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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/38

10:00 a.m., March 4, 1987

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Abdallah	
	Yang W., Temporary
C. H. Dallara	M. K. Bush
	D. C. Templeman, Temporary
	G. Seyler, Temporary
	C. A. Salinas, Temporary
M. Finaish	
	B. Goos
	A. Bertuch-Samuels, Temporary
J. E. Ismael	J. Reddy
	J. Hospedales, Temporary
	M. Foot
	S. King, Temporary
	H. Fugmann
	D. McCormack
Mawakani Samba	
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	
H. Ploix	S. de Forges
G. A. Posthumus	
C. R. Rye	
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
K. Yamazaki	M. Sugita
S. Zecchini	

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

Also Present

IBRD: F. Vakil, Western Africa Regional Office. African Department: A. D. Ouattara, Director; E. A. Calamitsis, S. E. Cronquist, M. G. Fiator, M. G. Gilman, G. B. Taplin. European Department: L. A. Whittome, Counsellor and Director; B. Rose, Deputy Director; A. Knöbl, K. A. Swiderski, T. M. Ter-Minassian. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; S. J. Anjaria, G. Bélanger, J. T. Boorman, E. Brau, S. B. Brown, N. Kirmani, P. J. Quirk. External Relations Department: P. J. Bradley, D. D. Driscoll, B. Nowzad. Legal Department: F. P. Gianviti, Director; W. E. Holder, A. O. Liuksila, J. M. Ogoola, J. K. Oh, S. A. Silard. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; M. A. El-Erian, S. H. Hitti, D. B. Noursi, G. Tomasson, M. Yaqub. Research Department: M. D. Knight, P. Wickham. Secretary's Department: G. Djeddaoui. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Computing Services: F. Partavi. Bureau of Statistics: C. A. Patel. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, L. P. Ebrill, J.-C. Obame, A. Ouanes, G. Pineau. Assistants to Executive Directors: A. R. Al-Abdullatif, F. E. R. Alfiler, J. de la Herrán, W. N. Engert, S. K. Fayyad, R. Fox, M. Hepp, L. Hubloue, O. Isleifsson, A. R. Ismael, K.-H. Kleine, V. K. Malhotra, T. Morita, R. Msadek, J. A. K. Munthali, C. Noriega, V. Rousset, D. Saha, G. Schurr, R. Manfredi Selvaggi.

1. UNITED ARAB EMIRATES - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with the United Arab Emirates (SM/87/20, 1/20/87, and Cor. 1, 2/13/87). They also had before them a background paper on recent economic developments in the United Arab Emirates (SM/87/39, 2/18/87).

Mr. Finaish made the following statement:

Following a period of exceptional growth financed by rising oil revenues, the United Arab Emirates has adjusted well to the steep decline in oil export receipts since 1981. The macroeconomic adjustment has been effected mainly through restraint in government spending, a policy stance that has also reflected the fact that the development of the country's social and economic infrastructure was nearing completion in the early 1980s. Reflecting the decline in growth impulses stemming from government domestic expenditures, growth in the non-oil sector slackened considerably, although some sectors of the economy, such as agriculture and large-scale manufacturing, were largely unaffected. Throughout this period of economic slowdown, which included some pressures on the government fiscal position and some difficulties in the banking sector, the external current account balance remained in surplus. The overall external payments balance remained in surplus as well, except in 1983 when it registered a deficit of about 1.5 percent of GDP.

In the face of declining oil revenues, the authorities have executed fiscal policy with flexibility, as government expenditures were significantly curtailed in all but one year since 1982. The contractionary fiscal policy stance was maintained in 1986 when government expenditures were reduced further by nearly 10 percent. However, with total budget revenues declining by about 36 percent during the year, mainly because of the sharp drop in oil receipts, the government budget deficit in 1986 is projected to have increased to double its level in 1985. It is to be noted that, notwithstanding the policy of fiscal restraint pursued by the authorities since 1982, the United Arab Emirates continued to be a source of sizable aid flows throughout the recession years. It is especially noteworthy in this regard that despite the substantial decline in government revenues during the year, official grants have increased in 1986.

Reflecting the policy of fiscal restraint and the general economic slowdown, the principal monetary aggregates have remained virtually unchanged in 1986. Commerical banks' claims on the private sector showed little change, although it should be mentioned that there has been some increase in consumer loans. Another development in the area of money and banking was the continuation of the improvement in the banking system that was brought about by the corrective consolidation measures undertaken by U.A.E. authorities in close cooperation with the Central Bank. This improvement in the banking system was corroborated by the findings of a Fund study, conducted in early 1986 at the request of the authorities. Yet another encouraging development in the banking sector was the adoption by several banks of measures aimed at reducing costs and enhancing profitability. Although total profits of the commerical banks in 1986 showed little improvement over their 1985 levels, which were adversley affected by provisioning for bad and doubtful loans, these measures are expected to bear fruit in the years ahead.

Developments in the external position of the United Arab Emirates in 1986 are indicative of the consequences of the collapse in oil prices as the surplus on the merchandise trade account and the surplus on the external current account are projected to decline to one third and one fourth of their respective levels in 1985. These declines were primarily accounted for by substantially reduced oil export receipts. However, notwithstanding these developments and in spite of a projected moderate overall payments deficit in 1986, the external position remains fairly comfortable. It should also be noted that, along with the U.S. dollar, the dirham has significantly depreciated vis-à-vis major currencies in 1986. Finally, the trade system has continued to be liberal, with import duties mostly approaching the lower end--4 percent--of the range agreed to by the Gulf Cooperation Council (GCC) member countries.

Looking ahead, the medium-term projections for the U.A.E. economy are highly sensitive to developments in the world oil market. Should there be a gradual recovery in that market in the period ahead, the economy, thanks to the substantial adjustment measures undertaken by the authorities, would seem to be well on the road to recovery and the resumption of normal growth. With most of the country's economic and social infrastructure already in place, the major focus of the authorities' medium- and long-term plans had shifted toward the diversification of domestic economic activities in a manner that will enhance the contribution to national income of the non-oil sectors of the economy. It is especially noteworthy in this reagrd that the authorities are currently actively considering means by which this diversification may be effected through an enhanced role of the private sector in the economic process. A helpful development in this regard is a recent agreement among the GCC countries permitting the national of any GCC member country to do business, including the undertaking of investment projects in any other member country on an equal footing with the nationals of the country concerned. Combined with a further consolidation of past adjustment efforts, it is hoped that enhanced cooperation within the GCC will help move the country to a new phase of recovery and sustained economic growth.

Mr. Al-Assaf made the following statement:

The United Arab Emirates has continued to adjust to the sharp deterioration in its export earnings and budgetary receipts owing to the steep reduction in oil prices. The authorities have reacted prudently and responsibly to these developments. They have reduced government spending, improved non-oil government revenues, and have, in the process, cushioned the impact of a reduction in fiscal stimulus to economic activity.

In the financial sector, I commend the authorities for their efforts aimed at consolidating the banking sector. In particular, I am impressed by the manner and smoothness with which the U.A.E. authorities overhauled the banking system. A strong and sound banking system, in view of the emphasis being given to the private sector, will be essential. I therefore encourage the authorities to continue to monitor the situation closely in the period ahead so as to prevent the recurrence of past problems.

Looking ahead, it is clear from the staff report that the overall economic position of the United Arab Emirates remains strong. The external account continues to register a healthy surplus, albeit much lower than in the past. As I see it, the main challenge facing the authorities in the medium term is that of restoring sustainable economic growth within the context of an economy that is more diversified and hence much less vulnerable to changes in the international oil markets.

Like other members of the Gulf Cooperation Council (GCC), the United Arab Emirates is in the process of shifting the orientation of its economy toward strengthening the role of the private sector. Whereas in the past the growth impulses were generated through massive economic and social infrastructural projects, it is clear that future growth will emanate from projects that are more attractive to the private sector. In this connection, the enhanced cooperation between member states of the GCC will facilitate the growth of the private sector in the United Arab Emirates as it will enlarge the size of the available market. This cooperation will help open up new investment opportunities to the private sector, in addition to providing markets for its goods and services.

In conclusion, as a result of the adjustment to recent developments in the oil market, the economy is emerging from a transitional phase with more efficient and more competitive private as well as public sectors and a sound banking system. This, together with a comfortable level of reserves, a substantial infrastructure, and an enlarged GCC market should help the United Arab Emirates diversify its economic base and resume a healthy and more durable growth.

Mr. Templeman made the following statement:

First, let me generally commend the U.A.E. authorities for the prudent way in which they have formulated and implemented their economic adjustment and reform efforts. Nonetheless, like other oil exporting countries, the United Arab Emirates experienced a shock to its economy from the sharp drop in world oil prices last year, with both oil export values and oil budget revenues falling 38 percent from 1985 levels. This has added some degree of urgency to the view expressed by the Board at the previous Article IV consultation that there was a need for further consolidating the economic adjustment effort and for fostering development of the non-oil sector. Specifically, the large decline in oil revenue points to the desirability of some additional strengthening of the fiscal adjustment effort, while the persistent decline in GDP in the non-oil sector last year underlines the continued need for economic diversification.

The staff report explains the weakness of the non-oil sector as reflecting such factors as: domestic payments delays, weakness in the construction and related manufacturing sectors, and the adverse impact of regional security problems on re-exports. It also mentions that agriculture and fisheries, while doing better, are subsidized. The authorities themselves cite the development of energy-based manufacturing by the private sector as a key to diversification over the medium term. We wonder whether anything additional might be said about the recent stagnation in the non-oil sector and about diversification prospects.

Despite the sharp drop in oil exports last year, it appears that the current account of the balance of payments may have remained in surplus by about \$1.3 billion. Of course, this is considerably less than the surpluses in the range of \$5.3 to \$7.5 billion of 1982-85. To some extent the decline in the U.A.E. dirham, in line with the declining dollar, has strengthened the U.A.E. competitive position recently. However, at least through October 1986, there had been a cumulative appreciation of the dirham against a basket of currencies by over 12 percent from the time when it was pegged to the U.S. dollar in November 1980. We wonder whether more recent exchange rate movements have further reversed that appreciation, and whether it can be concluded that any lost competitiveness has now largely been restored. The staff's medium-term balance of payments scenarios through 1990 suggest that competitiveness is not expected to be a problem, since a moderate upward trend in the current account surplus is envisaged, in the context, moreover, of a liberal trade and payments system, for which the authorities are to be commended.

The decline in oil revenues last year evidently contributed to a consolidated fiscal deficit of nearly 16 percent of GDP, continuing a generally upward trend in the deficit ratio since 1982.

In exploring the prospects for revenue increases and expenditure restraint, the staff and the authorities seem to come to the conclusion that not very much can be done very soon about either, and that fiscal deficits are likely to continue. It would be interesting to know more about the current level of interest payments on the public debt and on the medium-term outlook. We would hope that some way could be found, at least over the medium term, to boost non-oil revenues to some extent, given the low overall revenue ratio to GDP of about 20 percent and the fact that non-oil revenues only amount to a little over 3 percent of GDP. Similarly, the possibility of actually reducing the expenditure ratio somewhat should still be explored, as well as a possible shift in the mix of expenditures, as suggested by the staff.

In the financial market area, I would like to commend the authorities for the success achieved in strengthening the financial position of the banking system.

There seems to be room for improvement in U.A.E. statistics, if the authorities and the Fund are to be able to assess more reliably economic developments in the United Arab Emirates. For example, there are virtually no forecast data on the economic outlook for 1987. Evidently delays in publishing comprehensive oil and gas statistics, the lack of a domestic price index, and incomplete data on official holdings of foreign assets are important gaps. I would also take this opportunity to mention the importance of cooperation by the U.A.E. authorities in our new attempts to reduce the statistical discrepancy in worldwide current account statistics.

Lastly, I note that the authorities would like the United Arab Emirates to be put on a 12-month cycle for Article IV consultations. In light of our efforts to reduce the work load on the staff and the Board in this area, which are also on the agenda today, I wonder whether the authorities would consider, instead, remaining on an 18-month cycle or possibly adopting the simplified consultation procedure which has been proposed for Board consideration.

Mr. Salehkhou made the following statement:

The overall economic and financial performance of the United Arab Emirates--notwithstanding continuous adjustment efforts owing to the sharp decline in international oil prices in 1986--remained satisfactory, as elaborated in Mr. Finaish's statement. The authorities are to be commended for their cautious financial policy stance and timely implementation of corrective measures to cope with the difficulties facing the country. I also welcome the appointment of a committee to review the various issues raised by the conflicting provisions of religious and civilian laws on interest rates, as well as the promulgation of a framework law on Islamic banks, institutions, and companies. The financial shocks that hit the country at the time of the recession, resulting from the poor performance of commercial banks in providing doubtful and bad loans under the conventional banking system, necessitated focusing attention on Islamic banking, which is in close conformity with the nation's religious values. In this respect, I encourage the authorities to take full advantage of the available experience of several countries with the implementation of Islamic banking. Fund technical expertise in this respect could also prove most valuable.

Turning back to the financial performance of the United Arab Emirates, despite an increase of about 15 percent in oil and condensates production in 1986, export revenue from this sector declined to two thirds of its 1985 level, reflecting a sharper reduction in the world oil prices. Consequently, the authorities pursued a prudent fiscal policy of containing development expenditures in an effort to keep imports at the 1985 level. It is worth noting that the completion of huge infrastructural projects greatly helped the Government to adjust expenditures to the decrease in receipts from the oil sector. In this regard, while during 1986 the volume of imports remained unchanged compared with the 1985 level, payments for imports are estimated to have increased by 11 percent reflecting mainly the depreciation of the U.A.E. dirham against European currencies. Taking into account the stagnation in net service payments, the current account surplus fell sharply from less than one third of GDP in 1985 to 6 percent of GDP in 1986. However, the overall balance of payments position remained comfortable.

The overall fiscal deficit almost doubled in 1986 to 16 percent of GDP resulting from the steep decline in revenues from the oil sector. The actual deficit would of course be reduced markedly, if investment income were counted in the official budget rather than considered as part of foreign assets. However, given the uncertainty in the world oil market that has reduced the scope for increasing the revenue base, the implementation of further corrective measures on the expenditure side seems to be necessary in order to tackle promptly the financing gap. While I share the staff's view that it is difficult to envisage further significant reductions in either development or nondefense current budget expenditures, I believe that there may still be further room for some cuts on less necessary expenditures.

On the monetary front, the policies initiated since 1983 on the merger of the troubled banks and the reconstruction of their financial and liquidity position have been steps in the right direction. However, the United Arab Emirates remained "overbanked" and further efforts are called for to rationalize the commercial banking system.

In concluding, while I commend the authorities for their success in improving the coverage and currentness of statistical information, more remains to be done to close the existing statistical gaps. The authorities should also be encouraged to seek to narrow the existing differences with the Fund on generally accepted economic concepts such as investment income. This would help the authorities as well as the staff to improve their assessments of the economy.

Mr. Foot remarked first that he thought the staff report could have usefully devoted more time to ways to improve the fiscal position, which it was acknowledged would remain difficult for some time, and to the need to streamline federal budget procedures. Those procedures appeared less than satisfactory with a budget appearing only late in the year to which it related and with a somewhat arbitrary basis for funding the budget. The system had led to occasional domestic and external payments delays and must make it very hard to plan ahead on a coherent basis.

With respect to the banking sector, Mr. Foot continued, his authorities felt that the position continued to give cause for concern. It was noted on page 12 of the staff report that "the major part of past problem loans at the commercial bank level appeared to have been addressed in a satisfactory manner." But while much had undoubtedly been done, the Governor of the Central Bank had publicly stated, as recently as October 1986, that 30 percent of all loans to the private sector were nonperforming. He encouraged the Central Bank in its efforts to get banks to make adequate provisions against such loans and to obtain Central Bank approval before publishing their accounts and distributing profits. The matter was all the more important because of the uncertainty noted by the staff about the exact status of contracts involving non-Islamic payments of interest. He believed that courts in two of the major Emirates had taken a different line on that matter, and for the sake of the reputation of the United Arab Emirates as a regional financial center, it was vital that it be clarified as soon as possible.

He urged the authorities to improve the coverage and timeliness of statistics provided to the Fund, Mr. Foot added, with particular emphasis on the need for improvement in the external sector.

Finally, Mr. Foot stated that it was his authorities' view that members' requests for a 12-month cycle for consultations should be met. But he agreed with Mr. Templeman that the simplified 12-month cycle might be appropriate, particularly given the data weaknesses to which both he and Mr. Templeman had already referred.

The staff representative from the Middle Eastern Department said that the recent stagnation in the private sector had been brought about by the decline in investment activity since the early 1980s. The growth of the private sector in the previous decade had been very closely related to the rapid and substantial expansion of investment in economic and social infrastructure that had called for supporting services, which the private sector had been able to provide. With the subsequent decline of the pace of domestic investment, the need for adjustment in the private sector had become much more acute. During the recent consultation discussions, the U.A.E. authorities had raised with the staff the possibility of the Fund undertaking a special study of the manner in which the banking sector might more effectively support and encourage private sector development. In the past few years, the staff had taken on a number of special studies for the authorities on related issues, but after careful review on its return to Washington, the authorities had been advised that such a study would have to look at investment, production, and savings policies in a much more comprehensive manner than the Fund staff was equipped to undertake; therefore, they might profitably take up the matter with the World Bank and its affiliated institutions. The authorities were quite concerned about the substantial effort needed to promote the private sector, outside the oil and gas sector, to ensure a strong economy in future. They shared that concern in common with other member states of the GCC where the question of private sector development in the post-oil boom period remained a matter of active interest.

As for the fiscal performance in the recent past and the prospects for the future, the staff representative continued, while the published statistics on the fiscal accounts showed a serious gap between total outlays and recorded revenues, as had been noted, the sizable investment income earned on foreign assets was not included on the revenue side of the accounts. The staff was not in a position to estimate with any degree of certainty the magnitude of that investment income, with the result that it was uncertain whether indeed there was a sizable aggregate fiscal deficit in the United Arab Emirates, notwithstanding the decline in oil revenues during the past few years. The difficulty was that that uncertainty complicated the analysis of both the need for fiscal adjustment and the actual performance in that respect, highlighting the issue raised by both Mr. Templeman and Mr. Salehkhou of the need to improve the statistical base. The authorities were concerned about the need for a better compilation of statistics and coordination of statistical data collection between the different Emirates, and the Emirates and the Federal Government. The staff considered that the problem was due in large part to the political structure of the United Arab Emirates. The seven Emirates retained, under the provisions of the Federal Constitution, a high degree of independence in their economic and financial operations. The matter had been raised with the authorities during the course of the consultations, but both the staff and the authorities recognized that the endeavor was one for the longer term and that it would take a number of years to achieve significant results.

The massive efforts undertaken by authorities in the past two or three years to solidify the commercial banking sector still left some room for continued vigilance, as the staff had clearly indicated in its report, the staff representative observed. The Governor of the Central Bank in particular had given the highest priority to the continued pursuit of appropriate supervisory policies with respect to commercial bank operations.

In response to Mr. Foot, he noted that commercial banks were required to obtain approval by the Central Bank of their annual accounts prior to any distribution of profits.

The future development of economic activity in the region had become in the past few years very much a matter for consultation and effective cooperation within the framework of the GCC, the staff representative from the Middle Eastern Department commented. According to recent press reports, one important step in that direction had been taken during the past month in the form of an agreement by the Governors of the six GCC central banks to establish a cooperative currency system for the region along lines similar to those of the European Monetary System. In addition to fixing cross rates between the six national currencies with predetermined intervention bands, the central banks would establish lines of credit to be used in support of market intervention under guidelines that still had to be drawn up. Technical work on the details of the system was under way, but its final adoption was subject to acceptance by the six heads of state. Such an objective was one of the purposes of the GCC. Although the staff had prepared a technical report on the matter at the request of the GCC Secretariat in the past, it had not been specifically involved in the recent developments.

The staff representative from the Exchange and Trade Relations Department noted that there were probably arguments both for and against a longer consultation cycle for the United Arab Emirates. Many of the comments that had been made, for instance, with respect to the budget process and statistics, indicated the need for the staff to remain in frequent touch with the member. It seemed appropriate to ascertain further the wishes of the U.A.E. authorities, possibly in light of the outcome of the Board's guidance on simplified consultation procedures.

Mr. Finaish remarked that the Board had had an opportunity to familiarize itself with the general pattern of developments in a number of oil producing countries that had been affected seriously by the drastic decline in oil prices and oil revenues. To use Mr. Templeman's words, they had experienced a shock. Insofar as the United Arab Emirates was concerned, the price of oil had fallen from about $37 in late 1981 to about $8 in 1986; budget revenues in 1986 alone had fallen by about 36 percent; and the current account surplus had decreased in the past year by about one third.

The necessary response to those adverse developments was adjustment, Mr. Finaish said. The U.A.E. authorities had taken both demand-management and structural adjustment measures, and their development strategy had been recast to reflect those measures. Their emphasis had been mainly on the need to consolidate the adjustment effort, including a greater rationalization of government expenditures; an attempt to increase as much as possible non-oil domestic activities and their contribution to national income; and the need to emphasize privatization and an enhanced role for the private sector, following the huge investment in infrastructure and what might be called social overhead capital. Finally, there was the expectation that enhanced cooperation within the region, particularly in the framework of the GCC, would be helpful. Assuming a gradual recovery in export earnings in the period ahead, the U.A.E. economy would seem to be well placed to resume a normal rate of growth. Of course, the exceptional growth rates of the 1970s could not be expected to recur. Much would depend on the oil situation, because of its dominant role in the economy.

As for the need to reduce the budget deficit and possibly increase other sources of domestic revenue, Mr. Finaish observed that the fiscal impulse in the United Arab Emirates had been contractionary over the past few years. Given the structure of the U.A.E. economy, the impact of fiscal operations on domestic liquidity and economic activity was more appropriately measured in terms of net domestic expenditure: namely, domestic expenditure minus domestic revenues. Most receipts from oil exports accrued directly to the Government, and the initial impact on the money supply of increased oil export earnings, which would tend to increase the banking system's net foreign assets, was offset by a corresponding increase in the Government's deposits. It was only when the Government spent the increased revenues domestically that the money supply expanded. Thus, the primary transmission mechanism through which fluctuations in oil earnings affected domestic prices and nonpetroleum output was government expenditures which, as he had emphasized in his opening statement, had been drastically curtailed over the past few years.

Thus it became important to find a way to increase domestic revenue, Mr. Finaish added. The U.A.E. authorities had introduced certain measures to increase revenue, but as they had mentioned, certain constraints existed in that respect, probably in other countries in the region as well. Some of those constraints could be described as of a political and social nature. The population found it difficult to understand the requirement for additional government income, oil revenue having been the main stay in recent years, and the level of taxation in neighboring countries was also taken as a point of comparison. The issue of taxation was also relevant in the context of the need to enhance the role of the private sector. It would run counter to the objective of the authorities, which had been endorsed by the Executive Board, to give the wrong signal at the present time to the private sector. Likewise, the intention to promote the mobility of economic activities within the GCC countries would require coordination of new tax measures. Otherwise, the result would be a loss of competitiveness. An effort was already being made in that direction with respect to subsidized charges for public utilities. A collective effort to increase revenue that took into account the concerns of each country would promote factor mobility within the region itself and enhance the role of the private sector.

His personal view was that while there was a case for paying greater attention to increasing domestic revenue through taxation, the process would take time, Mr. Finaish remarked. Nevertheless, a start had to be made at a certain point. Certainly, it would be useful if there was sufficient public support on the part of the taxpayers for the idea of increasing revenue. The Secretariat of the GCC was discussing the matter, and attempts at coordination in the area were being made.

It would also take time to improve the presentation and coverage of the budget, especially because the Federation was relatively new, Mr. Finaish noted. In any event, the authorities had actively sought technical assistance from the Central Banking Department and the Fiscal Affairs Department. As to the currentness and coverage of the U.A.E.'s statistical data in general, he pointed out that while there was some room for improvement, significant progress had already been made. National income accounting was an area where such progress had been achieved.

Courageous measures had been taken to deal with the problems experienced in the banking sector in the 1970s, Mr. Finaish added. He was not aware of any problem loans. Adequate provisions had been made in that respect, and an active attempt was under way to improve the capitalization of the banks, in cooperation with the Central Bank. The department in the Central Bank responsible for the supervision of banks had been strengthened. A high level committee had been formed to study more carefully the issues raised by Islamic banking principles. The only Islamic bank, which was a very active and successful one, was subject like other commercial banks to the regulation and supervision of the Central Bank.

As for the length of the consultation cycle, Mr. Finaish noted that the authorities themselves wished to remain on a 12-month cycle. More frequent visits would enable the staff to give the authorities the advice that they apparently valued. Mr. Al-Assaf said that he agreed with Mr. Finaish that it was probably more appropriate to accede to the wishes of the authorities, pending the Board's conclusions on the general issue in the context of the review of surveillance.

The Acting Chairman made the following summing up:

> Executive Directors generally agreed with the views expressed in the staff appraisal. They noted that by 1986 oil export receipts had fallen to less than one half their peak level in 1981. In response to this development, the authorities had made substantial cuts in budget expenditures without undue sacrifice of important domestic economic and social development objectives.
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> Nevertheless, it was noted that the fiscal position of the Federal Government had been under sustained pressure because of reduced transfers to the federal budget of the prescribed share of current oil revenues by the oil producing Emirates. Directors welcomed the steps taken recently by the Federal Government to diversify its revenue sources. They suggested that the U.A.E. authorities should keep under review the possibility of introducing

in the medium term broader-based revenue measures in the interest of greater flexibility of fiscal management in the face of fluctuating oil revenues. Concurrently, recent efforts to rationalize government budget expenditures should be continued at both federal and Emirate levels. More generally, it was suggested that budget procedures could be strengthened to provide a more timely assessment of budget priorities and allocations.

The authorities were commended for the manner in which they had responded to the emergence of problem loans in the domestic banking system after the early 1980s. The action of the authorities had eased the short-term threat to the soundness of the commercial banking system. Nevertheless, Directors emphasized the continuing importance of active bank supervision by the Central Bank and the U.A.E. authorities in order to limit the chances of the recurrence of bad and doubtful debts on the scale of recent years. Directors also noted that a committee had been appointed to review and report on the various issues raised by the conflicting provisions of religious and civilian laws on interest rates.

The United Arab Emirates' external payments position has remained comfortable despite the decline in oil export earnings in recent years, reflecting partly a significant decline in import demand since the early 1980s. Staff projections suggest that the external payments position will remain reasonably strong in the medium term in the absence of unforeseen adverse developments. Directors viewed as appropriate the recent effective depreciation of the U.A.E. dirham brought about by its effective peg to the declining U.S. dollar, in light of the need to encourage greater diversification of economic activity outside the oil and gas sector and thereby create a more favorable environment for economic growth. They noted also that the U.A.E. authorities are currently consulting with other members of the GCC with a view to establishing a suitable framework for the future economic development of the country in the context of economic and financial cooperation on a regional basis. Such future development would be facilitated by the maintenance of the liberal exchange and trade policies which have been pursued by the U.A.E. authorities.

Finally, Directors also noted the need to improve the coverage and quality of statistics in the United Arab Emirates.

The U.A.E. authorities have expressed a preference for the standard 12-month cycle, with consultation discussions being held each year in March/April, when data become available on a calendar-year basis. Accordingly, it is expected that the next Article IV consultation discussion will be held in March/April 1988.

2. CENTRAL AFRICAN REPUBLIC - 1986 ARTICLE IV CONSULTATION; AND STRUCTURAL ADJUSTMENT FACILITY - POLICY FRAMEWORK PAPER

The Executive Directors considered the staff report for the 1986 Article IV consultation with the Central African Republic, together with a policy framework paper for access to resources under the structural adjustment facility (EBS 87/24, 2/6/87; Cor.1, 2/10/87). They also had before them a background paper on recent economic developments in the Central African Republic (SM 87/56, 2/26/87).

Mr. Mawakani made the following statement:

Economic and financial developments in the Central African Republic remained difficult in 1986, mostly as a result of unfavorable developments in the country's exports. GDP growth continued to slow down while the budgetary situation worsened. In the external sector, the deficit in the current account increased. Nevertheless, efforts aimed at improving the performance of the economy were made in 1986 in the context of an adjustment program. Unfortunately, these efforts turned out to be inadequate and led to some performance criteria not being met; thus, the program has become inoperative.

In the real sector, the growth of real GDP declined to 2.7 percent in 1986 from 3.8 percent in 1985 and 8.8 percent in 1984. The unfavorable development was largely a reflection of the low output of cash crops and the continued decline in the production of coffee, cotton, and timber. Activity in the construction sector picked up, mainly because of new infrastructural projects that were initiated. Some improvement in manufacturing output was also recorded. However, these positive developments were not strong enough to offset the adverse developments that contributed to the slowdown in GDP growth. To address these problems, the authorities are determined to pursue the comprehensive reform of the agricultural sector so as to diversify production. Greater emphasis will be put on promoting crop production for domestic consumption and export, as well as revitalizing the forestry sector's activity through improved feeder roads. As part of the authorities' strategy regarding the real sector, it is also envisaged to develop smalland medium-sized enterprises.

In the fiscal sector, the sluggish economic activity combined with a sharp drop in export prices for cotton and coffee caused revenue to decline in spite of a strengthening of tax collection procedures. This led to a substantial improvement in the collection of revenue from income and profits. On the expenditure side, the authorities continued their policy aimed at strengthening and monitoring current expenditure with emphasis on controlling the wage bill. Nevertheless, overruns occured mostly in extrabudgetary expenditures and resulted in an increase in the fiscal deficit for 1986. This outurn is a cause of concern to the C.A.R authorities. They therefore intend to strengthen the fiscal adjustment efforts pursued so far. In this connection, the authorities intend to take advantage of the recommendations made by the recent Fund technical assistance mission in order to improve fiscal revenue. They will continue their efforts aimed at strengthening tax collection procedures. On the expenditure side, strict discipline will be observed regarding current expenditures with particular emphasis on the wage bill.

With respect to the state enterprise sector, the process of reforming it was pursued in 1986. Indeed, with the assistance of the World Bank, a comprehensive reform program for public enterprises is well under way, with the main objective being the improvement of the productivity and the efficiency of these enterprises in order to reduce their financial burden on the Government. Under this program, in 1986, the airline company was liquidated, the state pharmacy was restructured, and negotiations were started with potential private partners for two other enterprises. As for the agricultural stabilization fund (CAISTAB) plans are also under way to strengthen its management and financial position.

In the monetary sector, the evolution of monetary aggregates was largely influenced by developments in the real and fiscal sectors. As a reflection of the deterioration in the budgetary situation mentioned above, credit to the Government was larger than envisaged. On the other hand, credit to the private sector was constrained by the borrowing requirements of the public sector, as well as the tight liquidity position of the commercial banks.

In the external sector, mainly as a result of the adverse developments that affected the country's main export products, the current account deficit worsened in 1986. It is estimated that compared to 1985, total exports decreased by 23 percent in 1986, while imports declined by 9.4 percent in the same period. Despite the higher than anticipated net capital inflows, the overall balance of payments deficit increased significantly from the level projected.

In spite of the progress made so far, economic and financial difficulties which are mostly of a structural nature continue to be a real challenge. In order to tackle them, the C.A.R. authoriities have prepared, with the assistance of the Fund and the World Bank staffs, a three-year macroeconomic policy paper. The objectives and the policies underlying this program are well described in the staff report. It is to be noted that the adjustment strategy will continue to be centered on demand-management policies aimed at promoting sustained economic growth in order to secure a viable internal and external financial position. They hope that the macroeconomic policies presented in the policy framework paper will meet the approval of the Executive Board and can form the basis for a program to be supported under the structural adjustment facilty.

Mr. Abdallah made the following statement:

I welcome the discussion on the 1986 Article IV consultation with the Central African Republic, including consideration of the policy framework paper, which I understand will constitute the basis for detailed discussions with the authorities on the annual programs under a structural adjustment arrangement. Accordingly, my intervention will be centered on the policy framework paper whose central thrust I find broadly acceptable.

First, it is encouraging to note that the authorities, in setting their growth objective, have provided for a modest growth in per capita income. At about 3.6 percent a year during the period 1987-89, the growth of real output should raise the level of per capita real income. It is essential that the estimated growth should take place so that the general population can experience some improvement in living standards. The initial impetus for achieving the desired economic growth will come from the traditional agricultural sector. It is essential therefore that the authorities should put in place specific programs to increase production and productivity through larger investments as well as all the necessary support mechanisms. I believe that, although sectoral performance was somewhat mixed in 1986, the economy has considerable potential. What has hampered performance in the past was the prevalence of severe dislocations in the economy. However, with the assistance of the World Bank, the authorities have embarked on appropriate reform programs, including liberalization measures and the provision of adequate price incentives.

In this connection, I also note that the authorities intend to raise the share of total investment in GDP over the medium term, to which end the rate of growth of public investment is expected to be increased considerably over the next few years. Investment outlays in 1987 are substantial and should go a long way to achieving the stated objective. I am confident that the authorities will work closely with their donors and creditors to ensure that disbursements are made on a timely basis. I raise this point mainly because recent experience with adjustment programs has unfortunately been characterized by increased delays in aid disbursements, which have in some instances thrown adjustment programs off the rails.

The World Bank has been playing a useful role in mobilizing resources for investment through its structural adjustment lending program in the Central African Republic. I hope that the implementation of the adjustment program under the structural adjustment facility will reinforce this catalytic role and thereby attract more appropriate financing for the investment program.

I should also like to endorse the call made by the staff for the authorities to address structural problems in the area of the budget and the parastatals. I find the measures adopted and those being contemplated to be sound and far reaching. Perhaps what needs to be emphasized is the need for the authorities to take prompt, decisive action. Therefore, I will be looking forward to seeing what specific policy actions are being taken in the forthcoming staff paper on the request for a structural adjustment arrangement. These measures should help to promote efficient use of resources, at least in the medium term.

I note that financial imbalances still exist. Thus far the authorities have clearly expressed their intention to seek the Fund's assistance under the structural adjustment facility. I wonder whether they also propose to continue with their stabilization program in order to deal with the apparent imbalances. If this is their intention, I would sincerely hope that the growth prospects incorporated in the framework paper will not be unduly compromised. I endorse the policy framework paper.

Mr. de Forges made the following statement:

The policy framework paper in Appendix I to the staff report appears to be a major step forward in the design of the adjustment efforts pursued by the Central African Republic since 1981 under four stand-by arrangements with the Fund and a structural adjustment credit from the World Bank. In the process, substantial progress has already been made both on the stabilization front, with the strengthening of budgetary monitoring, and on the structural front, with the gradual liberalization of pricing and marketing procedures. However, the progress remains fragile. The lack of buoyancy in the budget, together with the country's dependence on external factors, makes it difficult for the Central African Republic to absorb adverse developments and sustain a reasonable rate of growth. Both recent policy slippages and the decline in world cotton prices have illustrated these difficulties and demonstrated the need to consolidate the progress achieved and build up a security margin in order to be able to face unforeseen hardships.

In this context, I welcome the fundamental structural reforms provided for in the policy framework paper. I am particularly glad to see that the actions aimed at achieving budget equilibrium and eliminating domestic arrears will be of the highest priority. I also welcome the measures aimed at creating an economic and institutional framework more conducive to the development of the private sector, such as the pursuit of the process of liberalizing prices and marketing policies, the streamlining of the parapublic sector, and the attention which will be given to directing adequate domestic financing to the private sector.

Still, when reading the detailed program of actions in the policy framework paper, I am rather struck by the number of studies which still have to be launched or completed on issues as essential as coffee, cotton, education, export diversification, or the restructuring of public enterprises. I would have expected the process to be a bit more advanced after four or five years of adjustment. However, I take the current implementation of these studies to be a very positive sign of the authorities' willingness to address medium-term problems effectively; I hope that the studies will be quickly concluded and that the authorities will waste no time in translating their conclusions into operational decisions.

I would now like to make a few comments on the agricultural sector, presented in the policy framework paper as the sector expected to be the main growth factor. Two areas will benefit from the authorities' attention: the restructuring of the cotton sector and the diversification effort. With respect to the former, I welcome the program of reforms proposed by the authorities and the close involvement of the World Bank. The authorities should be encouraged to maintain their efforts in spite of the recent rise registered in world cotton prices; the cotton sector's difficulties are structural and not merely conjunctural. As for agricultural diversification, I look forward to the forthcoming commitment of the World Bank to a sectoral operation designed to foster the development of nontraditional exports.

Overall, the policy framework for 1987-89 appears well conceived, well balanced and realistic. Its success will require policy efforts on the part of the authorities, reductions in the fiscal deficit, the mobilization of domestic savings, and improvement in the quality of the public investment program. A critical factor will be the responsiveness of multilateral and bilateral donors, as the financing needs are considerable and efforts by all parties will be necessary. Besides the key role that the World Bank is expected to play in supporting this program, the Fund will also have an important role. I look forward to discussing in the near future the Fund's forthcoming assistance in the form of both a structural adjustment and a stand-by arrangement, as requested by the authorities. This participation will be essential not only from a financial point of view but also because of the need to monitor budgetary and monetary issues closely.

To conclude, I wish to say a few words on the procedure adopted for this two-stage presentation of the structural adjustment arrangement. If my memory serves me well, this is the first time we do not discuss a policy framework paper jointly with the approval of a first year's arrangement under the structural adjustment facility. I confess that I do not see the benefit to be derived from separating these issues. First, although we surely appreciate having the opportunity to express our feelings about medium-term policies, I do not really think that our comments on such framework papers are such that a modification of the basic components of a first-year arrangement could become necessary. Second, the dissociation of issues involves unnecessary additional work for the recipient country and for the staff. Third, the Board schedule is currently such that the Board would rather have its procedures simplified than further complicated.

I recognize that no additional delay is involved in the present case. Nevertheless, I think that in the future we should refrain from separating the discussion of a policy framework paper and approval of the first year's arrangement under the structural adjustment facility. Thus, I would have preferred a joint discussion of the new stand-by arrangement and the structural adjustment arrangement in its entirety, for instance, in May. I could have waited until then to discuss the Article IV consultation.

Mr. Bertuch-Samuels made the following statement:

It is unfortunate that the 1985-86 program, which ran into troubled waters almost from the outset, finally became inoperative at the end of last year. To be sure, adverse external developments continued to affect the country in 1986, but one can also clearly identify a number of domestic factors which contributed to the fact that performance under the program fell considerably short of expectations. On the one hand, there were important slippages in policy implementation--especially in the fiscal area--and on the other, the existence of deep-seated structural problems and rigidities seriously hampered the authorities' ability to deal effectively with the deteriorating external situation.

I therefore warmly welcome the authorities' intention to make a fresh start now by preparing a more comprehensive medium-term program that aims not only at reducing the financial imbalances but also addresses the major structural deficiencies of the economy. I am particularly pleased about the increasing role to be assumed in this context by the World Bank. In our view, the authorities' policy objectives and the planned structural reforms appear convincing. The policy intentions stated in the policy framework paper--if adequately translated into detailed and specified annual programs--do hold the promise of bringing the economy back onto a satisfactory growth path while at the same time moving toward balance of payments viability.

Nevertheless, the staff report also points to considerable risks. Since weak international markets for the major export commodity--cotton--have already been taken into account in the medium-term projections underlying the policy framework paper, these risks seem to lie more on the internal side. It would thus appear to be within the authorities' sphere of influence to reduce those risks substantially by making speedy progress in their plans to improve the overall efficiency of the public sector's operations. This applies to central government budgetary discipline as well as to the design and implementation of the investment program and the management of public enterprises.

In the past, fiscal performance has suffered excessively from problems both in revenue collection and expenditure control. I agree with the staff, therefore, that the improvement of the fiscal performance has to be one of the cornerstones of any adjustment program in the Central African Republic. As I already mentioned, this would of necessity include the public enterprise sector, which continues to draw heavily on the country's resources. It is alarming, for example, that because of domestic arrears by the Government and public enterprises, a large share of the banking system's resources are now blocked in illiquid operations. A rapid elimination of these arrears, combined with a major strengthening of the financial position of public enterprises, will be needed to ensure that the authorities' objective of increasing the role of the private sector will not be thwarted because of a lack of sufficient credit to the private sector.

While some comfort could be derived from the fact that extensive preparatory work in the area of public enterprise restructuring and rehabilitation has already been undertaken with the assistance of the World Bank, the authorities now have to preserve the momentum and follow up on this work with decisive steps to implement the planned reforms. Needless to say, I also look forward to speedy progress on the formulation of the 1987 budget, which should set the required policies in motion based on the recommendations for tax changes and administrative reform submitted by the Fund's technical assistance mission last December.

With these remarks I would like to associate myself with the staff appraisal and express the hope that a specified financial and structural adjustment program for 1987 can soon be brought to the Board for approval.

Mr. King made the following statement:

It is disappointing that the stand-by arrangement went off track in the second half of 1986 and that the authorities appear more recently to have encountered some difficulty in remaining current with the Fund. Lower than expected prices for some of the Central African Republic's major exports seem to have been partly responsible, although these seem to have been offset in part by changes elsewhere. I note from Table 3 of the staff report that the outturn for the terms of trade as a whole last year was much as expected.

In this light, it is encouraging to see that the authorities intend to request a new stand-by arrangement, and that they have reached agreement with the staff on a policy framework paper. The latter seems to cover most of the major problem areas facing the authorities. I have just a few comments to make on areas that seem to be particularly important.

First, the authorities have used the revenues generated from the coffee sector to subsidize the development of other cash crops. Table 5 of the background paper on recent economic developments highlights the fact that in the first half of this decade, the public sector received some 45 percent of the f.o.b. export price for coffee although this share seems to have fallen somewhat in the current year. These factors have, on occasion, led to the unofficial exporting of coffee into neighboring countries. I would therefore endorse the importance of reviewing the operations of the agricultural stabilization fund (CAISTAB). It is important, however, if the potential for coffee output to rise over the medium term is not to be lost, that producer price incentives be maintained, and where possible, in the light of prices on world markets, improved. More generally, and as the staff again notes, it is clear that further steps will be needed to improve the performance of the agricultural marketing system.

My second and related point concerns the diamond sector. The background paper documents the extent to which official production levels have varied in response to changes in export prices. In general, the supply response seems to have been fairly large, and it it is encouraging to note that the authorities have in recent years significantly reduced the export tax.

My third point concerns the size of the public sector. The "1 for 3 francs" rule--new costs of one franc must be accompanied by economies of two francs--is a useful short-term device for imposing greater control on the size and cost of the civil service. That said, the rule is obviously not a substitute for a more fundamental review of employment and salary levels and also of the educational system. I am glad to see therefore that the World Bank is conducting a comprehensive survey of the civil service. This will need to be supported by a reform of the educational system.

My final point concerns the public enterprise sector. As the staff points out, this sector employs nearly 20 percent of the manpower in the modern sector but contributes only 6 percent of its value added. This would suggest that there is considerable scope in some cases to improve efficiency. It is encouraging to see therefore that the "1 for 3" rule will be extended to cover this sector during the current year while at the same time the authorities are making progress in clarifying the present confused situation with regard to financial obligations within the public sector. I can support the proposed decisions.

Ms. Bush made the following statement:

I welcome this opportunity to review the economy of the Central African Republic. The nature of the review that we are conducting today is particularly important, given the effort that has been made in the country in the 1980s toward economic adjustment aimed at correcting rather severe imbalances. This effort, as we know, has been supported by a series of stand-by arrangements--some successful, some not. The latter were not successful partly due to some policy slippages and partly due to some exogenous factors. Given the economic adjustment efforts of the Central African Republic, and the fairly continuous involvement by the Fund in the form of four stand-by arrangements since 1981, it is important that the Fund, the World Bank, and the C.A.R. authorities have taken this opportunity to develop the policy framework prior to negotiating a loan under the structural adjustment facility. The development of the policy framework has given the institutions and the member a chance to assess the kinds of policies that have been in place and the successes and failures that have emanated from them. Using this assessment, and having the input of both the staffs, the Executive Directors of the World Bank and the Fund, and the C.A.R. authorities, I believe that we have brought into focus the underlying problems that have inhibited the success of the country's economic efforts. Having brought these problems into better focus, the probability is now higher that these underlying problems will be addressed in a manner that will enhance growth prospects under the forthcoming structural adjustment arrangement.

In considering growth prospects in the Central African Republic, it is encouraging to see the amount of emphasis that the authorities are placing on development of the private sector. As the framework paper makes clear, there continue to be a number of economic and financial practices that have made economic growth and the buildup of the private sector difficult. These include controlled prices for manufactured goods, fixed intermediation margins, producer prices that have been out of line and have therefore created a disincentive to production in some cases, absorption of credit by the Government that leaves insufficient credit for the private sector, and public sector enterprises that have not operated efficiently and that have also exacerbated problems related to exports of certain goods.

I note from the framework paper that the three-year program under the structural adjustment facility will address many of these problems. In particular, mention is made of reliance on market forces for determining prices, with cotton and coffee prices to be set in a flexible manner; the elimination of controls on manufactured prices; and the elimination of fixed intermediation margins. Important steps are also being taken to strengthen the parapublic sector, including divestiture, liquidation where necessary, and more efficient operations, where possible. In addition, it is important that special emphasis is to be given to the private sector with regard to the further development of trade and transport.

This emphasis on private sector development is also significant in another way. It is clear that the problem of the size of the civil service and the resulting wage bill will have to be tackled. The measure of the problem that this has created for the economy is the fact that in 1981 the wage bill was 87 percent of budgetary receipts. Of course, it was down to 61 percent in 1986, and that is a positive development. However, it seems that some of that reduction has been accomplished by not increasing wages for some time. A smaller civil service that permits greater flexibility in pay rates is likely also to assure better performance by civil servants. In spite of the fact that the Government intends to play a smaller role, it is still a sizable factor in the economy. It is therefore important that civil servants' performance be of the highest standards. The further development of the private sector will be important in creating employment opportunities for individuals who have been members of a civil service that is arresting its growth in employment.

More generally, the staff points out that the fiscal area continues to be a major weakness in the Central African Republic. What is also important, the staff notes that many of the structural problems have contributed to the fiscal weakness. The decline in incomes in real terms and the resulting implication for government revenue has been largely a function of the kinds of structural problems that have been mentioned; for example, producer prices that are too low to encourage production, subsidization of the cotton sector, and marketing bodies that operates inefficiently. I hope that the underlying problems that are affecting the fiscal situation will be forcefully addressed in the structural adjustment arrangement.

On a few more particulars, I note first that there are plans for a tax reform. In this regard, collection of revenues appears to be important; I assume this can be addressed to some extent through the tax system. There is also a schedular tax system on individuals' net profits from different kinds of income, for instance, from agricultural, commercial and industrial activities. I recall that a schedular tax structure was also a problem prior to the Philippine major tax reform. Is it a problem here? There continues to be an export tax on diamonds, but on the other hand the authorities wish to encourage production and export of diamonds which the export tax might be hampering. Are these issues being addressed in the tax reform, and can staff comment more generally on what is planned? Will the Fiscal Affairs Department be involved?

Second, I note that no debt rescheduling is planned during the program period, a welcome development.

Third, the staff points out that positive real interest rates are important to encouraging financial savings. I believe that this is also important from the standpoint of encouraging the growth of resources that will be necessary for further development of the private sector.

In general, the authorities' aim of positive real growth of 3.6 percent from 1987 to 1989, maintaining control over inflation, and reducing substantially the current account deficit should all be made much more feasible by tackling the structural problems that are evident.

Finally, we are glad to have had the opportunity to review this policy framework at this juncture. This is the first occasion on which we have had an oportunity to finalize such a framework paper prior to detailing the commitments under the structural adjustment arrangement. We believe that this opportunity to assess past policies and outcomes, when determining the focus and priority of future policies under its structural adjustment arrangement, will enable the Central African Republic to make more efficient use both of the resources that can be provided under the structural adjustment facility and of World Bank resources. More efficient use of available financing will heighten growth prospects for the Central African Republic. For these reasons, we believe that focusing on policy framework papers before negotiating the structural adjustment arrangements can, in some cases, be a very useful means of assuring that we are utilizing the policy framework and the facility's resources in a manner that can produce even greater benefits for members' economic efforts.

The staff representative from the African Department said that a technical assistance mission mounted by the Fiscal Affairs Department had visited the Central African Republic in September, and had made a thorough examination of the tax system as well as its administration. The mission's recommendations had been transmitted to the authorities and the more urgent ones had been summarized in Appendix VI to the staff report. The view of the mission was that the problems were not so substantative that they required a full-scale modification of the schedular tax system, although there was room for simplification.

To the best of his knowledge, the staff representative from the African Department stated, the Central African Republic was current in all its obligations to the Fund. A repayment on a Trust Fund loan had been due the previous week but had been settled.

The staff representative from the Exchange and Trade Relations Department remarked that Executive Directors would have an opportunity to comment on the broader issue of whether policy framework papers should be considered in some instances by the Board before it took up requests for structural adjustment arrangements when it discussed the staff paper reviewing the structural adjustment facility in which the matter was mentioned (EBS/87/46, 2/27/87).

The decision to take up the C.A.R. policy framework paper, together with the staff report for the Article IV consultation, had been a practical one, the staff representative from the Exchange and Trade Relations Department explained. The staff report for the 1985 Article IV consultation had been considered by the Board in September of 1985, based on discussions in the field in June 1985. Although the Central African Republic had subsequently been on the Board's agenda, the staff had hesitated to suggest a further postponement of the 1986 Article IV consultation, especially as the member was on a 12-month cycle.

Mr. Mawakani recalled that the adjustment process in the Central African Republic had begun in 1979, shortly after the restoration of the Republic. Since then, with the assistance of the Fund and the World Bank, considerable progress had been made in reducing the large external and internal imbalances with which the country was confronted. Despite the progress achieved so far, many problems, mostly structural, continued to pose a real challenge to the authorities, who were therefore committed to pursuing their adjustment effort in order to deal with those problems. In that connection, they believed that the future adjustment strategy presented in the policy framework paper was appropriate. The content of that framework paper having been endorsed by the Executive Board, it should be possible for the negotiations on the first annual arrangement under the structural adjustment facility to be concluded promptly so that the Board's examination of its request could be a timely one that would facilitate the implementation of the program.

The Acting Chairman made the following summing up:

> Directors agreed with the thrust of the views expressed in the staff appraisal for the 1986 Article IV consultation with the Central African Republic. They noted that because of adverse external developments and slippages in the fiscal area, the adjustment objectives set for 1985-86 had not been met. However, Directors were encouraged by the authorities' renewed commitment to pursue their adjustment efforts, in particular by dealing with structural obstacles to higher growth and to the attainment of balance of payments viability.

Directors noted with satisfaction that the economic and financial policy stance for 1987 and the medium term, as set out in the Central African Republic's policy framework paper, was geared toward the reduction of the external current account deficit to a sustainable level, the improvement of the fiscal position of the Government, and the resumption of economic growth. Directors welcomed the authorities' emphasis on stimulating investment and production in the private sector by promoting export diversification, further liberalizing marketing and pricing policies, and rehabilitating the public enterprise sector with the assistance of the World Bank.

With regard to fiscal policy, which is a cornerstone of the adjustment efforts, Directors emphasized that major weaknesses still existed and underscored the need for a tight policy stance in order to attain the target of reducing the fiscal deficit, particularly as revenue performance so far had not been satisfactory. Directors, therefore, urged the authorities to implement fully the recommendations of the recent Fund fiscal technical assistance mission and, in that context, they looked forward to the early approval of the 1987 budget and to progress in the area of tax reform. The measures to be put in place should be sufficiently strong to avoid the recurrence of the extrabudgetary expenditure and the accumulation of payments arrears. Directors welcomed the development of a much needed system for monitoring expenditures and receipts and hoped it would be strengthened and fully used. They underscored the need to check the rise in the civil service wage bill through a restructuring of recruitment and wage policies. In the investment area, Directors welcomed the continued involvement of the World Bank in the selection of viable projects and recommended that these be financed on appropriate terms.

Directors observed that the Central African Republic was very vulnerable to developments in the world markets. Therefore, there was a need for a major effort to strengthen the private sector and to diversify exports, in part through appropriate investments and reform of state agencies dealing with the export sector, in conjunction with appropriate producer price policies. They cautioned that excessive reliance on export taxes could discourage production and export revenues. Directors also welcomed the formulation of an emergency program to strengthen the cotton sector agency, and urged the authorities to monitor developments in this sector. They also called for structural improvements in the agricultural marketing system.

With respect to monetary policy, Directors encouraged the authorities to keep interest rates under review and indicated the importance of having positive real interest rates in order to encourage savings.

Directors hoped that the submission of the policy framework paper would soon be followed by the Central African Republic's request for use of Fund resources under the structural adjustment facility and that the World Bank would assume an increasing role in assisting the Central African Republic. Moreover, Directors called on donors to provide adequate assistance to the Central African Republic, on favorable terms, in order to finance its investment program and help achieve its balance of payments and growth targets. Timely disbursements of committed assistance was considered to be vital.

It is expected that the next Article IV consultation with the Central African Republic will be held on the standard 12-month cycle.

The Acting Chairman later submitted for the record the following summary received by the Fund of the main points covered by the Executive Directors of the Bank and IDA in their discussion on February 19 in Committee of the Whole:

1. The Executive Directors of the Bank and IDA, meeting as the Committee of the Whole, discussed the paper entitled "Central African Republic: Medium-Term Economic Policy Framework, 1987-89."

2. Broad endorsement was given to the Government's courageous, coherent, and comprehensive set of adjustment measures to be enacted over the program period. Particular appreciation was expressed for the Government's firm determination to alter the structure and direction of its economy. The Directors welcomed efforts to de-emphasize public sector intervention and to stimulate private sector activities.

3. It was generally agreed that supply responses would follow quickly so long as the program was on track. Yet it was recognized that the program remained fragile because of the many external factors over which the Central African Republic has no direct control. Thus the coalescing of efforts to reduce the Government's financial burden and to redress the biases against private initiatives was seen as a factor in eliminating rigidities in resource allocation and therefore allowing for private and public responses within reasonable time lags. Achieving this flexibility would be the cornerstone of a lasting adjustment in the face of uncertain international markets.

4. Concern for the vulnerability of the program to commodity price declines was voiced. This made the need for fiscal discipline all the more important. Noting that there had been some slippages in the 1986 fiscal program agreed upon in the context of the IMF stand-by arrangement, the Directors stressed that the

new targets for 1987-89 were of critical importance to the adjustment effort and that adhering to these commitments would be essential to the success of the program.

5. There were some reservations about the prospects for mobilizing the external financial resources required to support the program. As investment in the Central African Republic is highly dependent on these resources, it was hoped that no effort would be spared to forestall any shortfalls. Cutbacks, it was said, would inhibit growth and jeopardize the income gains that the Government was seeking.

6. While appreciative of the attention given to the social impact of the adjustment process, the Directors nevertheless suggested that the offsetting measures might be insufficient. The staff noted that the numbers affected would be modest and the transition gradual. Nevertheless the concern remained, despite a recognition that remedial actions were constrained by the lack of resources.

7. Finally it was agreed that much remained to be done despite the substantial progress already made. Speed was essential, and therefore it was hoped that the many studies now in progress would result in additional actions soon. Particular satisfaction was expressed for the joint donor effort in the cotton sector study.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with the Central African Republic, in the light of the 1986 Article IV consultation with the Central African Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that the Central African Republic continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 8544-(87/38), adopted
March 4, 1987

Structural Adjustment Facility - Policy Framework Paper

The Fund takes note of the Policy Framework Paper, dated February 11, 1987 from the Minister in charge of Economy, Finance and Planning of the Central African Republic, which describes the major economic problems and challenges facing the Central African Republic; the objectives of a three-year medium-term program; the priorities and the broad thrust of macroeconomic and structural adjustment policies; and the likely external financing requirements, together with the available sources of such financing.

Decision No. 8545-(87/38), adopted
March 4, 1987

The Managing Director then assumed the chair.

3. SURVEILLANCE - ANNUAL REVIEW OF IMPLEMENTATION; AND ARTICLE XIV CONSULTATIONS - PERIODICITY AND FORM

The Executive Directors considered a staff paper on the annual review of the implementation of the procedures for surveillance (SM/87/29, 2/4/87; and Sup. 1, 2/11/87, Cor. 1, 3/2/87, and Cor. 2, 3/3/87), together with a staff paper on the legal aspects of the periodicity and form of Article XIV consultations (SM/87/30, 2/4/87).

Mr. Fugmann made the following statement:

This chair supports the ongoing and pragmatic broadening and strengthening of surveillance. Even though, quite correctly, emphasis is placed on the multilateral aspects of surveillance, an important role must be reserved for country specific surveillance, especially for member countries whose policies in some areas strongly influence the rest of the world.

I have the following comments on the issues for discussion summarized in Section VI of SM/87/29.

I support the idea of a more systematic publication in International Financial Statistics (IFS) of indices for nominal and real effective exchange rates. I agree that as far as possible, actual data only should be reported in view of the sensitive nature of exchange rate questions. In those cases where this would imply considerable time lags, something which is likely to occur with respect to real rates, consideration could be given to using good estimates.

The section of the staff paper on the frequency of consultations mainly elaborates on Mr. Lundstrom's proposal for a consultation procedure involving annual consultations in principle for all members, but with those consultations being simplified for certain members every second year, the so-called "bi-cycle" procedure. The most important issue for this chair is to secure the main goals of its proposal, namely, to save staff man years and reduce the work load of the Board in connection with Article IV consultations. We would, therefore, be prepared to support any other proposal, including more radical proposals, upon which the Board could agree and which would achieve the same goals.

Let me first make a few general remarks and then comment on the issues which have to be resolved before we can take a final stand on this proposal. First, despite the very helpful and instructive way in which the staff has examined the proposal and its implications, a few questions remain that need further clarification.

Second, I want to stress that my constituency fully endorses the view--which was made explicit in the proposal--that any change in the present consultation procedure has to be consistent with the emphasis being put on strengthening Fund surveillance.

Third, it is equally obvious that there is an urgent need for a reduction in the number of Board hours and staff man years devoted to Article IV consultations. Such a reduction, if properly directed, may also enhance the effectiveness of surveillance by allowing our limited resources to be more concentrated on countries where Article IV consultations are particularly important because of the economic situation of those countries or because of the impact of their economic policies on other countries.

My fourth general point may seem to be a semantic one but it is probably more than that. The staff paper makes a distinction between "biennial formal consultations" and "interim simplified consultations." This suggests that the simplified consultations would not only be less comprehensive, which was certainly what the proposal aimed at, but would not be considered as formal consultations at all. I do not want to overrate the importance of this question, but I wonder whether a clarification on this point would not be useful.

This brings me to the first of the specific questions put to us, that is, the role of the Executive Board on the occasion of the interim consultation. There are two main options. One would be to place the staff report on the Board's agenda only if so requested by the member, management, or an Executive Director; absence of such a request would be seen as an implicit broad endorsement of the staff appraisal or would at least be considered as concluding the consultations. The alternative would be to place the report on the Board's agenda as a matter of course but with a clear expectation that there would be no discussion unless the member, management, or an Executive Director so requested. This chair has a strong preference for the latter alternative. And I would add that if there is a discussion, it would be presumed to be very brief. The objective of achieving a substantial saving in Board hours has to be kept in mind. For practical reasons, advance notice of possible statements should be given, say, a few days before the Board meeting.

The second objective is of course to achieve an even more substantial saving in staff resources. The means to this end is a very much simplified reporting by the staff on the occasion of the interim consultation. I am convinced that in order to achieve this aim we have to take a much more radical approach than suggested by the staff paper. We are thinking of only one document, something along the lines of an abbreviated version of the background paper on recent economic developments, or perhaps in the format of the briefing paper prepared now prior to consultations, with the bulk of the document consisting of tables preceded by 6-7 pages of text. But I know that there are misgivings on the part of the staff about the durability of any guidelines for the scope and content of substantially abbreviated consultation reports. I would therefore add that it is incumbent on the Board to exert strong self-restraint in its demands for additional information and analysis.

Finally, there is the question of the countries to which the new, bi-cyclical consultation procedure would apply. Let me distinguish between the country groupings used in the guidelines on consultation frequency.

With respect to the 25 largest members, I submit that, with the new procedure, it would be possible to limit substantially the number of countries which, because of the impact of their economic developments on other countries, would remain on the standard 12-month cycle. A limitation to the countries with the ten largest quotas would seem quite reasonable to us. About half of the remaining 15 countries belong to another group and would, in that capacity, remain on the standard cycle. However, even for this group we believe that a somewhat stricter application of the criterion of "possible balance of payments difficulties" is feasible. It should be remembered that even the simplified consultations are meant to provide a comprehensive updating of developments and that a switch to the standard cycle would always be possible, should the situation so require.

As for three other categories--one country "considered important at the regional level"; 51 countries with a stand-by or extended arrangement, current, recent, or under consideration;

46 countries "whose situation indicates a need for close contact"--there would be no change, except that the existence of the new procedure would make it easier to limit the last group than when the only alternative was an 18-month or 24-month cycle. Such a limitation would of course have to be applied on a case-by-case basis.

With regard to the six countries on standard 12-month cycles at the request of the authorities, simplified consultation procedures would seem to commend itself, since it would mean that they would remain on a 12-month cycle but require less resources every second year.

The 14 countries on an 18-month cycle might be advised to choose between the "bi-cycle" and the 24-month cycle.

There would be no reason for any change with respect to the seven countries on a 24-month cycle.

As a final observation, member countries with significant external imbalances should, of course, be subject to the comprehensive 12-month cycle. I take it that this will be the case irrespective of the character of payments imbalances, that is to say, surpluses or deficits.

On the use of indicators in consultations I concur with the need for a "reasonably fully specified and quantified framework" for the analysis of a country's economic policy. As in the multilateral analysis, the country specific analysis is already based on a number of economic indicators. Therefore, the staff proposal, which I support, implies a widening and a systematization. I agree that supplemental consultations should take place at the initiative of management. However, this chair is of the view that the Board has an important role to play in this area. We could conceivably decide, on a case-by-case basis, that signficant deviations from the forecasts for important indicators should lead to renewed discussions between the staff and the member country concerned. These discussions would then be an important element in the Managing Director's assessment of the need for a supplemental consultation in the sense of the Articles.

As for the handling of Fund documents, we definitely agree that the well-motivated existing rules on confidentiality should be adhered to, implying, among other things, that the Board should approve the release of documents to commercial banks in exceptional cases only. By making this policy explicit, the Fund would also indirectly support individual member countries in resisting the pressures of banks, helping them to make stronger demands to banks to replace in future financial agreements the inappropriate proviso "unless specifically prohibited by the Fund" with, for example, the term "if specifically authorized by the Fund."

As has become clear from my statement, the strengthening of surveillance is very much a question of gradual, concrete measures. A number of measures to strengthen surveillance were suggested, in connection with the G-10/G-24 reports on the international monetary system, over and above the ones touched upon in today's discussion. These suggestions have been discussed and on the whole accepted by the Board. It would be useful to have a report on the extent to which these measures have been implemented in the Fund's surveillance activity.

Mr. Yamazaki made the following statement:

At the outset, let me reiterate my authorities' broad support and commitment to strengthening international surveillance through a better use of indicators. Considerable progress has been made in this respect since last year, and the Fund has played a major role in the process. At the same time, my authorities continue to believe that promotion of policy coordination among countries should be based on enhanced dialogue and persuasion through "peer pressures." In my authorities' view, it is not appropriate to give indicators the role of an automatic trigger device. And, indeed, indicators cannot be a substitute for judgmental analysis.

Having said that, let me proceed to the specific points, which I will make according to the order presented in the summary and conclusions in the staff paper.

First, indicators of real effective exchange rates are a useful tool for the assessment of competitiveness. However, theoretical and practical problems associated with the weighting and deflators used in estimating these rates argue for some caution against their publication, lest they should be taken as the single most important indicator in passing a judgment on the appropriateness of the exchange rate.

Second, with respect to the frequency of consultations, we can broadly support the adoption of the bi-cycle system proposed originally by Mr. Lundstrom. Strengthening international surveillance is, of course, one of the most important tasks entrusted to the Fund at this juncture, and any step that would lead to an effective reduction in such function needs to be avoided. On the other hand, it is clear that the Executive Board as well as the staff is overloaded and the continuation of the present practice is likely to result in either a deterioration in the quality of overall surveillance and other important policy discussions or a substantial increase in the number of staff. Under the circumstances, I believe that some streamlining of surveillance procedures would not be inconsistent with the current task of strengthening effective surveillance and would contribute to enhancing the overall efficiency of the Fund at a difficult time.

Guidelines for the specification of 12-month intervals need not be changed, but should be interpreted flexibly and liberally so that maximum savings can be secured within the framework of maintaining effective international surveillance. As regards the scope of the analysis and reporting in the interim year, I can broadly support the staff suggestions. In dealing with the interim report, a desirable procedure would be to place it on the Board's agenda with a clear understanding that there would be no discussion unless there were substantive issues that should be brought to the attention of the Board.

For those members that avail themselves of the transitional arrangements of Article XIV, Section 2, the inclusion of a comprehensive review of the restrictions in the interim report to the Board would, I believe, satisfy the legal requirement.

Third, on the use of indicators in consultations with individual countries, the staff documents suggest a greater degree of specificity and quantification in Article IV consultations. In this respect I note that considerable progress has been made in the use of indicators as far as consultations with major industrial countries are concerned. The staff is encouraged to further this process by trying to enter into a detailed and quantified dialogue with the authorities in a wider group of member countries. At the same time, it has to be emphasized that while balance of payments analysis is important in assessing the interaction of economic policies, a balanced analysis of a wider range of indicators from the viewpoint of assuring medium-term sustainable growth without inflation remains as essential as ever.

The staff proposes a new procedure that links policy and other economic developments after the Article IV consultation to a preliminary review by the staff and management of whether a supplemental consultation would be called for. I believe that the present practice of leaving the initiation of supplemental consultation to the judgment of the management is practicable enough, and I do not see the need for introducing a mechanical procedure as envisaged by the staff. Linking a preliminary review to certain deviations from a projected path involves an element of automaticity, and my authorities cannot accept such a procedure as it is clearly inconsistent with our basic understandings on the use of indicators. In the same vein, a suggestion that the dicussion of the world economic outlook could be utilized for the same purpose also infringes upon the conclusion of our discussion in January on enhancing the role of indicators as a tool for surveillance, when it was agreed that indicators should be used to promote a dialogue rather than to trigger an automatic mechanism. My authorities are also concerned about the effect of introducing such a procedure on the Board discussions, which could become too narrowly focused instead of consisting of an exchange of views on various aspects of economic developments and policies.

Finally, I can support the staff proposal on confidentiality of Fund documents.

Mr. Mawakani made the following statement:

Like other Directors, I wish to reaffirm that this chair attaches great importance to the Fund's surveillance role. As noted in the staff paper, the past year has witnessed substantial changes in nominal and real effective exchange rates of member countries and the number of notifications under the Information Notice System has almost doubled. The implications of such a development for the economic and financial policies of those countries is a cause for concern, indicating an underlying instability in the exchange rate system. Under these circumstances, the strengthening of the surveillance exercise has become imperative.

It is worth noting that in the majority of cases, the exchange rate has moved generally in one direction, downward. With such a large number of devaluations having occurred in a short period of time, I wonder whether the staff could comment on their consequences in a global context. Have they had the positive impact that we are told devaluations always have? Has competitiveness increased and thus led to an increase in trade or has this period been associated with deflation? I would very much like to hear the staff's views on these issues. Let me add that we now have a good occasion to make a complete study of the full effects of devaluations. Such a study could improve our understanding of the working of the exchange rate system and could guide us in the future advice we give and the decisions we take.

Wide fluctuations in the exchange rates of major currencies in which developing countries' export prices are denominated have too often been the cause of instability in the external balances of the latter countries. Partly as a result of the fluctuations, and in the face of inadequate international reserves, these developing countries have been forced to take more severe adjustment measures than called for. A stabilization in the movement of exchange rates would help these countries in their adjustment policies.

With respect to the implementation of surveillance in 1986, I wish once more to deplore the weakness of this exercise when it comes to countries that are not using Fund resources. Many Directors in the past have commented extensively on the asymmetry of the implementation of Fund surveillance, namely, on its severity on countries using Fund resources and its leniency on those that do not make use of them. I shall not repeat those arguments again, but I would like to associate myself with those who want to see an improvement in the system so that it treats all members equally. Countries which have large external deficits because of the strength of their reserves or currency and those that build up large surpluses need to adjust just as well as these small deficit countries. In that respect, the consensus that seems to be emerging on the use of indicators to strengthen the surveillance process augurs well. I also found appropriate the inclusion in the September World Economic Outlook of a chapter on policy interactions in industrial countries and their potential implications. This is a welcome innovation and a step in the right direction toward a more symmetrical approach in surveillance. But if the exercise does not lead to corrective actions by the countries concerned, the present asymmetry will persist.

On the four issues that were raised in the staff paper, first, I believe that the publication of indicators of nominal and real effective exchange rates will contribute to the improvement of the surveillance process. However, I would like to suggest that the staff exercise caution in its calculations, especially in the case of countries that do not have satisfactory data. The use of inaccurate or limited price indices, for example, can give a false picture of exchange rate movements which may lead to policy changes when actually none is called for. As regards countries that use a composite exchange rate, I agree that the member's agreement to publish the data should be sought.

Second, on the frequency of consultations, I share the concern of other Directors and the staff at the increase in the work load that annual consultations have entailed. However, I am afraid that at a time when we are talking about a strengthening of the surveillance process, a reduction in the frequency of consultations may give the wrong signal. As noted by the staff, these consultations are an essential element in the fulfillment of the Fund's obligations to exercise firm surveillance over the exchange rate policies of its members. They are also a source of information for the world economic outlook exercise, and any reduction in the consultation cycle can only have adverse effects on that exercise. Furthermore, they provide many of our member countries with an opportunity for a thorough examination of their economic policies and thus a chance to identify problems at an early stage. For many countries, this is the only source of outside advice they have access to, and the lengthening of the one-year cycle could adversely affect their policymaking processes.

The countries represented by this chair would prefer to stay with their present consultation cycle. However, it is important to continue to maintain a certain flexibility in the system and to accommodate members' preferences for a longer consultation cycle.

With respect to countries under Article XIV, the paper on the periodicity and form of Article XIV consultations has brought to light the legal problems we overlooked in our desire to reduce the work load of the Board in connection with Article IV consultations. Since the Board does not have the power to amend the Articles of Agreement in order to allow us to lengthen the consultation cycle for countries availing themselves of the transitional arrangements of Article XIV, I am of the view that we should conform to the provisions under the Articles, and observe an annual consultation cycle with those countries. In that case, the amendment proposed in SM/87/30 to the 1977 decision on procedures for surveillance would not be needed.

Let me make an additional remark on the issue of the work load. While Article IV consultations do take a large proportion of our time, we also have to deal with other items, such as requests for stand-by arrangements and use of Fund resources under the structural adjustment and compensatory financing facilities, overdue obligations, and various policy matters, including in seminars. These other items also impose a heavy burden on the time and resources of the Board and the staff. I would not want, therefore, to see a reduction in the work load associated with Article IV consultations only. A thorough review of all Board activities and procedures should be undertaken before suggestions regarding priorities can be made.

Third, on the use of indicators, as has been mentioned by this chair before, we would welcome a strengthening of the surveillance process over countries whose economic policies can have repercussions on the economic performance of others. I agree with other Directors that the use of indicators can only improve this process and thus remove some of the asymmetries that we have noted in the past regarding the way surveillance is exercised. In that respect, I welcome the statement of the G-6 communiqué of February 22, 1987 regarding the agreement on additional refinements in the use of indicators for multilateral surveillance.

On a more practical level, as the staff notes, the process could be improved by "a greater degree of specificity and quantification in staff reports" as well as by "the presentation of more detailed and quantified short- and medium-term policy plans in the context of Article IV consultations." The presentation of medium-term scenarios in the World Economic Outlook, following the approach taken last September, together with an assessment of consistency and sustainability of policy plans as well as their effects on other countries, should strengthen the process. I would, however, like to see us go a step further by having a separate Board discussion at regular intervals on a staff paper on the main indicators of economic policy of major countries. During those discussions, it could be determined whether the policies being followed by some countries are such as to require a special consultation. In the absence of a Board discussion on the matter, the Managing Director should exercise his judgment as to whether or not a special consultation should be initiated.

On the fourth issue of the confidentiality of Fund documents, I am concerned at the increasing practice of commercial banks to systematically request Fund staff reports from countries, especially from those that are negotiating a rescheduling of their loans. On page 29 of SM/87/29, the staff writes "Fund documents are known to have been given to creditor banks without Board approval...." Could the staff elaborate on this statement and let us know if anything has been done to address the problem?

I feel that management should reiterate to member countries the policy of the Fund regarding the confidentiality of Fund documents and of the Fund's views regarding distribution of these documents. Fund documents should be distributed only in special circumstances and with prior Fund approval, and only after a very careful editing of sensitive material. It is essential to preserve the confidentiality of Fund documents in order to ensure that the free and frank exchange of views between the Fund and member countries is maintained. Commercial banks need to be told that they should make their own assessment of a country's economy and not rely on the Fund to do this job for them. Furthermore, continuation of the practice of making the staff report available to banks may reinforce the wrong perception that the Fund is an instrument of the creditors rather than a cooperative institution which works in the interest of all its members.

In conclusion, let me say that I welcome the agreement reached by the Group of Six at its Paris meeting, as I feel that it will undoubtedly strengthen the surveillance process. I am hopeful that this agreement will lead to a better coordination of monetary and fiscal policies which will in turn lead to more stability in the international monetary system, a stability that is much needed if the goal of sustainable, noninflationary growth is to be achieved.

Mr. Nimatallah said that it was not clear from the staff paper whether the staff was proposing that Fund documents should never be released, or whether the concern was with ensuring that such release took place in specific circumstances only, and with the approval of the Board.

The Director of the Exchange and Trade Relations Department recalled that the Board had agreed that staff reports could be released in certain cases in connection with enhanced surveillance consultations. The objective was to help a member obtain multilateral rescheduling arrangements, in particular from the banks. The issue raised in SM/87/29 concerned the attempt of banks to obtain staff reports in cases of rescheduling that had not been brought to the Board under the procedures for enhanced surveillance. The staff was seeking the reaction of Executive Directors, and, if the Board wished, confirmation of the policy that the release of such confidential reports without the authority of the Fund could not be sanctioned.

The Director of the Legal Department confirmed that the documents of the Fund, whether they were staff documents or documents reflecting views of the Executive Board, were confidential and could not be disclosed by any member of the Fund without the prior approval of the Fund. The Fund had authorized the transmittal of staff reports, under certain conditions, under Decision No. 8222-(86/45), adopted March 12, 1986, on enhanced surveillance.

Mr. Ortiz made the following statement:

> We welcome this discussion on the annual review of the implementation of surveillance. On several occasions, the Board has recognized the increasing significance of the international impact of policy interactions among major countries and thus the need for policy coordination. In this context, Fund surveillance acquires a new dimension which calls for the need to find the appropriate instruments and procedures to strengthen its implementation. The procedures for such surveillance, however, should not foster undue expectations; as we stated in January, their effectiveness "will be limited to the extent that adequate mechanisms for implementing the correction of deviations from mutually agreed policy intentions or outcomes are absent." The use of such mechanisms, moreover, depends on the political will of member countries to cooperate in every manner with this institution. It also depends on the ability of the Fund to provide an appropriate, pragmatic framework acceptable to those countries with a substantial impact on the world economy. In this respect, we appreciate the efforts of the Managing Director, who has informed us in a most useful way of his participation in the G-6 meetings held recently in Paris. He perceived this meeting as an important step forward in policy coordination (and I would recall here Mr. Lankester's important remark during our Monday lunch that there is a remarkable consensus on the direction and stance of policies). The Fund's role in providing a common statistical and analytical framework as a basis for discussion and for assessing the extent of the global effects of alternative policies is very important, and so is the Managing Director's role in transmitting the views of other member countries in this forum. We thus strongly endorse his active participation in these meetings.

In terms of the innovations in the implementation of surveillance, the issue that is far from settled is the purpose and use of indicators. The Board expressed its views on this topic in January, when the document "Enhancing the Use of Indicators" was discussed, and we will not delve further into the matter. Suffice it to underscore the lack of consensus regarding the effects on economic performance stemming from policy actions, and the insufficient knowledge on the part of analysts about the fundamental determinants of key variables.

In this context, we are of the view that the most promising avenues for research are the medium-term scenarios, and in particular cular, the investment-savings framework. This methodology should be further developed at national and multilateral levels. On the national level, one may focus with more detail on the viability of external accounts in smaller economies under alternative scenarios of the world economy. Although this type of analysis is done during regular Article IV consultations, a more formal and homogeneous analysis across countries may be performed. The global exercises would highlight potential inconsistencies among policies in major countries.

The usefulness of this type of exercise to both major and smaller economies can be appreciated from the comment made at the end of Section III on developments in exchange rates that "changes in real effective exchange rates for smaller industrial and developing countries do affect the competitiveness of major countries." The report stresses the convenience of assessing the trade-off between the external position of an individual country versus global adjustment.

This chair has tried to be very careful when advocating a more active exchange rate policy as a means of adjusting balance of payments disequilibria, in particular when price stability is also a target. A multilateral approach is clearly a most advantageous instrument to analyze the measures for correcting individual countries' imbalances and simultaneously maximizing world welfare.

Regarding the implementation of surveillance, several comments in the staff paper are worth noting. A concluding remark on page 30 to the effect that publication in IFS country pages of nominal and real effective exchange rate indices would meet the Fund's responsibility for surveillance over exchange rate policies is somewhat ambitious. And yet there are important advantages to publication of the series: when allowance was made for the methodology recently adopted, which introduces a new weighting scheme, the series provides a homogeneous framework for analyzing the evolution of exchange rates. One argument against the publication of real and nominal effective exchange rates is that some member countries regard the information as sensitive. Often variations in real exchange rates have been mistakenly identified as deviations from equilibrium exchange rates, thereby affecting the management of exchange rate policies.

On the frequency and depth of Article IV consultations with member countries, we share the concerns which were at the origin of Mr. Lundstrom's "bi-cycle" aimed at alleviating the work load of the staff and of the Board, while at the same time maintaining or even improving the quality of current consultations. In essence, the proposal analyzed in the report would lengthen the period of formal consultations for a larger number of countries. Those countries falling in this category would avail themselves of a simplified annual consultation. In this respect, we are of the opinion that more countries than those proposed in the report could fall into this new category on the assumption that, if the member so requests or conditions warrant it, a full-fledged consultation would occur annually.

As for the role of the Board, two possibilities arise: the first is that both the full-fledged biennual consultation and the simplified annual consultation should be brought to the agenda with an understanding that they will be discussed only if the member, management, or an Executive Director requests it. The second option is that only the biennual consultation would be discussed, while the report on the simplified annual consultation would simply be circulated among Executive Directors. Although we prefer the first option, we would accept an alternative solution which ensures that the Board is kept well informed and which has consensus support.

Finally, on the issue of confidentiality, we are of the view that wide circulation of internal reports should be avoided, not only because authorities and staff members would be more reluctant to communicate candidly, thus impinging on the quality of reports, but also because establishing a practice of providing these reports to commercial banks would in the end result in a heavier work load for the staff. And this is a problem that is already becoming serious.

Mr. Reddy made the following statement:

I propose to state this chair's position on the respective issues raised on pages 30-32 of the staff paper, SM/87/29, before addressing the staff's treatment of the conduct of monetary policy in industrial countries. First, I would like to state that there are divergent views among members of my constituency on the publication of nominal and real effective exchange rate indices in IFS country pages. I could, therefore, support the idea of publication only for those countries which publish exchange rate indices in their domestic publications; for countries which do not, the Fund should publish these data only with the consent of the member. Having stated my position on publication, I have a question for the staff: there may be cases where the Fund uses different weights in calculating the real effective exchange rate from those used by the national authorities. This could lead to differences between the IFS data and those published by the authorities and consequently could result in confusion. I wonder if the staff could say how this type of problem could be avoided, and what steps would be taken to reconcile Fund indices with those published by the authorities.

The second issue raised in the paper relates to the frequency of consultations. I could support the idea of a two-year consultation cycle with an interim report every second year in order to reduce the work load of the Board. For Article XIV countries, I would suggest that the interim simplified report should provide a draft decision to be approved on a lapse of time basis. The longer consultation cycle should apply only to countries whose economic policies do not have a major impact on other countries, to countries which do not have Fund programs, and to countries where there are no serious doubts about the medium-term viability of the balance of payments. On the definition of countries that have a major impact on other countries, I could go along with either the 25 members with largest quotas or members with quotas of more than SDR 1 billion.

Turning to the third issue, I can support the use of indicators in consultations with individual countries, especially for countries with a major impact on the world economy, so that developments can be continuously monitored and supplemental consultations instituted if developments in the economy deviate from the desired path. I also support the idea of a more detailed and quantified dialogue between the staff and the authorities on likely developments and policy requirements. These discussions should help to further strengthen the link between Article IV consultations and multilateral surveillance under the world economic outlook exercise.

On the fourth issue of confidentiality, my authorities believe that there is a two-way problem--sometimes, the staff releases information without the approval of the authorities; and at other times, the authorities release documents without Fund approval. In one country in my constituency, there has been a blatant disregard of the rule of confidentiality by the staff, which has been giving the mission's conclusions to some foreign diplomatic missions located in that country without the approval of the authorities. This type of practice does not contribute toward enhancing the member's collaboration with the Fund; therefore, I would urge you, Mr. Chairman, to remind the staff who go on missions to strictly observe the rules on confidentiality. I could also agree with the suggestion in the staff paper that the authorities in member countries be urged to respect the confidentiality of Fund documents.

One important issue which is not raised in the staff paper relates to the staff's evaluation of monetary policy. The staff generally feels very confident in reaching judgments on the appropriateness of monetary policy in developing countries. Yet when it comes to industrial countries, the staff seems to feel very uncomfortable about passing judgments. There are several industrial countries which currently have excessive monetary growth of around 20 percent per annum, and these countries also have large budget and external deficits. There is a danger that the high rate of liquidity growth in industrial countries could accentuate their external problem and also lead to the re-emergence of global inflation, which may require another prolonged recession to bring it back under control. Such a development would indeed be very harmful to the world economy, and it is therefore important for the Fund to give policy advice with longer-term stability in mind. This chair would thus prefer the staff to come up with very clear judgments on the stance of monetary policy in industrial countries.

Mr. Foot made the following statement:

At the outset let me reiterate my authorities' strong support for effective Fund surveillance. Over the past year the indicators exercise has significantly improved the process of multilateral surveillance. The use of indicators having been discussed fairly recently, and with the world economic outlook to be discussed shortly, I should like to concentrate on the process of bilateral surveillance.

To start first with things which could be improved, we feel that the international implications of policies in the major countries have often been inadequately explored in Article IV reports. This is an area that must be worked on if surveillance is to be more effective. There is considerable scope for developing the analysis of policy interactions, linking indicators in the world economic outlook with those in individual Article IV reports. Quantified medium-term projections have made a useful contribution to assessing the consistency and sustainability of policies, but there is scope for further improvement with the use of medium-term projections of a fuller range of indicator variables in the Article IV reports of G-7 countries and the extension of the practice to other countries where appropriate.

A second area which requires more work is regional surveillance, a topic that is in danger of becoming a hobbyhorse of mine. But I do find it extraordinary that we can, to take some recent examples, discuss tourism trends in Barbados without looking explicitly at the rest of the Caribbean; that we can consider Malawi's problems in financing maize without explicit reference to supply and demand conditions for maize elsewhere in the region; or that consideration of individual Middle Eastern countries can usually occur with only limited reference to the outlook elsewhere for expatriate earnings. There has to be more cross-fertilization of information and ideas within area departments, along the lines of the tentative beginning in the European Department in considering different Western European countries' approaches to structural unemployment.

A third area requiring more work would be adoption of the procedures outlined on pages 25-28 of the staff paper for enhancing the use of indicators in individual Article IV reports and especially the procedures for supplemental consultations. The current contingency for holding supplemental consultations has been invoked rarely; yet these consultations could represent an important strengthening of the process of surveillance. As we have said before, supplemental consultations should not be triggered automatically but should remain at the discretion of the Managing Director. Significant deviations from agreed indicators or other variables specified as important by the Board during the previous consultation could provide the basis for the Chairman to judge whether or not a supplemental consultation was appropriate. The enhanced Information Notice System could play an obvious role here. If deviations occur but it is felt inappropriate to have a supplementary consultation, then the reasons could be explained in the next Article IV report. We would also welcome it if Article IV reports contained a more explicit assessment than at present of the authorities' response to the points made in the summing up of the previous consultation.

Maintaining effective surveillance in these ways will necessarily absorb considerable staff time. Any scope for reducing the work load the staff and the Board must therefore be exploited to the full. We do not believe that there is great scope for reducing the frequency of Article IV consultations and we feel that the 1983 guidelines on the frequency of consultations remain broadly appropriate. Certainly those countries which have an important bearing on developments in other countries should remain on an annual cycle. However, it is not obvious that Fund quotas are the best measure of that bearing. That being said, the list in Table 2 of SM/87/29 seems about right although it might be possible to move some of the smaller industrial countries on to the Lundstrom bi-cycle.

Annual consultations should also continue for members where there are substantial doubts about medium-term balance of payments viability. Countries included under that heading will change from year to year, and we would therefore want to retain the flexibility of the present procedure of recommending a cycle length in concluding each year's Article IV consultation. Any country which wants to remain on an annual cycle should be entitled to do so.

The only way we might want to modify the 1983 guidelines relates to countries with Fund programs. We wonder whether there is a need in all cases for a fully fledged Article IV report and background paper when there are already regular program reviews. We appreciate the distinction between surveillance and the conditionality required of a program country. However, in view of the more frequent monitoring required in the average stand-by arrangement, the Article IV element of the discussion might not actually add much. In this respect I note that discussion of the Article IV report is often delayed anyway while program discussions and staff papers are finalized. At the very least the Board should be content with a less comprehensive review of recent economic developments, which are likely to have been covered in the program papers, and a separate report for the Article IV may also be superfluous.

Where we feel there is real scope for staff savings would be in greater use of biennial cycles with simplified reporting in the intervening year. This offers scope for greater flexibility and saving of staff and Board time while maintaining effective surveillance. In order to maintain the authority of the surveillance process, we would prefer the interim report to be placed on the Board agenda but on the understanding that it would not be discussed unless a Director or management requested it. We would suggest a four-week circulation period--which is supposed to apply at present--with any Director wishing to make a written or spoken intervention making it apparent by the end of that period and noting the nature of his intervention. A Board meeting could then be scheduled, say, one week later, or five weeks after the paper was circulated. Discussion could be very brief and focus only on the previously specified areas. The result would be to put more weight than at present on the staff report and appraisal, which would serve implicitly as the basis for the Board's considered view. The interim policy dialogue should be reasonably comprehensive and penetrating but we would support the idea of a very sharp drop in the volume of paper produced and put before the Board. We would like to aim, in general, for a 10-page main report plus some appropriate supporting macroeconomic tables. There is going to have to be considerable experimentation here and no doubt individual cases will differ widely. But let us start by aiming for substantial savings.

I have two other points to make on saving staff resources. First, with respect to countries under full annual surveillance, we feel that considerable economies could be made in the current background paper on recent economic developments, especially for the smaller industrial countries. (In the United Kingdom, these documents have no relevance either for our Export Credit Agency or for our aid ministry). Staff may find it useful to have some record of recent economic developments for reference purposes but whatever material they see the need for does not have to be circulated to the Board, other than in a short annex of tables to the main report. I feel that an informal survey among the staff and among Executive Directors would help to clarify what purposes the background papers serve and thereby illuminate what could be cut out both of reports for full consultations and a fortiori for the "thin years" under the simplified process.

My second point relates to medium-term projections, which are heavy users of staff time but, where appropriate, are a very valuable analytical tool. I think that there needs to be more informal discussion about the perceived value of these projections before we can decide whether a net cut or expansion would be appropriate, both in full and thin years.

As a final point on the question of consultation cycles, there would seem to be little point in putting countries onto the new biennial cycle if they are already on cycles longer than 12-months. This would only reduce potential staff savings. As for Article XIV, the need for annual consultations raises no difficulties with countries that are either on an annual cycle or that move to the simplified cycle. In the latter case, we would be happy for the decision concluding the Article XIV consultation to be taken on a lapse of time basis. For countries on longer cycles, the Article XIV consultation will need to be treated in a separate paper with a decision also to be taken on a lapse of time basis.

On the two final issues raised in the staff paper, the nominal and real effective exchange rate data used in the Information Notice System should certainly be published although some attempt at calculating real rates can already be made from what is published now. We feel that such information must be timely. Therefore, if real effective rates are not available before, say, 3-4 months have elapsed, we would prefer to reduce this information lag by using estimated data where this can be done with reasonable reliability. The calculation of real exchange rates is sufficiently complex to make it difficult, if not impossible, for users to derive these assumptions from the final series. And estimates that are provisional could be flagged as such. We would also prefer the nominal and real exchange rate data to take account of transactions made at multiple exchange rates, and we would encourage the authorities of the countries concerned to permit this.

As for the confidentiality of Fund documents, we certainly feel this should be respected. We recognize that the release of staff reports to creditor banks may play a useful role in negotiations with commercial banks but if the release of Fund documents were to become widespread, then staff discussions would become less frank and banks could be deterred from improving their own monitoring procedures.

Mr. Rye made the following statement:

The staff has usefully reminded us of recent pronouncements on surveillance by both the Interim Committee and the Tokyo Summit. A key element of these pronouncements was recognition that developments in the major economies are of crucial importance for the rest of the world. The Interim Committee, in its April 1986 communiqué, "stressed the importance of taking into account the views of the whole Fund membership," and the Tokyo Summit leaders reaffirmed their undertaking "to cooperate with the IMF in strengthening multilateral surveillance" and to consult with the Managing Director in so doing. In short, the Fund has been given a key role in multilateral surveillance, and we must move to make sure that we take full advantage of the opportunity. Of course, we discussed this at lunch the other day, and here I would associate myself with the remarks of Mr. Ortiz.

On the four issues listed for consideration today, first, I note that the number of notices issued under the Information Notice System increased sharply last year and is now running at around one a week. If this trend continues, we may need to consider whether the 10 percent move in real effective rates which triggers off the issue of a notice should not be increased. For the time being, however, I have no objection to the proposal that the information notices be more widely disseminated by way of publishing estimates in IFS of real and effective exchange rates. Where the calculations are based only on preliminary staff estimates of inflation, an alternative to the staff suggestion would perhaps be to use suitably qualified provisional estimates, with, say, a one-month lag. Such provisional estimates would, of course, be revised as actual data became available, and would require approval, at least in principle, from the relevant members.

Turning to the issues on the implementation of surveillance procedures, I note with interest the graphs on page 16a of SM/87/29. It is clear that there have been periods in the past--during most of the 1960s and the early 1980s--when the number of consultations fell below a desirable level. However, we seem now to have gone to the other extreme, with 80 percent or more of the membership being engaged in consultations in each of the last four years, a quite unprecedented level. In the light of the historical perspective given by this graph, it would seem to me reasonable to aim at something in the 70-75 percent range.

Whether we like it or not, we have to find some way of reducing the amount of time taken in the Board on country matters. We will need to make room in the next year or two for additional Board time on matters such as the next quota review, the intensifying problem of arrears, and surveillance itself. More generally, we will probably need to spend more time on policy matters, as the role of the Fund comes increasingly into question in what will be, I fear, some very difficult years for this institution. That the Board is already meeting at inordinate length is, I think, being reflected in the quality of our discussions of country matters, other perhaps than of the major economies and the high debt countries. Our discussions of Article IV consultations are too often quite perfunctory--which is good neither for the Fund nor for the member concerned. It is very possible that fewer consultations would lead to more considered interventions and a better result all round.

I think the staff paper is unduly worried about the implications of reducing the work load on consultations. Perhaps I can illustrate this by reference to the concluding sentence of the first paragraph on page 18: "Changes in procedures which substantially diminish the Fund's surveillance role as exercised through the regular consultation process clearly would not be consistent with the emphasis being put on strengthening the influence of Fund surveillance." It could be argued that the various possibilities canvassed in the paper would not substantially diminish the Fund's surveillance role. But leaving that aside, I think it is quite arguable that reduced surveillance in some cases would free resources for more surveillance of other--and more significant--economies and thus lead to better surveillance of the economic system as a whole.

As to the various possibilities for reducing the frequency of consultations, the staff paper dismisses too readily, I think, the 18-month cycle. There is surely room for flexibility here. I can think of at least one country in my own constituency--and possibly two--where an 18-month cycle would be entirely appropriate, and I note that the Board recently adopted without a qualm an 18-month cycle for Finland.

I also think that Mr. Lundstrom's "bi-cycle" proposal has much to be said for it. I very much agree with Mr. Fugmann that it must be aimed at a substantial saving in staff resources and that, to this end, there would need to be a much more radical approach to simplified reporting than suggested by the paper. I had been thinking that the staff report should certainly be less than 10 pages--supplemented by necessary statistical tables--and that there would be no background paper on recent economic developments. Nor would I be concerned about leaving aside the quantified medium-term scenarios, which I think we tend to overrate, and about which I shall have more to say later. Of course, an appropriate qualitative assessment of the viability or sustainability of members' policies in the medium term should remain central to the simplified consultation.

Incidentally, I note from Table 13 in the supplement to SM/87/29 that staff reports have tended to grow longer in recent years, and I think that efforts should be made to reverse this tendency.

Of course, the savings in Board time will materialize only if we exercise self-discipline and seek a discussion only where it is clearly necessary. For that reason, unlike Mr. Fugmann, I rather prefer the first option--to place the staff report on the Board's agenda only if so requested by the member, management, or an Executive Director. The benefits of listing interim consultations on the Board agenda when there is a presumption that there will not be any discussion are unclear to us.

I note that none of the changes in this respect requires an amendment of the guidelines on frequency which were established in 1983. It is rather a matter of interpreting the word "substantial" more strictly. Thus, it would be difficult to argue that all the top 25 economies listed in Table 2 have a substantial impact on other countries. This list could, I think, readily be pared back. Equally, we should prune somewhat the third category to include only those countries where there are substantial doubts about medium-term balance of payments viability--not merely a possibility of some balance of payments difficulties.

I turn now to the question of the use of indicators in consultations with individual countries. We are in broad agreement with the staff proposals, but I must say that I am uneasy about the heavy stress on seeking to quantify the medium term. I think this approach is highly questionable, particularly the suggestion that more effort be put into a "quantified medium-term policy framework" and "more detailed and quantified...medium-term policy plans" at the expense of other aspects of staff preparation and analysis. Especially if that approach is meant to apply broadly across the Fund membership, or even outside the Group of Seven, I am doubtful whether such efforts would be either necessary or productive. From my own experience--of more years than I care to think about--in forecasting in a national administration, it is difficult enough to quantify the short term. Going further than the staff already does in trying to quantify the medium term is likely, in most cases, to be a waste of time and resources. It simply cannot be done with an acceptable degree of accuracy--and nothing is to be gained (indeed, there is much to lose) by crunching out numbers in lieu of carefully considered qualitative analysis.

Finally, the issue of the confidentiality of Fund documents is not a straightforward one. In considering the rules for the release of staff reports, there are two alternatives. One would be to attempt to reinforce the existing rules--the staff recommendation. There are undoubtedly good reasons for this; in particular, any general easing of the confidentiality requirement could adversely affect the relationship between the staff and national authorities to the detriment of the candor and quality of staff reports. The second alternative is to recognize reality; circumstances do arise, and they are not limited to a wish to release reports by the debtor countries to their creditor banks, in which some degree of flexibility might be called for. I would therefore have no objection, in cases where the country concerned specifically wanted release of a report, to changing the point of authorization from the Board to management, thus enabling a speedy response to such requests.

Mr. Goos made the following statement:

I welcome the papers before us, which give an excellent overview of last year's implementation of surveillance and the major issues that have arisen in the process. At the same time, the papers provide once again clear evidence of the high and ever-increasing work load faced by this institution and especially its staff. I therefore would like to take this opportunity to express my authorities' and also my own appreciation of the staff's untiring dedication to the Fund and its membership.

This leads me to the issue of how we can reduce the work load associated with consultations. I recognize, of course, that endeavors to this end could bring us into conflict with the increasing importance that is being attached--and I should add, rightly so--to surveillance as one of the central responsibilities of the Fund. Yet I feel that we have to look into ways and means of using our limited resources more effectively. It would certainly be in nobody's interest if the quality of the Fund's performance, including its surveillance, deteriorated under the pressure of a work load that threatens to become unmanageable.

Having said that, I feel that the proposed introduction of alternating formal consultations and simplified interim consultations could strike a reasonable balance between the conflicting concerns. As to the range of countries to which this simplified consultation procedure should apply, I would caution against the adoption of too rigid criteria. Basically, management and the Board should have as much discretion as possible to experiment with this procedure and to adapt the content and frequency of consultations to the specific circumstances of individual countries.

More specifically, while I agree that the existing guidelines for consultation frequency should be retained--although preferably on a much more limited basis--there seems to be no compelling reason to subject all the countries not explicitly covered by those guidelines to a uniform simplified consultation procedure. To be sure, it might be appropriate to start from the general presumption that this procedure should normally apply to all of the countries in question. But those countries should remain entitled to opt for regular annual consultations and they should also be free to remain on an 18-month or two-year cycle, or even to switch to such a cycle subject to management and Board approval. Recognizing, however, that too low a frequency could weaken Fund surveillance, such switching should be limited to exceptional circumstances.

Countries with Fund arrangements should be kept on the standard 12-month consultation cycle as should countries that have a substantial economic impact on other members or that face potentially serious balance of payments difficulties. I would agree that with the adoption of the simplified consultation procedure, it should be possible to limit the application of the last two criteria to fewer countries, in particular bearing in mind that the frequency of staff contacts with the countries' authorities and of reporting to the Board would not be reduced. However, while the application of the criterion of balance of payments difficulty should be decided by management and the Board on a case-by-case basis, I feel there is substantial scope for reducing the present list of the 25 largest countries. As to the extent of such a reduction, I am prepared to go along with the majority of the Board, but my preference would be to limit the number of countries to the 10 largest members or even to the G-7 members only.

As regards other issues relevant to the proposed simplified consultation procedure, I should like first of all to endorse the idea of simplified reporting by the staff for the interim consultations. The main paper before us rightly emphasizes that such simplified reporting provides the greatest potential for saving both of Board and staff resources. However, like Mr. Fugmann, I feel that exploiting the full potential of such savings would require a more radical approach than the one proposed in the paper. Indeed, it should be possible in the case of countries eligible for simplified consultations to capture the salient features of economic policies and developments on a few pages, say, up to ten. In this context, I am not so sure whether we would need in each and every case a full-fledged discussion of medium-term scenarios. That issue should perhaps be decided in the light of the specific circumstances of the countries. But in general, I would agree that an adequate assessment of the medium-term sustainability of policies should remain at the center also of interim reports. Those reports could be supplemented by an updated set of the normal consultation report tables and some of the more important tables that are normally presented in the standard background papers, so that there would be no separate background papers on recent economic developments.

In this context, I should stress that we could, of course, also economize considerably on the Board's and the staff's time by shortening the normal consultation reports. Even without compromising on the substance, it should be possible to keep these reports within a limit of, say, a maximum of 20-25 pages as is being demonstrated from time to time by quite a number of excellent brief staff reports. Similar considerations apply to the size of the background papers on recent economic developments, which at an average length of roughly 100 pages are simply indigestible.

With respect to the Board's involvement in interim consultations, we would prefer the staff reports to be placed on the agenda only if requested by management, the member, or an Executive Director. Executive Directors should be provided with the possibility of addressing such requests directly to the Managing Director on a confidential basis. Moreover, if an interim consultation report were placed on the agenda there should be sufficient advance notice to the Board.

I can endorse the conclusions in the legal paper regarding the need to hold separate annual Article XIV and Article VIII consultations with certain members and to amend the procedures in the 1977 document on surveillance over exchange rate policies. However, considering the need to maintain pressure on countries to remove restrictions that are inconsistent with the Articles and also in view of the rather limited number of potential cases, my authorities would prefer to see a discussion of those Article XIV and Article VIII reports by the Board. Perhaps it might be possible to schedule as many such reports for consideration as possible on one single day so as to economize on our time. But I believe that we could also go along with a lapse of time procedure if the majority of the Board favored such an approach.

Turning now to the issue of using indicators in individual country consultations, I would agree with the staff that a wider use of indicators in such circumstances could help strengthen Fund surveillance. I also recognize that it could provide a useful and logical complement to the multilateral surveillance exercise undertaken in the context of the world economic outlook. However, as in the case of multilateral surveillance, we continue to hold strong reservations against using indicators as a trigger for specific action, including supplemental consultations. In this respect, I share the views presented on the top of page 28 of SM/87/29, in particular the concern over the ambiguity of signals emanating from indicators. Consistent with that view, like Mr. Yamazaki, we feel that the use of indicators can lead to reasonable results only if undertaken in the medium-term framework of a comprehensive assessment of economic developments and policies. Such a comprehensive assessment should continue to provide the only basis for any decision on the possible need to conduct supplemental consultations. We feel strongly that it would be counterproductive to the objectives of surveillance if the use of indicators were to result in taking a short-term view and in a narrowing of our focus on specific and partial economic issues, or if it led us to ignore the necessary medium-term perspective.

Finally, on the remaining subjects of the publication of real effective exchange rates and the confidentiality of Fund documents, since I agree with the views presented in SM/87/29, I can endorse the respective proposals.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/37 (3/3/87) and EBM/87/38 (3/4/87).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/97 through 86/99 are approved. (EBD/87/61, 2/25/87)

Adopted March 3, 1987

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/41 (3/2/87), and Correction 1 (3/3/87) is approved.

APPROVED: October 6, 1987

LEO VAN HOUTVEN
Secretary