionary stance of monetary and credit policy in 1984 had, therefore, contributed to the improvement in the external position, which had been helped by favorable exogenous conditions. A strengthening of that policy, a more flexible exchange rate policy, and reduced reliance on foreign resources was required to ensure sustainable ecomonic growth.

Unfortunately, however, the authorities appeared determined to stick to an expansionary growth strategy, which would lead to a further deterioration in the external current account and heavy recourse to short-term foreign financing, Mr. Hammann noted. The staff had indicated the consequences of such a strategy in the medium term. Thus far, foreign resources had been readily available from donor countries and the international capital markets, but the expansionary strategy would leave serious balance of payments difficulties in the medium and long term, forcing the authorities to terminate that approach. A more appropriate adjustment and development strategy, particularly with respect to fiscal policy, had been outlined by the staff.

Fiscal policy should be geared toward reducing the budget deficit and addressing the structural weaknesses, Mr. Hammann stated. The narrow revenue base was cause for concern; revenues were either derived from trade or profits of public enterprises. No income tax was collected at present. Technical assistance by the Fund in designing a balanced revenue structure might be advisable. Increased control over capital expenditure was desirable, and priority should be given to monitoring and controlling public expenditure.

A more flexible exchange rate policy should be adopted, Mr. Hammann considered. The continuing real appreciation of the rufiyaa was an important cause of the external imbalances. Whether to peg the currency to a trade-weighted basket or the SDR deserved further consideration. The detailed financial program outlined by the staff provided a framework within which policy choices could be meaningfully discussed.

Mr. Prowse endorsed the staff appraisal, supported the proposed decision, and urged the authorities to consider the detailed adjustment program outlined by the staff. Although Maldives had not exhausted its capacity to borrow from the market, it needed Fund guidance.

Maldives was made up of 1,200 islands, constituting only 300 square kilometers, Mr. Prowse observed. The economy's vulnerability to external developments should be taken into account when analyzing the economic variables. The Maldivian economy had performed well in 1984; the rate of real GDP growth had doubled, government revenues had increased, the fiscal deficit had been reduced, and the overall balance of payments deficit had been halved. However, those improvements stemmed primarily from the recovery in the world economy, improvements in the terms of trade, generosity of donor countries, and the authorities' delay in implementing some externally financed projects. The trend of medium- and long-term external debt, low level of gross official reserves, and real appreciation of the exchange rate were cause for concern. Additionally, the fiscal deficit, equivalent to 11.4 percent of GDP, including grants, was unsustainable. Even given Maldives' access to external finance, the present rate of growth was unsustainable. The underlying balance of payments situation was weak and the medium-term scenario, based on the authorities' present policy stance, indicated that the overall balance of payments would deteriorate significantly, and external debt would increase sharply.

While he recognized the authorities' concern with the need to strengthen the country's economic and social infrastructure and to expand the export-oriented sectors of the economy, a policy approach directed toward achieving a rate of growth that was too high would jeopardize their objectives, Mr. Prowse considered. The authorities should therefore seriously consider the staff suggestions before the economic situation deteriorated further. Could the staff indicate whether the authorities would increase their adjustment effort in 1985? What were the social and administrative factors constraining them in the fiscal area?

Mr. Zhang noted from the table on page 21 of SM/85/4 that the terms of trade of Maldives had changed dramatically in the past four years. The correlation between the changes in the terms of trade and the changes in the balance of imports and exports was poor. Between 1983 and 1984 the terms of trade had improved, but the balance of trade had remained unchanged. He would appreciate an explanation of those curious developments.

The staff representative from the Asian Department stated that the authorities were not progressing on the tariff reform as fast as originally envisaged. They had circulated a draft resolution of the proposed tariff structure to various agencies of the Government for comments and hoped that the final draft would be submitted to Parliament by end-February or early March. The tariff reform was aimed at rationalizing the existing system by classifying commodities according to three broad categories--basic items, necessary items, and luxury items. A more rational rate structure would also be applied.

On the merits of treasury bills versus certificates of deposit, the staff representative stated that the sale of treasury bills might give the impression to government agencies and the public that the authorities were advocating financing of the deficit, the staff representative remarked. The issuance of certificates of deposit by the monetary authorities was more appropriate than the sale of treasury bills by the Government at a time when the authorities were proposing to reduce the government deficit.

An appropriate peg for the rufiyaa was difficult to determine, the staff representative commented. A basket of currencies, whether trade-weighted or tourism-weighted, was not always perfect. The basket should be evaluated against the developments in the external sector and other economic objectives.

Regarding the lack of correlation between the fluctuations in the terms of trade and the trade balance, the staff representative pointed out that Maldives' exports were concentrated on small items whose price fluctuated considerably, particularly fish, and, more recently, garments. In 1982, the terms of trade had deteriorated sharply, reflecting a decline in prices of fish exports; however, in the same year, garment exports had increased rapidly, more than offsetting that adverse impact. Thus, exports had increased significantly.

The staff had calculated that the overall balance of payments deficit would stabilize at $3-4 million between 1985 and 1989, assuming that the authorities pursued policies aimed at an annual increase of about 4 percent in real GDP and an annual rate of inflation of 4-5 percent in every year through 1989, the staff representative stated. The debt situation would improve, and total outstanding debt by 1989 would be one half of that indicated in Table 5 of SM/85/4. The staff had urged the authorities to pursue a more moderate growth strategy.

Although the authorities had been in broad agreement with the staff's assessment of the Maldivian economy and its concern for the future and the sustainability of the present growth strategy, they had indicated that the population of the outer islands had been criticizing the Government for neglecting its needs, the staff representative from the Asian Department commented. Some groups within the Maldivian population were pressing for increased economic growth.

Mr. Finaish remarked, on the question of the development strategy, that Maldives was a new country and that the authorities were concerned with providing the basic infrastructure, such as roads, water supply, and schools. The Maldivian economy was performing relatively well given its vulnerability to external developments, such as problems in a neighboring country and quotas imposed by the United States on textile imports from the Maldives. The authorities were directing efforts toward expanding tourism, fishing, and manufacturing. They had also made efforts to keep the development policy largely in line with the availability of foreign assistance, balance of payments, and demand management considerations, and the absorptive capacity of the country. In addition, the formulation of policy remained cognizant of social constraints. The authorities did not consider that they lacked the ability to implement projects, which had been delayed largely for technical reasons, such as delays in the preparation of feasibility studies, the delivery of ships, or appraisals from some multilateral institutions. With respect to the disbursement of loans, seven countries had made commitments at the donors' meeting in Paris in July 1984, but only Pakistan and Sri Lanka had actually made some disbursements.

On monetary policy, reserve requirements for banks were already 25 percent, which was not low by international standards, Mr. Finaish observed. Moreover, the use of reserve requirements as a monetary instrument would raise the rates of interest of the monetary agency and might affect the ability of the STO to import essential goods. Interest rates were already positive in real terms.

With respect to the exchange rate, the authorities were willing to consider the staff's suggestion to peg the rufiyaa to the SDR or a currency basket and had requested technical assistance for that purpose, Mr. Finaish commented. They also recognized the need to limit future external debt. The National Planning Council was required to approve any new loan commitment, which would be made only if the project was expected to generate or save, directly or indirectly, foreign exchange. The debt service ratio was expected to remain well below 20 percent in the medium term. The wage bill had increased in 1984 because the authorities had raised some wages to provide incentives for civil servants to move to the outer islands.

The Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They noted the strong performance of the economy in 1984, with a significant expansion in economic activity and a noticeable reduction in the deficits of the overall balance of payments and the Government's fiscal operations. The favorable outcome was attributable to a combination of an improvement in the world economy, unexpectedly large grants from donor countries, and a less expansionary financial policy of the Government.

At the same time, Directors noted that the Maldives economy was very susceptible to external factors and that Maldives continued to face structural weaknesses in the balance of payments which were likely to be aggravated by the continued pursuit of a development strategy aimed at a high rate of growth in real GDP through a rapid expansion in public investment expenditure. Directors expressed concerns about the medium-term consequences of such a strategy and encouraged the authorities to adopt policies geared toward strengthening the external payments position and achieving a realistic growth rate. In this context, Directors believed that it would be appropriate to adopt a somewhat less ambitious development program and that the authorities should intensify their adjustment efforts.

Concern was expressed about the sharp increase in the overall fiscal deficit envisaged by the authorities in 1985, and it was felt that this deficit should be reduced substantially by strengthening revenue efforts, including a widening of the revenue base, and by being more selective in undertaking development projects, thereby reducing the growth of capital expenditure. In addition, the importance of tightening control over public expenditure was stressed. Directors also urged that credit expansion be further restrained, and some speakers alluded to a possible increase in reserve requirements. Directors noted that the present exchange rate arrangement had contributed to a secular appreciation of the rufiyaa in both nominal and real effective terms, aggravating the underlying weakness in the balance of payments. They stressed that the authorities should maintain a flexible exchange rate policy geared toward improving the external payments position. They believed that the authorities should consider moving away from a single currency peg to, for instance, a trade-weighted or an SDR basket. Noting the rapid growth of external debt in recent years to a level that well exceeded GDP, Directors urged caution with regard to foreign borrowing, particularly at short term, and suggested that administrative supervision of those operations would be tightened.

It is expected that the next Article IV consultation with Maldives will take place on the standard 12-month cycle.

The Executive Board took the following decision:

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Maldives, in the light of the 1984 Article IV consultation with Maldives conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Maldives maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Decision No. 7891-(85/10), adopted
January 23, 1985

2. CLASSIFICATION OF COUNTRIES

The Executive Directors considered a staff paper containing a proposal to simplify the system for classifying countries in certain types of Fund documents and publications (SM/85/8, 1/3/85; Cor. 1, 1/17/85; and Sup. 1, 1/17/85).

The Chairman said that it would be helpful if Executive Directors could offer guidance on the proposal in SM/85/8, which was to limit the basic classification of Fund members to a single distinction between industrial countries and developing countries, with formally standardized subdivisions among the developing countries being based on geographic rather than on economic criteria. The staff need for flexibility in presenting a wider variety of data classifications for developing countries for analytical purposes had been stressed in SM/85/8.

Mr. Nimatallah stated that he supported the staff proposal to revise the existing classification of countries in the Fund's major publications for three reasons.

First, the present system had outlived its usefulness, Mr. Nimatallah considered. The need for flexibility had been widely recognized in the Executive Board's discussions in 1979 of the classification of countries (SM/79/275, 11/28/79; Cor. 1, 12/14/79; EBM/79/185 and EBM/79/186, 12/17/79). Moreover, subsequent developments in the world economy had made obsolete the rigid distinctions among the developing countries that were based on economic criteria. The present classification prevented analysis of the underlying picture; it had also been difficult to focus on new problems that had emerged--for instance, those relating to external debt. It was therefore timely and appropriate for the Fund to change its system of classification to one better suited to changing circumstances. The change was particularly important because the Fund was a prime source of statistical information for the international financial community.

Second, the new scheme of classification proposed by the staff had several advantages, Mr. Nimatallah considered. It was simpler, more flexible, and should be more lasting. It was based on known distinctions and geographical criteria. It provided a useful, broad framework for analyzing present and future developments in the world economy. It also gave the Fund the flexibility to select subgroups of countries for analytical purposes. The Fund could thereby to examine particular problems using ad hoc classifications. That broad but flexible framework should be of considerable benefit to other users of Fund statistics.

Third, while any change might lead to transitional problems, Mr. Nimatallah commented, users should be able to adapt. The transitional problems would also be eased because the present series would be continued for a reasonable period. In the longer run, of course, the users of Fund statistics should gain much from the move to a more appropriate and more realistic system of classification.

Mr. Prowse said that he had no objection to the proposed changes in classification. The points made by Mr. Nimatallah were well taken. Presumably, the classification would continue to evolve over time, and it would be important to retain flexibility. The inclusion of other selected subgroupings shown in Table 3 of SM/85/8 was potentially useful. Had consideration been given to the possibility of another subcategory, under Column C, on developing countries' debt ratios, and perhaps in Columns A and B also, covering small island economies?

Mr. Zecchini observed that the collection and presentation of statistics by the Fund served essentially two purposes. First, to back up economic analysis made within the framework of the Fund's activities, relating in particular to the preparation of the World Economic Outlook survey and the Annual Report. Second, to provide member countries and the public with consistent and comprehensive data on the international economy. Those two objectives had to be considered separately when questions of country classification were under study.

The basic issue was how to compile the most appropriate and useful subtotals, because data on all countries, although it might be arranged differently, were included in the Fund's statistics by individual country, Mr. Zecchini said. The guiding principle for purely analytical work should be to have a basic, simple, permanent classification but to adopt and to abandon additional specific classifications in response to particular analytical needs. De-emphasizing the distinction between oil and non-oil countries was appropriate in the present world economic situation. Clearly, nothing would prevent those or other distinctions from being reintroduced in future as the need arose.

The requirements were somewhat different, Mr. Zecchini continued, for the provision of data to member countries and to the public. Although users would eventually adjust, there was a dual need to ensure continuity of data for some of the older classifications and a historical basis for the new series. To include memorandum entries in the tables in International Financial Statistics (IFS) was acceptable. Among the key entries were the aggregates relating to oil exporting countries, non-oil developing countries, and the two subgroups in the latter category, comprised of the major exporters of manufactures and low-income countries. Member countries that received Fund data periodically on tapes would automatically be assured of the availability of historical data. However, to meet the needs of other potential users of data, consideration should be given to publishing statistical supplements containing retrospective series.

Mr. Wijnholds remarked that he endorsed Mr. Nimatallah's position. In carrying out its responsibility to provide the best possible analysis of the world economic outlook, management and staff had proposed a new classification that deserved support. It was not the task of the Board at the present stage to predict whether the staff's proposed approach would improve the quality and usability of the World Economic Outlook survey. The Fund also had a responsibility, as Mr. Zecchini had noted, to outside users of its statistics. But a surveillance exercise as important as the World Economic Outlook should be affected as little as possible by providing continuity to outside users of Fund statistics. In that respect, it would be important to include memorandum entries on the existing subcategories of oil exporting and non-oil developing countries in the statistical appendix to the World Economic Outlook survey. It seemed optimistic that users would adapt readily to new frames of reference. The staff should be prepared to continue to include memorandum entries for a longer time for users accustomed to certain data.

Ms. Bush commented that she sympathized with the staff in grouping developing countries in a variety of ways for analytical purposes. However, the existing two-way split between oil and non-oil developing countries remained useful for the presentation of raw statistics and analytical presentations such as those in the World Economic Outlook survey and the Annual Report. Users of Fund statistics in the U.S. Government and nongovernment institutions in the private sector still needed access to data broken down between oil and non-oil countries, particularly for looking backward to 1979 in analyzing the world economic adjustment problem and its impact on international financial markets. The existing two-way breakdown also provided data on terms of trade, export and import volumes, the prospects for exports, current account imbalances, the financing of such imbalances, the buildup and rundown of international reserves, and other variables.

It could not be foreseen when that distinction would cease to be important, although the need might become more evident as the world economic situation evolved, Ms. Bush continued. The transition from one method of statistical presentation to another might have to be made at some stage, but not abruptly. Furthermore, a change in the statistical base while progress in dealing with the problem of debt and the situation in international financial markets was still being evaluated would blur the resulting analysis. The financial and economic community relied heavily on statistics and information from the Fund, and the change proposed in SM/85/8 would make assessment of progress difficult. Therefore, keep the current presentation of data but give the staff as much flexibility as it needed for analysis. The oil/non-oil breakdown should be continued in all raw data as well as in the analytical presentation of statistics in IFS, the World Economic Outlook, the Annual Report, and other Fund documents as well. Of course, the staff should be allowed to focus its analysis on the oil/non-oil breakdown whenever the distinction was relevant to an understanding of developments and policies. Indeed, the staff should have the freedom to combine oil and non-oil countries into groups for analytical purposes in whatever way was convenient and useful.

Mr. Grosche remarked that it was easy to make a clearcut judgment of the staff proposal. A number of convincing arguments had been made by the staff in favor of simplifying the present classification scheme; Mr. Nimatallah had added force to some of those arguments. However, the subdivision of developing countries into oil exporters and non-oil producing countries had been helpful analytically. Nevertheless, the subdivision had become less meaningful over recent years. On balance, therefore, he could go along with the staff proposal provided that for the sake of continuity the existing subdivision was maintained as memorandum items in the main tables in IFS and the World Economic Outlook survey. The staff had that approach in mind, as could be seen from Table 3, Column A, on payments balances on current account.

Mr. Nguyen inquired whether the staff had taken into account the views of the World Bank staff for a better harmonizing of economic concepts and data. A possible interruption in statistical series, especially those relating to the World Economic Outlook, was a legitimate concern; thus, data should be provided on oil exporting countries and non-oil developing countries in a statistical annex to the World Economic Outlook survey.

Mr. Clark said that he approved of keeping the Fund's country classification under periodic review. Country groupings that proved useful at one stage might become obsolete with the passage of time. However, he approached the proposed reclassification with some caution. No categorization would be perfect, whatever criteria were followed. Although there were defects in the existing division between oil and non-oil developing countries and the three-way split of the non-oil developing country group, they were not serious. In fact, the starting point for the change was of less concern to him than the direction in which the proposal would ultimately lead. He was not sure that the grouping of nonindustrial countries on a geographical basis was necessarily the most useful one. Other bases were feasible, including per capita income, and it would be helpful to explore some of them before deciding on a new system that would have to be maintained for a number of years. Therefore, he would prefer to have more time to think about the options for reclassification.

Procedurally, a change in statistical definitions, even if it did not raise a major issue in itself, did affect a great number of users of Fund data, both in official and nonofficial quarters, including universities, private research and financial institutions, Mr. Clark noted. It would not of course be possible to conduct a survey of the needs of all those groups before a decision was reached. However, the staff proposal for significant changes in the system had been submitted to the Executive Board within the past three weeks, which had not allowed time for the U.K. authorities to consider the proposed change, let alone for them to obtain the views of other U.K. users of the Fund's statistics.

The flexibility made possible by new technology should be exploited, Mr. Clark said, but a standardized categorization that was both useful and capable of general application was still necessary to deal with what would otherwise be an unwieldy number of various groupings. He also questioned the staff proposal to include groupings of countries in tables containing data on various specific areas. While it might be helpful to group together countries with, say, the largest debt, the individual amount of debt of each country might well need to be analyzed in relation to other characteristics of an economy--for instance, the fiscal deficit or the rate of inflation. Again, he endorsed the remarks by other Directors about the need for flexibility in collecting statistics to analyze a specific issue; the way in which data should be presented was a different matter. Finally, had the staff proposal been discussed with the World Bank and other international institutions?

Mr. Alfidja said that he would be interested in the answer to the question raised by Mr. Nguyen and Mr. Clark about the extent to which the proposed reclassification had been coordinated with other international institutions. His specific question was how oil exporting countries would be classified in future. In Column A of Table 3 of SM/85/8, there was a new category of fuel exporters, but the memorandum items would remain broken down between oil exporting countries and non-oil developing countries according to the existing classification. Two countries in his constituency exported oil, although they were not included in the current category of oil exporting countries. How would they be classified in the future?

The Deputy Director of the Research Department explained that all fuel exporting countries would be so classified under the proposed definition in Table 3. For the sake of continuity, the existing distinction between oil exporting and non-oil developing countries would be retained for the memorandum items. Table 3 was illustrative, and the proposed category of fuel exporters was not being established as a fixed classification. Rather, the purpose of moving countries whose exports of oil--or countries that were heavily reliant on one particular commodity or type of product for 50 percent of their total exports--was to facilitate the analysis of their economy.

Mr. Almeida said that he had no problems with the staff proposal. However, like Mr. Grosche, he thought that it would be helpful to retain the present categories as memorandum items for about two years until there was no longer any economic rationale for doing so.

Mr. Sugita said that he could go along with the proposed new classifications provided that the staff paid attention to the interests of the users of statistics by extending the present series for as long as possible.

Mr. Schneider remarked that the simplification of the classification system raised two issues: the need to maintain continuity in the statistical data and the ability to adapt statistics to changing circumstances.

For purposes of continuity, he would be satisfied with memorandum items along the lines shown in Table 3, Mr. Schneider added. Otherwise, he welcomed the room being made for a more flexible analysis of different subgroups. The changed situation of the subgroup of major oil exporting countries justified a simplification of categories. If developments in the oil market in future years were to necessitate a further change in the classification, he hoped that it would be less difficult to agree on the categories than it had been when the Executive Board had first discussed the matter in 1979.

Mr. Ortiz stated that his chair could go along with the staff proposal, but he would be interested in knowing why the countries listed in Table 1 of SM/85/8 included, as mentioned in footnote 1, some but not all non-Fund members and dependent territories. He would also be interested in some clarification of the criteria used to classify countries as industrial or developing. In addition, he asked for an explanation of the rationale for including, under Column A in Table 3, major borrowers, newly industrializing countries, and small low-income countries as other selected subgroups. A country could very easily fall into more than one of those categories, which appeared to be based on a different concept from the other subgroups.

Mr. Mtei said that he had little to say about the staff proposal for reclassifying countries. Even with the current classification, which had been used since 1979, it had been possible to regroup non-oil developing countries into middle-income or threshold countries and least developed countries, depending on the task or issue at hand. Users of Fund statistics needed continuity, although it was no longer relevant to categorize countries as oil exporting and non-oil developing. In short, he could accept either the proposed reclassification or the current classification.

In the footnote to Table 1 of SM/85/8, the term "country" did not mean a territorial entity or state as understood in international law, Mr. Mtei observed. For instance, the staff had listed as a country the Faeroe Islands in Europe, and the Falkland Islands in the Western Hemisphere. However, one significant omission was Namibia or South-West Africa; he asked the staff to include that territory as an entity and to seek separate statistics and other data from the relevant authority currently administering Namibia. He had made that suggestion during the discussion of the 1984 Article IV consultation with South Africa, and he hoped that it could be implemented, if the Executive Board approved the new classification list.

Mr. Weitz said that his chair could support the staff proposal to revise the current classification of the countries in Fund publications. Basically, he agreed with Mr. Nimatallah's position. Also, like Mr. Ortiz and Mr. Mtei, he asked the staff to explain the rationale for including certain territories in Table 1.

Mr. Pickering observed that the staff paper was a useful review of the current classification system and presented some well-crafted arguments for a simpler, more flexible system. He could support the proposed change. However, some of the countries that had elected Mr. Joyce had reservations about eliminating the distinction between oil developing and non-oil developing countries because they believed that a good case could still be made for maintaining the current breakdown for developing countries for the time being. Last, it would be useful if the staff could select the number of key series appended to memorandum items in the transitional period. Staff response to additional requests from member countries for data would also alleviate concerns.

The simplified system was to provide classifications for the analysis of specific issues of current interest, Mr. Pickering noted. His concern was maintaining continuity in subgroup classifications between sequential Fund publications. Any new system, however well designed, would have peculiarities. The admitted weaknesses of the current system were many, but its important advantage was the users' familiarity with those weaknesses. Continuity should be kept in mind by the staff in designing subgroup classifications.

Mr. Hansen remarked that his chair could go along with the staff proposal but supported strongly the request for continuity. He also endorsed the request by Mr. Nguyen and Mr. Clark for information on the extent to which an attempt had been made to harmonize the proposed classification with that of other international organizations.

Mr. Malhotra said that his authorities could not take a definitive view on the staff proposal unless they had additional information. For instance, Table 3 of SM/85/8 did not indicate clearly whether the staff expected to classify countries by groups or subgroups as it needed, or whether the Executive Board's view would be sought beforehand. His authorities considered that country classifications were important and that any changes in them or in the subgroups should be made only after consultation with the member countries and the Executive Board.

He was concerned to maintain a degree of continuity in the Fund's statistical series, Mr. Malhotra added. It would have been helpful to have a fuller examination of the definitional problems arising out of the need, for instance, to distinguish between oil exporters and net oil exporting countries, in an attempt to improve the underlying concepts. The category of low-income countries had also been limited to cover small, low-income countries, for reasons that were not clear. In what subgroup would large low-income countries be classified?

His conclusion was that the existing classifications should be maintained for the World Economic Outlook survey under preparation, Mr. Malhotra said. Subsequently, a more definitive reclassification could be devised without leaving the matter entirely to the staff.

Mr. Zhang remarked that in principle he was in agreement with Mr. Malhotra. It would be helpful to have a more flexible classification system, but that was not a good reason for abandoning classifications that were useful, especially for purposes of economic analysis. The concept of oil exporting countries was of use, both in analyzing cyclical fluctuations and prospects for medium-term growth in those countries, all the more so because the oil exporting countries as a group were international creditors and changes in their cyclical balance of payments positions in the medium term could be quite significant. From time to time, the Fund might have to analyze those countries as a group, and he was not in favor of relegating that subgroup to a memorandum item.

A geographical classification was the most natural one, but it too sometimes presented difficulties, Mr. Zhang commented. On some continents, there might be many heterogeneous countries, in varying stages of development; on other continents, one country could have a dominating influence.

Referring to the proposed standard classification of countries in Table 1, Mr. Zhang noted that if the countries were the same as those for which data was given in the IFS World Table, reproduced in Table 2, then that should be stated clearly. Furthermore, it was stated on page 4 of SM/85/8 that the classification in Table 1 excluded certain countries because their national data were not strictly comparable to those used in IFS trade tables. There should be a separate table for eastern European countries. Romanian and Hungarian data might not be sufficiently comparable to that of other countries, but they were nevertheless included in IFS; if Poland became a member, would the data it provided suddenly become comparable?

Despite the illustrative nature of the categories in Table 3, Mr. Zhang added, he sought assurance that they would not be the standard ones used in preparing the World Economic Outlook survey for 1985, but that those categories would be used flexibly. As Mr. Malhotra had observed, the definition of a small low-income country, and by analogy, a large low-income country, posed a problem of definition. He also had difficulty with the concept of newly industrialized countries, and with the possible implications for trade negotiations. Finally, it seemed necessary to add a footnote to Table 1 that there were two Koreas in Asia.

Mr. Finaish observed that he was no more convinced now than he had been in 1979 that a good case could be made for distinguishing between oil exporting countries and non-oil developing countries. But because it was difficult to find a universally acceptable classification, it was necessary to look for one that was workable and acceptable to the majority, and he could accept the staff proposal in SM/85/8.

It was no longer relevant, if in fact it ever had been, to single out certain oil producing countries, Mr. Finaish considered. Many of the countries currently classified by the Fund as non-oil developing countries had become important oil producers. Moreover, the number of net oil exporters among developing countries had increased to 28 over the past several years. A classification that had clearly become deficient should not be used indefinitely, even as a memorandum item, for the sake simply of continuity. If at some future date it became useful to analyze oil exporting countries separately as a group, a more rational and up-to-date classification could be devised for the purpose. Several oil exporting countries that had previously been considered to have structural balance of payments surpluses had experienced significant deficits in the past few years. In fact, two oil exporting countries were among the seven largest debtors. He therefore supported the staff proposal to amend the present classification.

At the same time, it would be helpful to have an explanation from the staff of how it intended to arrive at the geographical categories of developing countries by continent, as shown in Table 3, Mr. Finaish said. Economic and political considerations in certain cases weighed as heavily as geographic ones. In 1979, for instance, many Executive Directors had raised questions about the inclusion of South Africa in the category of

African countries. A problem of a similar nature arose in the case of the Middle East. Furthermore, various international organizations used a different definition of the Middle East. He asked what definition the Fund would use.

Mr. Salehkhou stated that pending a more thorough review by the staff, he supported the continuation of the present classification. He looked forward to the staff's response to some of the interesting questions raised during the discussion, especially Mr. Mtei's question relating to the countries listed in the standard classification in Table 1, and the question relating to South Africa's inclusion among the countries on the African continent and the way in which countries in the Middle East would be classified.

The Deputy Director of the Research Department noted that one broad theme of the discussion was that any statistical presentation used for analytical purposes had to meet the goals of flexibility for changing circumstances and continuity for a frame of reference familiar to users of the statistics. He assured Directors that the staff would not sacrifice continuity, to which they attached great importance, in the interests of flexibility. The staff had been reluctant to propose increasing the number of categories presented as memorandum items as a solution because the tables would become more numerous and larger. The preference was to have a full measure of continuity, in particular with respect to the memorandum items on oil exporting and non-oil exporting developing countries, which were considered by Executive Directors still to be useful for analytical purposes. Those existing categories that had been found helpful in providing continuity would therefore be shown in the tables presented by the staff in connection with the forthcoming World Economic Outlook.

A second general but less overt theme of the discussion was how ambitious the change in the classification should be, the Deputy Director continued. The staff had limited its objectives to abandoning the formal distinction between oil exporting and non-oil developing countries. No attempt had been made to reclassify other countries or subgroups. It was not that the existing categories were entirely satisfactory; the considerations underlying the present classifications had been discussed in 1979. The immediate goal had been to enhance the staff's capacity to analyze developments for purposes of the World Economic Outlook. The minor change proposed was of course, as noted in SM/85/8, without prejudice to a more thoroughgoing discussion, which a number of Directors favored and which would cover some of the more difficult problems of classification. The existing classification by regions, dependent territories, and industrial versus nonindustrial countries might also not be fully satisfactory, but many of the issues raised in those respects during the discussion went beyond the limited scope of the staff proposal.

The staff recognized that geographical classification presented difficulties in all areas of the world but particularly in the Middle East, the Deputy Director noted. Therefore, no attempt had been made to alter the present definition of the Middle East for statistical purposes.

On the question of the various categories of countries and territories listed in the standard classification in Table 1, the Deputy Director explained that the list covered all countries for which data were currently submitted separately to the Fund. The only difference from previous presentations was that the 12 oil exporting countries had been allocated to their respective geographic regions.

Because the proposed changes in the standard classification were so limited, the Deputy Director continued, consideration had not been given to moving toward the classification made by the World Bank. A further reason was that the World Bank's classification was based largely on per capita income, a basis that the majority of Executive Directors of the Fund had failed to endorse as a general purpose criterion when the issue had been raised in the Executive Board in 1979. An important issue for consideration in a more fargoing examination of the Fund's country classification system at a later stage would be the possibility and desirability of coordinating the Fund's presentation of statistics and classification of countries with those of the World Bank. In fact, the categories currently used by the two institutions differed more in their presentation than in their basic intent. Some of the illustrative stubs suggested in Table 3 of SM/85/8 had been put forward with the intention of facilitating comparative analysis. For instance, in the existing classification of major exporters of manufactures, the Fund included a number of countries whose export structure was not primarily oriented toward manufactures, such as Argentina, Brazil, and South Africa. The proposed subgroup of newly industrializing countries was closer to the category used by the World Bank and covered countries whose development had been based on the export of manufactures.

As noted in the footnote to Table 3, the subgroup of small low-income countries specifically excluded India and China, the Deputy Director remarked. All other low-income countries were covered by that category, the purpose being to analyze all countries with high debt service ratios. India and China had relatively low debt service ratios, and because of their size, their inclusion would totally distort the statistical aggregates.

The submission of statistics on a comparable basis was an obligation of Fund membership, the Deputy Director noted. Thus, countries that became Fund members, including Eastern European countries, would presumably be able to provide the type of data required for purposes of the World Economic Outlook.

Mr. Zhang remarked that if a group of low-income countries with high debt service ratios was to be singled out for analysis, it would seem advisable to so identify them.

The Deputy Director responded that the subgroups in Table 3 were of course illustrative, and would evolve as the staff developed its analytical presentations. The objective had been to look at small low-income countries in order to determine the extent to which they were highly indebted, rather than to separate out those countries having high debt service ratios. The staff would use the most revealing criterion for the purposes of its analysis, as Mr. Zhang had suggested.

The Chairman, in response to a question by Mr. Hassan about the inclusion of separate statistics on Namibia, confirmed that the objective of the staff paper had not been to change the standard classification in terms of the countries or territories included in current statistical presentations. Rather, the aim had been to shift the emphasis away from the distinction between oil exporting and non-oil developing countries toward one that paid more analytical attention to subgroups that distinguished more clearly between developing and industrializing countries.

There had been three different threads to the discussion, the Chairman observed. First, a majority of Executive Directors were willing to move away from the rigid classification of countries into oil producing and non-oil developing countries. Second, several of those Directors had nevertheless advised strongly against moving too hastily in that direction, in deference to the need of the users of Fund statistics for continuity in the presentation of data for the type of analysis they had been undertaking. Memorandum items would therefore have to be appended to tables, which might themselves include a greater number of classifications than in the past. Third, the illustrative nature of Table 3, with its inevitable blanks, had left a number of Directors uncertain about the way in which the staff intended to define the various subgroups and about how it would use those classifications. It would be necessary for the staff to provide Executive Directors with satisfactory explanations.

Ms. Bush remarked that she had been encouraged to learn that the existing classifications would be phased out slowly to preserve continuity. She asked whether the two memorandum items for oil exporting countries and non-oil developing countries would be included in all the tables for the World Economic Outlook and Annual Report.

The Deputy Director of the Research Department responded that the intention had been to include those memorandum items in all tables for which they had important analytical meaning, but not in those for which they were of less significance--for instance, in the tables on consumer price inflation. If it would reassure Executive Directors, the staff would make it a general practice to include those memorandum items in all tables to provide the desired continuity. The only inconvenience would be the proliferation of entries. The staff would make the most meaningful use of the statistics in terms of the analysis in the text.

Mr. Zhang commented that the purpose of the memorandum items was still not clear to him. Was the objective to continue simply to classify those two groups of countries in the same way, or would the staff actually use the data, if they revealed significant developments, as a basis for analysis? He also remained uncertain about the definition of the other new classifications in Table 3, although he recognized that they were for illustrative purposes. For instance, it would seem necessary to distinguish, in referring to primary exporters, between countries that exported fuel, other minerals, and agricultural products. As for the subgroup of newly industrializing countries, it would be essential to make a distinction between countries whose industrial output was exported, and those like India and China, where exports took second place to production for the domestic market.

The Deputy Director of the Research Department replied that memorandum items were usually added to tables to identify a subgroup that was not reflected in the way in which the table itself was disaggregated, the purpose being either to draw attention to a development of interest or to meet a specific request to highlight a subgroup.

As Mr. Zhang had suggested, it might be useful to clarify the distinction between fuel and other primary product exporters, the Deputy Director added. The precise grouping of newly industrialized countries for analytical purposes might again differ, depending on the type of analysis. For instance, as Mr. Zhang had mentioned, if the objective was to analyze the experience in those countries whose development strategy had been based on export-oriented manufacturing, China and India might well not be included in the definition. If the issue for analysis was the impact of protectionist measures in industrial countries on the export and trade position of developing countries, it might be necessary to include China and India. The staff would attempt to use classifications that had analytical meaning.

Mr. Finaish stated that he had heard no convincing arguments for continuing to divide developing countries into those exporting oil and those that did not. The staff itself had made a case for moving to a less specific and broader framework that would not restrict its ability to analyze relevant phenomena. Continuity had been cited as the main reason for retaining the oil/non-oil division; but if tables were not to become too complicated, there should be a clear understanding of the purpose of the memorandum items, as well as of the length of time during which they would be used. As he had already mentioned, it would always be possible to return to the old concept in the future, if it became useful, within the broad framework proposed by the staff.

Mr. Clark commented that he too was uncertain about how those countries currently divided into four categories--non-oil developing, low-income, exporters of manufactures, and middle-income countries--would be classified in the future. He was also still not sure that it was sensible to group countries differently depending on the issue for analysis and the type of data collected. It might be useful to try to correlate the debt situation of major borrowers with, for instance, the rate of inflation or the current account position for the group as a whole; but too many classifications of data and the heterogeneity of regional groupings suggested that it would be difficult to make a sensible analytical relationship between different aggregates.

Finally, Mr. Clark asked whether there was any particular reason why a matter that raised sensitive issues had been submitted to the Executive Board without enough time for consultations with the various interested parties.

The Deputy Director of the Research Department responded that the staff proposal had been submitted to the Executive Board at the present time because the staff would be hampered in its analysis of issues to be discussed by the Interim and Development Committees in April 1985 if it were confined to the country groupings used since 1979. The staff had not expected that its proposal would arouse so much interest.

The intention had been to replace the existing five-way division of developing countries by one covering issues selected for analysis, the Deputy Director continued. But in response to the desire of the Executive Board for continuity in the capacity for analysis, the existing groups would be retained, although as in the past the staff would still find it helpful to adopt various groupings for specific purposes--for instance, the analysis of debt.

Theoretically, there might be advantages in grouping countries in terms of the issues to be analyzed, the Deputy Director commented, but in practice, those advantages became less obvious. For instance, the major group of exporters of manufactures included several important Latin American countries with extremely high rates of inflation, and East Asian countries with low rates of inflation; none of the countries in the group had a rate of inflation anywhere near the average rate. The problems of countries confronted with high rates of inflation needed to be analyzed in relation to their causes, which might be monetary and fiscal policies; if countries were adversely affected by the terms of trade, then they should be classified based on the structure of their international trade. Certainly, wherever there were clear connections between one aspect of economic conditions or performance and another, the grouping should be defined consistently so that the implications could be analyzed. In sum, his concern was that retaining only one scheme of categorization would obscure the analysis for purposes of the discussion of the World Economic Outlook.

Mr. Clark added that the risk was that the heterogeneity within a group might lead to the conclusion that nothing could be learned from looking at the aggregates. In addition, providing data only for those variables that were considered to be related would prejudge the existence of relationships and would not be analytically helpful.

In response to a question by the Chairman, Mr. Clark noted that he was more concerned about how to divide 130 or so developing countries into groups than he was with the division between oil and non-oil developing countries, which would be covered in the memorandum items. Data should still be made available according to the existing four-way division of the group of non-oil developing countries.

The Deputy Director of the Research Department said that while the staff intended to move away from the old four-way classification, it was not impossible to provide data according to the existing classification wherever it had been given previously.

Mr. Malhotra said that the staff appeared to be saying that the existing classification was not being changed; but that two countries would no longer be included in the definition of low-income countries; yet, for a different purpose, the staff intended to treat them as newly industrializing countries. The concern of his authorities was precisely with the open-ended way in which the categories in Table 3 had been drawn up.

Mr. Nimatallah commented that flexibility argued for adopting a classification in response to a need to analyze a specific issue.

The Chairman reiterated that the majority view was in favor of shifting away from the predominant and rather rigid dual classification of oil and non-oil developing countries. However, it was agreed that users of the Fund's statistics should continue to receive data permitting them to draw the customary comparisons, until they became more familiar with the new classifications. Finally, the criteria to be utilized in introducing the classifications illustrated in Table 3 would need to be clarified, for the information of Executive Directors, in a note by the staff, especially as different international institutions used different categories in various publications, as did some private institutes. It should be noted that some of the definitions in Table 3 were already clear; for instance, a fuel exporter was a country whose fuel exports accounted for more than half of total exports.

The Deputy Director of the Research Department added that the subgroups selected for the analysis of inflation would be based on a somewhat arbitrary view of the point at which hyperinflation could be said to exist, as well as on whether such a rate of inflation would have to have been experienced for a year or two or for a period of several years to meet the definition. The staff had had in mind including from six to eight countries in that category. He could not say with any certainty how the staff would measure an average or low rate of inflation. Subgroups by predominant exports had been considered useful because if more than 50 percent of a country's exports were concentrated on any one commodity or on manufactures, its balance of payments should be analyzed based on developments in the terms of trade. The category of diversified exporters was a residual group consisting of countries that were less dependent on the performance of a particular category of goods.

The classification of countries by debt had so far been made in terms of the absolute amount of debt, the Deputy Director commented. It was appropriate to classify debt in that way in evaluating the significance of a country's debt for the world economic and financial system, but the impact of that debt on the country's economic performance and on its exports might not thereby be properly taken into account. The existing classification had almost invariably led to the exclusion of small countries with high debt burdens. Obviously, the sheer size of a country's debt would on occasions be a matter of international concern, in which case the existing classification would remain suitable. In the forthcoming World Economic Outlook survey, the subgroup of major borrowers would probably consist of about seven countries, as in the previous survey; the larger number of 25 used in the spring of 1984 had been unwieldy.

Mr. Nimatallah commented that users should be able to adjust to the new classification, as they had to the existing one, within a short period. The management and staff should be given enough discretion to decide on the appropriate classifications. Because of the unique character of the Fund, the criteria for classifying countries might need to differ from time to time from those of other organizations.

Mr. Zhang said that he understood Mr. Clark's preference for a standard classification that would make it possible to analyze the relationship between changes in variables. The staff had responded that if the relative share of manufactures in total exports was used as a basis for standard classification, it would be obvious that it could not be used for an international comparison of experience with inflation. But the correlation between exports of manufactures and consumer prices was a spurious one that should not be attempted. The argument in favor of a standard classification thus held.

Furthermore, Mr. Zhang remarked, the geographical classification was ambiguous. Would it be used to calculate correlations of economic variables based on the standard classification?

The Deputy Director of the Research Department said he agreed that the staff should not focus its analysis on the geographic classification, which did not provide an economic rationale for grouping countries. However, the geographical breakdown had considerable practical interest, and the staff did not propose to change it. For instance, countries were classified geographically in IFS.

Mr. Nguyen observed that his point had emphasized better coordination with the World Bank in developing new, harmonized concepts. The Fund should not be developing concepts for its own purposes.

Mr. Malhotra said that while he could appreciate the need for a certain measure of flexibility in the classifications, the interests of member countries should not be overlooked. He would prefer those issues to be clarified in a staff paper.

The Deputy Director of the Research Department explained that the need for new categories had become evident during the preparation of the World Economic Outlook survey. Too little attention had been paid in the past to the causes and consequences of high inflation because of the lack of a tractable subgroup of countries for the purpose. A vehicle for considering the impact of debt on the economic performance of indebted countries had also been lacking. Similarly, the utility of the oil/non-oil classification for analyzing balance of payments developments was much less useful than it had been in the early 1980s. The staff had also been without the advantage of a tabular presentation enabling it to follow developments in the terms of trade for countries producing manufactures rather than primary commodities, even though it had mentioned such factors in its analysis.

The addition of too many memorandum items to the existing classification might make the tables more difficult to use, but would provide Executive Directors with the information they needed to make the familiar relationships, the Deputy Director added. The staff had not expected to depart from its previous practice in the World Economic Outlook survey.

Mr. Ortiz recalled that he had asked whether the subgroup described in Table 3 as "according to other criteria"--namely, by major borrowers, newly industrializing countries, and small low-income countries--were mutually exclusive, like the other categories in the table.

The Deputy Director of the Research Department replied that those subgroups should probably be categorized as memorandum items, which were usually the only incomplete or mutually inclusive classifications in tables.

The Chairman concluded that the sense of the meeting was to streamline the existing classification of countries--industrial countries, oil exporting developing countries, and non-oil developing countries--first, by eliminating the dominance of the oil/non-oil distinction among developing countries; second, by redefining the regional subgroups of developing countries to include the oil exporting countries; and third, by providing scope for more elaborate and meaningful analytical groupings of developing countries. At the same time, in response to the wish of Executive Directors to give users of the Fund's statistical presentations the continuity they needed, aggregates based on the existing classification would continue to be published for an interim period. In addition, the staff would provide the rationale for any major and permanent regroupings among developing countries that it made over time, in light of changing circumstances in member countries and in the world economy. It should be noted that no such major change had been made for most of the categories in Table 3.

The points raised by some Directors relating to improved collaboration with other organizations, including the World Bank and the OECD, would be kept in mind, the Chairman added. The Fund would not make a major shift in its classifications without informing other agencies about its intentions, thereby offering them an opportunity to mention any major difficulties that they might have.

In response to a further question by Mr. Malhotra, the Chairman confirmed that the staff would provide more complete information on the categories that were illustrated in Table 3. If necessary, Executive

Directors could discuss the matter further with the staff in order to avoid to the extent possible the need for discussing such matters in detail in the Executive Board.

Mr. Malhotra explained that it was the novelty of many of the suggested classifications that had led his authorities to request more complete information.

The Deputy Director of the Research Department noted that the staff would try to explain the innovations fully. He suggested that it would not be necessary to provide a dual geographical classification for purposes of comparative analysis, since the only changes in the new standard classification in Table 1 were the inclusion of Indonesia in the Asian region, of Venezuela in the Western Hemisphere, of Algeria and Nigeria in Africa, and of a number of other oil exporting countries in the Middle East. Statistics could be made available separately to users, on request.

The Executive Board took the following decision:

> The Executive Directors agreed that the classification of countries used in several types of Fund documents should be adapted along the lines described by the Managing Director, in light of the discussion at EBM/85/10. 1/

Adopted June 5, 1985

APPROVED: October 25, 1985

LEO VAN HOUTVEN
Secretary

1/ See also World Economic Outlook - Classification of Countries (SM/85/8, Supplement 2 (3/5/85)).