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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/53

3:00 p.m., March 23, 1987

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
	Yang W., Temporary
	E. L. Walker, Temporary
	H. S. Binay, Temporary
	M. Hepp, Temporary
	T. Alhaimus
	K.-H. Kleine, Temporary
J. E. Ismael	
	J. Hospedales, Temporary
	M. Foot
	O. Isleifsson, Temporary
	W. N. Engert, Temporary
	C. V. Santos
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	L. Filardo
	S. de Forges
	H. van der Burg, Temporary
C. R. Rye	C.-Y. Lim
G. Salehkhou	
A. K. Sengupta	
	K. Murakami, Temporary
	N. Kyriazidis

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present

European Department: L. A. Whittome, Counsellor and Director. Exchange and Trade Relations Department: M. Guitián, Deputy Director; S. J. Anjaria, J. T. Boorman, D. Burton, M. R. Kelly, N. Kirmani, P. P. Moutot, J. M. T. Paljarvi, C. Puckhatikom, P. J. Quirk. External Relations Department: C. S. Gardner, Deputy Director. Fiscal Affairs Department: M. Katz, D. J. Robinson. IMF Institute: O. B. Makalou. Legal Department: R. H. Munzberg. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; M. Corden. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Williams, Deputy Treasurer. Western Hemisphere Department: S. T. Beza, Associate Director; J. Ferrán. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, M. B. Chatah, A. Ouanes, A. Vasudevan. Assistants to Executive Directors: A. R. Al-Abdullatif, F. E. R. Alfiler, S. K. Fayyad, Hon C. W., A. R. Ismael, S. King, M. A. Kyhlberg, S. Rebecchini, B. Tamami, I. Zaidi.

1. PROTECTION AND LIBERALIZATION - REVIEW OF ANALYTICAL ISSUES

The Executive Directors continued from the previous meeting (EBM/87/52, 3/23/87) their consideration of a staff paper reviewing analytical issues with respect to protection and liberalization (SM/87/43, 2/13/87).

Mr. Foot made the following statement:

The staff paper provides a clear defense of trade liberalization. The United Kingdom is committed to the liberalization of trade and to the reform of agricultural policies in both developed and developing countries. Therefore, my authorities strongly endorse the staff paper's conclusion that "there has to be an acceptance by governments and legislators that free or freer trade generally yield rather direct national benefits."

I strongly agree that a current account imbalance does not justify protection. In all cases, macroeconomic policy and exchange rate adjustments are the most appropriate policies to correct imbalances.

The threat of increased protection underscores the need for the Fund to examine the sustainability of balance of payments positions in its surveillance. This examination would help to create a better balance of policies in the major industrial countries, thereby helping to avoid the conditions that lead to popular pressures for protection.

It is important to keep up the pressure to reduce protection in agriculture and clothing and textiles. If countries wish to avoid all the consequences of a free-market system--for example, by wanting to have a minimum percentage of the total food supply be met by domestic producers--they should explicitly cost this option and allow their policymakers to assess fully the appropriateness of incurring this cost. The reluctance to cost explicitly the social values that a government wishes to protect is one of the major weaknesses of a great deal of policymaking in member countries. It should be possible, within a rational framework, to price the things that a government values, such as strategic grain reserves, in order to take into account the actual effective cost.

I agree that there may be cases in which short-term fiscal needs point toward the use of tariffs and export taxes--for example, in cases in which the tax base of an economy is limited and easy compliance with cross-border taxes can be obtained. That particular solution should be seen as a short-term one.

I accept the general argument against tariffs and import quotas for infant industries.

The staff has raised an interesting set of questions about the appropriate pace of trade liberalization and about the timing of trade liberalization vis-à-vis capital market liberalization. In many respects, the World Bank seems to be in a better position than the Fund to judge the appropriateness of the pace of liberalization. I have noted with regret that most of my information on trade policy comes from my World Bank Executive Board colleagues and not the Fund. Of course, the Fund undertakes considerable policy lending related to the trade area, and it would be interesting to invite the World Bank staff to speak to the Fund Executive Board about the rationale applied by the World Bank in its lending in support of liberalization. Large and important trade-related policy loans have recently been negotiated with Argentina, Nigeria, and other countries, and the World Bank clearly has an interesting and detailed philosophy about the way in which their loans can be put to the best use. The benefits of capital market liberalization are often underestimated. The argument in favor of infant industry protection rests to some extent on the existence of capital market imperfections. Therefore, fairly rapid action to eliminate those imperfections can be highly desirable.

My authorities have adopted a policy that could be called financial market liberalization. They have opened up markets for securities, but the liberalization is extended only to foreigners who are willing to provide reciprocal facilities for U.K. financial institutions. I wonder what views the staff might have on that approach, which does not constitute purely free capital market liberalization but is designed to make an opening in the United Kingdom at a time when other countries might not be willing to take similar steps. The U.K. approach clearly focuses on countries with strong financial sectors that might wish to take advantage of the London markets but were previously reluctant to do so. In a number of cases, an encouraging degree of reciprocal action has been needed.

In general, protection is greater in developing countries than in developed countries. It is clearly not in the best economic interest of developing countries to resort to retaliation in the trade area, although I agree with Mr. Kafka that the economic logic of this view is not easy to transform into domestic political support.

The proposal to circulate bi-annual fact sheets in lieu of the present trade notices is attractive, and I look forward to the staff's comments on it. Such fact sheets could most usefully be circulated prior to each Interim Committee meeting.

Mr. Nimatallah made the following statement:

The question that I would ask is why countries impose protectionist measures, and, when they do, are the measures justified? In the real world, countries that introduce protectionist measures claim that they suffer from a current account deficit, unemployment, and/or a lack of foreign exchange to service debt.

Sometimes countries impose tariffs not for protection, but merely to raise revenue. Thus, in asking whether a country is justified in resorting to protection when it suffers from a misaligned exchange rate the staff would have us consider what is merely an imaginary case--to my knowledge, no such case has existed.

However, it is appropriate to ask whether an increase in protection will improve the current account of an industrial or developing country. For an industrial country, the answer depends on what else the country in question suffers from. For example, it could also be facing a large fiscal deficit, as is the case of the United States. Obviously, increasing protection will not be of much help in such a case; appropriate fiscal and exchange rate policies would be more useful. I agree with the staff that protection could eventually be self-defeating by causing an appreciation of the national currency, and, therefore, an increase in the demand for imports. The real reason for the problem of protection in industrial countries is that some of those countries have sustained aggregate demand artificially, by maintaining high levels of expenditure financed through borrowing. In other words, they have managed to live beyond their means through budget deficits, and, therefore, current account deficits have emerged. Thus, while protection could play a limited role in industrial countries, the true solution to the problem of protectionist pressures is the pursuit of a program of steady fiscal consolidation in conjunction with a depreciation of the exchange rate and a cautious monetary policy.

For developing countries, the situation is somewhat different. For example, current account deficits could be caused by factors beyond the control of these countries, such as a sudden deterioration in the terms of trade, but the deficits could be worsened by fiscal pressures that lead to relatively high rates of inflation in addition to external debt servicing demands and, possibly, capital outflows. Obviously, these countries need to find policy tools that help their current account without exacerbating their other problems. To that end, they first have to adopt appropriate fiscal and monetary policies to help control inflation, enhance growth, and diversify exports. A flexible exchange rate can have a role to play, but probably not as great a role as in the industrial country case, as it might exacerbate the problem of inflation. Protection could also help, but only on a temporary basis.

A lack of foreign exchange is a real problem in developing countries. A decline in income brought about by a fall in export revenues will reduce the demand for imports, but only after a significant lag. If the country does not have the reserves to meet its import and debt service payments, it either has to borrow, or it must cut imports by whatever means. In that event, resort to protection, at least for a while, becomes inevitable. If such countries are already pursuing an infant-industry protection policy, or are using tariffs for revenue purposes, these policies can justifiably be stretched further. In other words, one can envisage a limited use of protection--in terms of magnitude and duration--in such circumstances, provided, of course, that other appropriate policies are already in place.

As to whether protection can be used to reduce unemployment, I believe that, for industrial countries, high priority should instead be given to introducing appropriate structural and fiscal policies. Furthermore, I agree with the staff that if aggregate unemployment is due to real wage rigidity, steps should be taken to enhance labor market flexibility. This is what has happened in certain industrial countries where real wages have declined to restore competitiveness. I also agree that if countries resort instead to restrictions on trade, the net effect over the medium term will be a resurgence of inflation, rather than a reduction in unemployment.

Relying on protection to maintain employment in specific ailing industries is, in general, ill advised. This policy tends not only to be expensive, but also can become addictive without solving the underlying problems of these industries. Instead, industrial countries should concentrate on new high-technology industries and permit the low-technology industries to move to other countries that have a comparative advantage in those industries.

We must accept the reality that some developing countries may have to protect certain industries from dumping during the infancy of those industries, provided that protection is not excessive, the protected industries can eventually compete with similar industries internationally in price and quality, and, to the extent possible, the protection covers commodities for which the country has a comparative advantage. These conditions are met in Saudi Arabia.

The answer to the question whether tariffs and export taxes are acceptable for fiscal reasons is that they may well be so in a developing country context. The use of income taxes in developing countries is constrained both because such taxes may hinder growth and because they may be difficult to administer. However, if trade taxes are used, it is important to reduce them over time, as the economy grows and as tax administration improves. Furthermore, I would encourage the use of uniform rates, to the extent possible, as they make the rationale for imposing for the measures--namely to raise revenue--more convincing. Of course, in the light of the necessity to enhance the savings ratios, it might be preferable to combine tariffs with consumption taxes, which can also be difficult to administer at the beginning.

The question whether industrial country protection can justify protection by developing countries is largely political. However, since, on average, developing countries tend to benefit relatively more from trade, and if developing countries can afford not to retaliate, it is better not to justify protection in one country solely on the ground that others have introduced protection.

If, for whatever reason, protection is introduced and subsequently increased, I think that sooner, rather than later, protection and controls should be dismantled and liberalization should be restored, although gradually, in line with the country's growing ability to build up reserves and to strengthen export capacity. In the end, that effort will depend upon the efforts of the industrial countries to sustain growth and keep their markets open. They are in a better position to help each other and the developing countries.

Mr. Rye made the following statement:

The staff paper debunks effectively much of the folklore associated with recent widespread calls for increased protection. In particular, it effectively rebuts the argument that the imposition of tariffs and quotas is an effective alternative to devaluation in achieving short-term current account adjustment.

While the staff paper aims to increase acceptance by governments and legislators of the national benefits of freer trade, it seems fair to say that those benefits are already well understood at the analytical level. The problems are practical and, above all, political. Nevertheless, I would not wish to diminish the importance of the message that the staff paper carries for industrial and developing countries alike.

I have no substantive problems with the staff's analysis that provides obvious answers to the questions raised on pages 34-35--at least in principle, although in practice, the lags involved may be sometimes longer than the staff seems to suggest.

I strongly endorse the view that protection cannot be justified in countries where exchange rates are "misaligned." In cases of floating rates, macroeconomic policies causing such misalignment need to be adjusted.

A topic frequently mentioned in the Executive Board is the effectiveness of export taxes as a means of raising revenue. The staff paper has an interesting section on this topic, and I endorse the conclusion that such measures reduce the volume of trade and replace economic export production with less economic import-competing output. This can have adverse long-term effects on resource allocation and, possibly, growth. A related point made in the staff paper is that restricting trade through export controls may improve a country's terms of trade for a period, but only at the expense of other countries and, if the effects are significant enough, to the detriment of the world trading system and growth. In the end, of course, such measures will be self-defeating.

If I have any criticism of the staff paper, it is that some parts might usefully have been a little more forthcoming. This applies, perhaps, to the conclusion of Part III, Section IV, particularly the discussion on "classical" unemployment. Excessive wages and the failure of labor markets to adjust to falling productivity growth and supply-side price shocks have been characteristic features of countries with unemployment for most of the past two decades. To respond to such unemployment by intensifying protection might increase employment in the short run in the protected sectors, but only at the expense of employment in unprotected sectors. There are plenty of examples--including textiles and clothing in Australia--of cases in which the imposition of even high levels of protection has failed to stem losses of employment; and, in the longer run, the distortions created in the supply structure of the economy become significant. Efficiency and productivity growth are likely to be reduced as the economy's exposure to international competition is reduced, and wage push within the protected sector is likely to increase. The probable outcome is that classical unemployment would be increased. This analysis certainly has lessons for the present, given the call for increased protection in some countries to maintain jobs in industries that are subject to efficient import competition.

The paper rejects the argument that, given protection in industrial countries, developing countries may be better off pursuing import substitution. I hope that no one will interpret this as playing down the importance of market access for developing countries' exports. Access to export markets is particularly crucial at this time for the highly indebted developing countries if their growth and development are to revive and they are to be able to service their outstanding debt. In any event, the reminder that the supposed benefits of protection are largely illusory for industrial and developing countries alike, and that a choice has to be made between inward-looking and outward-looking policies, is timely.

In developing country analysis, the intersectoral effects of protection are particularly worth underlining. The pursuit of sectoral interests is at the expense not only of consumers, but also, importantly, of the unprotected tradables sector.

While the case for short-run protection to assist current account adjustment may be sustainable in some circumstances, it will almost certainly involve sacrificing medium- and long-term benefits for short-term gain. With many developing countries facing continued weakness in commodity prices, financing constraints, and large debt-servicing commitments, current account adjustment will likely be required for some time. Maintaining high levels of protection while this adjustment occurs would run counter to the growth-oriented strategy that we all support. In particular, sheltering the import-competing sector from international trade is likely to reduce efficiency and increase factor returns in that sector. Resources would thus be drawn from the export sector, and its cost structure would be raised. In the great majority of cases, appropriate exchange rate adjustment should be the preferred policy alternative.

What practical conclusions can be drawn by the Executive Board from the staff paper? I would say that it reinforces the need to address vigorously issues of protection in the context of both the design and implementation of Fund-supported programs and the need to upgrade the importance that is given to protection in Fund surveillance of industrial and developing countries alike. I agree with Mr. Wijnholds that the Fund could give greater publicity to its views on these matters, including, as appropriate, in the Managing Director's speeches. The proposal to distribute bi-annual fact sheets on protection is worth examining.

Mrs. Hepp made the following statement:

The staff paper contains an exhaustive analysis of the costs and benefits of protection and shows that the Fund's fundamental approach to protection is well founded. Protection appears to be generally opposed to member countries' national interest. With few exceptions, protection is the result of sectoral pressures. In exceptional cases, even if protection may be necessary for a country as a whole, it damages the international community: the negative effects of protectionist measures in one country spill over into the rest of the world by inducing resource misallocation and limiting the degree of specialization in production in countries around the world. Protection tends not only to affect negatively the allocation of existing world resources, but also to undermine the growth of the availability of those resources over time. The benefit of protection for a particular sector in an economy cannot compensate for the total costs of the protection.

To understand the trend toward protection, it is important to deepen the analysis of the political institutions in which economic policy decisions are made in specific countries. How is it that an interest group in a country can obtain special protection that is inconsistent with the best interests of the country as a whole? This outcome might result from a lack of knowledge of the consequences of accumulating protectionist measures. In this event, the Fund contributes to the solution of the problem by stimulating the preparation and discussion of reports like the present one.

Protectionist measures are taken not only because of a lack of knowledge of their effective costs, but also because they are a part of the policymaking process in member countries. The Fund should not attempt an extensive analysis of how protection could be eliminated from the set of legitimate negotiating tools in member countries' policymaking processes. This subject has been studied extensively, and while additional studies are required, the Fund's main contribution should be to continue to take every opportunity to stress the cost of protection for individual countries and the world. The Fund's role is particularly influential in countries that, because of financial difficulties, have had to request Fund resources in order to maintain access to other sources of financing. These countries would certainly agree that the Fund should continue stressing the importance of a rational trading system. Of course, given the political realities in these countries, the Fund has to be careful in promoting appropriate reforms while taking into account the political constraints that governments are able to measure more accurately than the Fund. Despite the Fund's knowledge of the extent to which protectionist practices are contaminating the world trade system and adding to the difficult external environment in which member countries must undertake adjustment, the Fund should be careful in defining the degree of adjustment that can be sustainable in the countries concerned.

The extent of protection in the world is another reason why the Fund should consider introducing longer periods in which members can complete adjustment programs. The existence of protection should induce the Fund to demand more helpful actions by the creditors of the countries that have to adjust; such actions will help adjusting countries to make sustainable progress.

In the implementation of surveillance the Fund should give priority to the use of liberalization as an important policy tool. The Fund should analyze each country's situation to detect protectionist pressures and to quantify the effects of protectionist measures, and it should stress the importance of eliminating such measures as a part of a sound economic policy stance.

Mr. Murakami made the following statement:

In addressing the issues concerning protection, the staff has adopted a unique approach of concentrating on national interests rather than the international interest. I endorse the staff's conclusion that protection cannot be justified even from a national viewpoint. This argument should help the Fund in its discussions with policymakers and in other discussions related to surveillance or the use of Fund resources. At the same time, as an international organization the Fund has an important role to play in supporting international interests in the expansion of world trade, the avoidance of a retaliation cycle, and the preservation of orderly trading arrangements, especially through the GATT system. Therefore, the staff paper should be supplemented by an analysis based on the international point of view.

While I accept the economic theory that under a floating exchange rate system there is no strong presumption that an increase in protection will improve the current account position, it is difficult to accept the argument that market liberalization measures may not lead to a reduction in a current account surplus. That argument should not be emphasized.

As we have seen recently, macroeconomic policy coordination among industrial countries is important to achieve exchange rate stability, thereby creating a favorable environment in which to reduce protectionist pressures. The staff has successfully argued in favor of stressing the importance of policy coordination from this particular perspective.

The developing countries as well as the industrial countries have an important role to play in further liberalizing world trade. The staff has noted that, for developing countries facing balance of payments problems, exchange rate adjustment is clearly preferable to restrictive measures or can be a helpful complement to liberalization measures. In addition, countries that do not face immediate balance of payments problems are in a position to implement steadily liberalization measures.

A clear distinction should be made between the role of the Fund and the role of the GATT. Accordingly, it would not be desirable for the Fund to undertake in-depth discussions on matters related to specific goods. The Fund does not have sufficient information on specific goods, although this does not mean that the Fund's interest in trade policy is unimportant. I am pleased that the staff paper shows that the staff is mindful of this point.

Mr. Binay made the following statement:

Occasionally we should pay less attention to discussing the consequences of problems or the effects of proposed remedies, and more attention to attempting to define the problems themselves. Protection is only the tip of an iceberg. We have a tendency to accept as normal and immutable some of the factors that cause protection and to discuss means to deal only with protection's most dangerous effects.

What promotes protectionist trends in the world economy--unforeseen overcapacity in world manufacturing and agricultural output, or the social and political rigidities that hamper the competitiveness of several leading countries but which are assumed to be permanent? Is protection encouraged by the decreasing incomes of the developing countries, lagging adjustment by these countries, or, perhaps, even the adjustment programs supported by the Fund?

It is also useful to consider the validity of the well-known theory of comparative advantage in the prevailing world economic conditions. Given the present instability of exchange rates and the resulting distortions in relative prices, as well as the political barriers to resource mobilization, the world no longer fully enjoys the benefits of comparative advantage. The restructuring of an economy is a lengthy process that requires the existence of sure and stable market indicators. Investment decisions are generally based on historical profitability data, but exchange rate fluctuations break this history into segments that are too short to be useful. Therefore, new investment decisions seem to reflect a preference for either import substitution industries, which appear more stable in the long run, or no investment at all. This withdrawal of activity in reaction to unstable and uncertain exchange rates worsens the situation: the decreased demand for investment goods, supported by growing current account deficits, is ammunition for the advocates of protection in countries that are exporters of investment goods. In addition, some countries use protection as an instrument of foreign policy. By definition, "favored nation" treatment cannot produce externalities as great as those obtained by equal treatment of all countries. A more nearly equal distribution of wealth and growth among the developing countries would boost demand for investment goods more effectively than relatively favorable treatment of just one or two such countries.

Claiming that exchange rate flexibility is an alternative to protection is essentially equivalent to inviting an indefinite number of players to take part in a game theory exercise in which the rules are made up as the game proceeds. Such an exercise must soon end in a situation called the "prisoners' dilemma" in which the world is the "prison" and its member countries are the "prisoners."

There is an interesting difference between the sectors to which protectionist measures are applied in industrial countries and the sectors so covered in developing countries. Industrial countries tend to protect agriculture in response to their fear of higher unemployment. However, an economy with a mobile workforce, minimal rigidities in its wage structure, and sufficient public resources to provide basic services in urban areas has little to fear from migration caused by the gradual easing of protection. Helping developing countries to increase their infrastructure investment and export earnings would benefit the industrial countries themselves by promoting both domestic and external demand for investment goods in industrial countries, which could bring unemployment in those countries down to natural levels.

In the developing countries, protectionist measures serve other objectives. As the staff notes, the classic argument is the protection of infant industries. As Mr. Kafka and other speakers clearly noted, most developing countries have generally underexploited markets that are small enough to cause any newly established industry requiring economies of scale to become, by virtue of its size, a natural monopoly that never outgrows its infancy. The early stages of development are highly import intensive, and for many developing country governments, as Mr. Nimatallah noted, import taxes serve as an important source of revenue as well as a form of protection. Because of cost considerations, or for other reasons, such as the limited skill levels of the workforce, or a need to promote employment, developing countries may prefer to import and use an older technology. When they do so, the industry in question looses its competitiveness even before it begins to produce; it is likely that investments in such industries will return a profit only if the enterprises concerned are protected.

Developing countries that adhere to systems of frequent exchange rate adjustments and quota protection must labor under additional disadvantages that stem not only from the rent-seeking activities of quota holders, but also from the increased costs of protection. When import distribution is accomplished through a system of quotas and the date of the next major devaluation is uncertain, manufacturers tend to hoard imported inputs and spare parts; moreover, if the cost of working capital is high, owing to a scarcity of resources or to the absence of capital markets, enterprises with large passive inventories cannot be competitive, even if the disadvantages they face are somewhat offset by low wages.

In sum, the increased tendency toward protectionist measures can be seen not as a cause, but rather as an effect of present conditions. I fear that the ongoing fluctuations in exchange rates will worsen this disease rather than cure it.

Mr. Yang made the following statement:

The staff paper covers a wide range of issues. My comments will center on the issues that in my view require further examination.

During the two years since the previous Executive Board discussion of this subject, protectionist pressures and actions have continued to increase in most industrial countries--despite policymakers' stated intention to promote a liberal world trading system; and the policy measures that have been taken to roll back protectionism have not matched governments' stated intentions. Naturally, we cannot help wondering what lies behind the persistence of protection. The staff seems to argue that blame should be placed mainly on widely held beliefs in the usefulness of protectionist measures. If this is true, we can probably assume that effective refutation of these beliefs would lead to a halt in the rising trend in the use of protectionist pressures. Unfortunately, the continued use of protectionist measures is probably traceable not to a lack of economic knowledge, but to the absence of sufficient political will to act. As we all know, the rise in protection in the industrial countries is concentrated in sectors where the comparative advantage enjoyed by those countries has been diminishing. In addition, the intensity of protection is greatest when decision makers are subject to political pressures from sectoral interest groups. Therefore, it could be argued that the long-standing structural rigidities resulting from developed countries' efforts to preserve their declining industries have led to the strong and increasing demand for protection. Furthermore, the strains from the enormous trade imbalance among the major trading countries have given added impetus to the rising trend of protectionism. Structural adjustment by the major developed countries is a necessary step to reverse that trend, as it would smooth the relocation of industries that have lost their comparative advantage. Strengthening macroeconomic policy coordination among the major industrial countries to correct their trade imbalances would also encourage them to roll back protection.

The threat of the possible adoption of protectionist measures was sometimes used as a bargaining chip in trade negotiations in the past and has recently been found to be useful in the process of policy coordination. If such threats result in reciprocal actions, there would a spiral of mounting protectionist pressures. It is not difficult to imagine how the uncertainties created by such tensions could affect the stability of the world economy. Once a major trading country is compelled actually to take action, the consequences of a chain reaction would be disastrous.

Some might hold the view that all countries--developed and developing--are guilty of using restrictive trade policies. At first glance, this accusation seems to be justified. However, it fails to take into account the vastly unequal circumstances of the developed and developing countries. In general, the developing countries are still in the early stages of economic development, when structural distortions typically remain pervasive. The price system in underdeveloped countries is not always proficient in transmitting correct signals, and the imperfections of market mechanisms inhibit resources from being efficiently allocated. In such circumstances, laissez-faire policies may result in even greater distortions that impair certain infant industries that are of vital importance to the developing economies; the distortions might also permit other undesirable activities to flourish.

Trade liberalization requires a macroeconomic foundation of stability. Stimulating exports through large devaluations of a national currency spurs inflation and worsens the government deficit, which is usually associated with foreign debt. Liberalization is unlikely to succeed in an environment of macroeconomic instability, particularly in an economy facing serious balance of payments problems. Furthermore, the price elasticity of some important imports in developing countries is relatively low owing to the countries' development needs. Undue reliance on depreciation of the exchange rate would therefore increase the costs of imported goods, particularly capital goods, thereby impeding investment and economic growth.

The argument that protection is difficult to eliminate is generally reasonable. It is applicable mainly to the restrictive measures that are aimed at protecting declining industries in the developed countries; the elimination of that protection would result in the collapse of those industries. Nevertheless, the protection of infant industries in developing countries is basically temporary; it can be eliminated once the industries begin to hold their own. When those countries become strong international competitors, protection would be surperfluous and its gradual phasing out would be the natural course of action. In this connection, the experience of some Asian economies is convincing.

Although we recognize the positive effects of trade liberalization on the economic efficiency of developing countries, the desirable and feasible pace of liberalization in a particular country has to be compatible with the course of economic developments in that country. In addition, the principle of different treatment of developed and developing countries with respect to trade liberalization is a fundamental one and should be maintained. A stereotyped trade liberalization program--regardless of the development stage of the economy--may not be appropriate.

Mr. Zecchini made the following statement:

It is useful to recall the importance that the Articles attach to the objective of trade liberalization. Article I states that one of the objectives of the Fund is "to facilitate the expansion and balanced growth of international trade" and "the elimination of foreign exchange restrictions which hamper the growth of world trade." In abiding by this line of thought, this chair has always acted to promote and expand the role of free trade in the world economy, keeping in mind, however, the complex reality of the social, political, and economic environment in which policymaking is actually carried out.

Under the assumptions of perfect competition, perfect production factor mobility, and absence of government interference, liberalization of international trade flows optimizes the allocation of resources across countries and maximizes real national incomes. Unfortunately, reality is very different from this ideal, frictionless world that economists assume. Therefore, the real issue is not so much "what should we aim at," as we are convinced in principle of the superiority of the free trade system, but rather "how shall we get there?" The role of policymakers should be to foster the attainment of these optimal conditions while utilizing "second-best" solutions that can reduce the costs of the transition phase. Consequently, although the objective is to extend the common market notion to the entire world economy, the problem we have to face in the meanwhile is to define the optimal process toward trade liberalization and the scope that should be allowed for limited protectionist measures.

In this context, I will comment on some of the analytical issues raised in the paper, namely, the correction of current account imbalances, the use of protectionism in cases of misaligned exchange rates and "structural" unemployment, and the problems of implementing trade liberalization.

I broadly agree with the arguments presented in the paper on the issue of improving the current account of industrial countries through the adoption of protectionist measures. Protection is basically an inefficient policy instrument, and it is a cause of misallocation of domestic resources. In the specific case of the United States, moreover, the proposal to introduce a uniform ad valorem tariff is unacceptable, even if over the very short term it could prove to be effective in reducing the external deficit. The main reason for this opinion is that correction of the external imbalance brought about by such a tariff would come through import reduction, rather than export expansion. The consequent fall in world demand would be incompatible with the responsibility of the United States to contribute to ensuring sound economic growth for the world economy. Moreover, it is likely that any protectionist initiative on the part of this major industrial country will set a dangerous precedent for other countries and, given the large impact of the U.S. economy on the rest of the world, will lead to a round of retaliations. If the ultimate objective of the tariff is to increase government revenues, reduce the budget deficit and thus improve the current account, I agree with the staff that a general tax on consumption or output could yield the same result with fewer distortions.

On the issue of exchange rate misalignment and protection, I agree, in principle, with the paper's conclusion that, for any given current balance and real exchange rate level, there is an optimal allocation of resources brought about by free trade. The real issue, however, is that adjustments are not without costs. If the misalignment is due to exogenous shocks and is "temporary" in nature, then some scope for "temporary" protectionist measures can be envisaged in order to avoid the costs of adjusting first and readjusting later the allocation of real resources. By the same token, very temporary trade protection could be allowed in the face of permanent external shocks in order to ease the restructuring process for some economic sectors. In this context, the crucial point is to set firm deadlines for the dismantling of these measures in order to prompt the economic agents to carry out adjustments decisively.

In this connection, two limitations to this approach have to be recognized. First, in the case of economies characterized by large persistent surpluses of labor supply, mainly in the backward agricultural sectors, the level of money wage that is consistent with the employment of additional labor in industry may be close to zero; but money wages cannot, for social and political reasons, be so low, even in the short run. Second, the long-run growth of capital stock can be hampered by the inefficiency or nonexistence of financial and credit markets. While these structural weaknesses are being corrected, there might be scope for some protection of industries requiring relatively large amounts of labor. Such protection should be progressively reduced as the degree of industrial development increases. The liberalization process can be accelerated if sufficient financial resources for fixed investments are made available and, at the same time, structural reforms to improve the efficiency of the financial sector are pursued.

On the issue of implementation of liberalization measures, I agree that large-scale liberalization should be associated with realignment of the exchange rate. This should help avoid a deterioration of the current account and could contribute to reducing employment and output losses. In this respect, rapid or significant liberalization measures might be difficult to implement in countries that are part of a currency zone and therefore cannot unilaterally move their exchange rate. For these countries, aside from the possibility of devaluing the real exchange rate by slowing down the dynamics of relative nominal wages and prices, liberalization could be gradually implemented by replacing existing trade restrictions with a uniform ad valorem tariff combined with a uniform export subsidy. These measures would have effects similar to those of an exchange rate devaluation.

In principle, liberalization of trade during a balance of payments crisis does not seem advisable. Unless liberalization can be expected to yield immediate improvements in the external account, it does not seem advisable to add the short-run costs of liberalization to the difficulties owing to the balance of payments.

As to the choice between trade and capital market liberalization, priority should be given to the former. In view of the costs and the time lags associated with redirecting flows of real resources, capital flows causing unwarranted financial and exchange rate developments affecting trade flows should be avoided. In this respect, a useful distinction can be made between financial transactions that are broadly related to production and trade, and short-run flows that are more speculative in nature. The successful experience of the EEC industrial countries in promoting free trade while only gradually relaxing international capital movements seems to support such a contention.

The paper covers a broad range of analytical issues by contrasting partial equilibrium approaches and solutions with general equilibrium, long-term solutions. Although the analysis is extensive, it does not cover important aspects of protection. For instance, the paper does not deal with the implications of protection that is carried out through manipulation of exchange rates or through taxation at the consumer level of some products and inputs of foreign origin while domestically produced substitutes for these products are not taxed. Some attention also has to be paid to these aspects.

Mr. Isleifsson made the following statement:

The staff paper contains a systematic review and analysis of issues concerning protection. It is important to disseminate as much knowledge as possible about the arguments against protection and the effects of protectionist measures. The public must be informed of the real costs of protection. However, as valuable as it is, the staff paper cannot serve these purposes on its own, as it is very analytical and contains considerable economic jargon.

We broadly agree with the staff analysis and conclusions. The staff paper clearly shows the medium- and long-term effects of protection and makes the arguments against protectionist measures. Such measures are based on erroneous economic analysis and should be opposed by political authorities; in this context, political leadership in many member countries is often called for. It is important to emphasize the difficulty in eliminating trade restrictions once they have been introduced even as temporary measures.

The cooperation between the Fund, the GATT, and the World Bank in the trade area is appropriate. In Article IV consultation discussions with authorities the Fund staff should try to provide information on the total economic effects of existing or planned restrictive measures and suggest alternative policies to achieve the desired results. In addition, the staff should pay more attention to indirect subsidies that affect trade flows, even if those subsidies do not have the character of straightforward trade-distorting measures. In this connection, it is important to note that the treasuries of small countries cannot afford to compete with the treasuries of the large countries.

Since the staff paper can serve only part of the important purpose of providing arguments for politicians and others against protection, and since I generally agree with the staff's conclusions, I will not comment on all the issues outlined by the staff. Instead, I will comment on two areas on which a future staff paper should concentrate, namely, the political mechanisms, and the fact that the new protection in the form of sectoral protectionism is significant and may well have more damaging effects than has been realized. I hope that the summing up of this discussion will reflect some of the arguments that have been made today but are not contained in the staff paper. Any future paper on the subject of protection should take into account the many studies that have been made of the costs of protection.

There is unanimous opposition to protection. Given the many adverse consequences of protection, which are widely recognized, I wonder why more is not done about it. One reason may be that decisions on economic policies are made by noneconomists. It is fair to say that academic economists have not been successful in delivering their message, often because of disagreements among themselves on certain highly technical interpretations of findings which may not be fully relevant or necessary in making arguments against protection. Another factor is that governments or bureaucracies do not learn as quickly as private firms about the effects of trade policies; as a result, policy mistakes in the past are repeated. It should be recognized that politicians and bureaucrats may well give way to the pressure exerted by interest groups because they have an incentive to take visible short-term action and to ignore the long-term implications of protection. This political mechanism of protection is especially effective in periods of slow economic activity, when it appears that growing competition from imports adds unduly to internal difficulties, thereby paving the way for public sympathy for the application of restrictions or the granting of subsidies. I am pleased that the staff paper clearly recognizes this point on page 9 in stating that high employment and growth make widespread liberalization much more acceptable and easier. There has been a tendency in recent years to argue the opposite, namely, that in a very unfavorable external and domestic environment, pressures to liberalize the domestic economy increase. However, this argument fails to take into account the political process.

One of the salient features of recent protectionist measures is their selectivity--they are closely linked to the pressures and needs of specific sectors. One particularly unfortunate example of sectoral protection is the Multifiber Arrangement. It has been estimated that four fifths of North/South trade in this area is being managed by bureaucracies, compared with 60 percent in 1974. As a result of the most recent renewal of the Multifiber Arrangement, industrial country textile and clothing producers are destined to receive relief from not only actual import pressure, but also import pressure that might arise in the future. The lack of any commitment to terminate the Multifiber Arrangement is disappointing. As experience has shown in other sectors, protection for one activity easily spreads to other activities, even to those that have been operating within the framework of liberal trade.

As to the costs of protection, selective protectionism has particularly negative effects, since it severs ties to market conditions and progressively reduces the structural adaptability of an economy. It is safe to argue that a country itself will have to bear the costs of its own protectionist measures, and that in a global perspective the dangers of selective protectionism are serious: as the staff notes, too much labor, capital, and entrepreneurial skills are confined to uncompetitive industries. It has been estimated that, for the world economy as a whole, protection has slowed the rate of economic growth by roughly 2 percent a year, and it could be argued that this estimate is conservative.

One of the international repercussions of protection is trade deflection: relatively open countries become the target of foreign exporters who face import barriers elsewhere. This is a popular argument in defense of the Multifiber Arrangement. Moreover, sectoral protection leads to income transfers among industrial countries and to shifts of the adjustment burden that may have nothing to do with the strength or weakness of particular economies. All this is bound to lead to trade disputes among governments, as we have seen in recent years; such disputes encourage retaliation.

Sectoral protection aimed at saving jobs in declining industries in industrial countries can keep developing countries from making full use of their comparative advantage in the manufacture of labor-intensive products. The danger for developing countries in the medium term is that they will promote exports of goods in which they have not competitive advantage merely because access to markets seems to be easier; as a result, those developing countries incur considerable domestic resource costs.

One of the most hopeful means of combating protection is to mobilize the populations in member countries in their capacity as consumers and taxpayers to press for trade liberalization. In addition, the basis on which governments and bureaucracies reach decisions should be broadened and strengthened. The Fund can play an important role in this respect by publishing documents that can be appreciated by noneconomists as well as economists.

Mrs. Walker made the following statement:

The staff paper thoroughly covers the arguments against protection and for trade liberalization that are relevant to the current world trading environment. The costs and benefits of trade measures, as described in the staff paper, should be the basis for the Fund's efforts, consistent with the Articles, to encourage trade liberalization. Trade issues are fully covered in the Article IV consultations between the staff--including staff from the Exchange and Trade Relations Department--and senior officials from the U.S. Treasury and Commerce Departments as well as the Office of the Trade Representative.

Since I basically agree with the staff analysis, I will comment on only some of the issues for discussion before outlining some new developments in U.S. trade policy.

The potential revival of protection is a symptom of both domestic and external macroeconomic imbalances; protection is not necessarily a cause of these imbalances. Problems in the underlying economic fundamentals must be addressed before protectionist pressures will be mitigated. Positive results from strengthened international economic cooperation will be a key factor in reducing protectionist pressures.

The staff paper highlights two areas where protection, particularly in industrial countries, poses problems, namely, textiles and agriculture. Restrictions on textile imports in industrial countries are relatively high. However, it is useful to note that, while there are quotas on some of the large exporters of textiles, some small, new suppliers are being allowed into the market and are enjoying significant growth in their textile exports. As to protection in agriculture, the Tokyo Summit communiqué recognizes the problems stemming from the long-standing policy of providing domestic subsidies and protection in agriculture, and the Heads of State agreed to review the issue in the context of OECD studies. In addition, rules for agricultural trade will be included in the Uruguay Round.

I strongly agree with the staff that the use of export taxes for fiscal reasons can have protective effects and frequently discourages the production of exports. Avoiding the use of export taxes or reducing those in existence is very important, particularly in many developing countries, where increasing exports of goods and services is critical to correcting external payments imbalances and to servicing external debt obligations.

The use of tariffs should be reduced, and where they remain, I agree with the staff that a harmonization of tariff rates is preferable. However, if tariffs are temporarily deemed to be necessary for revenue reasons, ad valorem rates should be used instead of specific tariffs on individual products.

Improvements in the external current account can be accomplished through a variety of mutually supportive efforts, including appropriate exchange rate adjustment, encouragement of the export sector through structural reforms, and sound macroeconomic policies. In some cases, the movement in the exchange rate necessary to improve the current account may be difficult to accomplish in one adjustment, and the impact of exchange rate adjustment often is felt with a lag. However, complete exchange rate adjustment is the preferred option. I do not think that the imposition of tariffs and import quotas or quantitative restrictions in place of complete exchange rate adjustment will encourage the appropriate domestic resource allocation needed to secure a lasting improvement in a country's payments position.

As to the timing of trade and capital market liberalization, it may seem difficult to accomplish significant trade and capital market liberalization in the midst of substantial balance of payments problems and while required macroeconomic adjustment measures are being implemented. However, to generate a lasting improvement in the economy and medium-term growth, trade and capital market liberalization should be initiated in conjunction with other macroeconomic and structural adjustment measures and should continue at as rapid a rate as possible, bearing in mind Mr. Ortiz's comments on the need for credibility and the perception of sustainability.

The question whether protection in industrial countries justifies protection in developing countries is clearly answered in the staff paper, as the staff argues that even if protection in industrial countries increases, it would not be in the best interest of developing countries to forgo their own liberalization for that reason. Developing country trade does not take place with industrial countries alone; it includes other developing countries. A trend toward protection among developing countries themselves can only perpetuate the problem. In addition, the possibility of retaliation against protectionist measures is in itself an argument against protection.

I will now comment on the current trade environment, particularly in the United States, since many of the arguments in the staff paper relate to the practical and political realities of the current situation. The staff suggests on page 4 that, thus far, the revival in protection, with the exception of a few areas, has been more of a cloud looming on the horizon than an actuality. However, the large and growing U.S. trade deficit and the previous appreciation of the dollar had led to heightened interest by the U.S. Congress and some of its constituents in protectionist legislation. As the staff suggests on page 16, this interest has been further stimulated by regional or industryspecific concerns in the United States and by unfair trading practices by other countries.

Because of the concern in the United States about the large trade deficit, the Administration has been forced to pursue a somewhat more activist trade policy. However, much of that activity has been focused on opening foreign markets rather than on restricting U.S. markets. The premise for the Administration's stand against protection is based on the national interest arguments that are presented in the staff paper, namely, that free and open markets are the best means of assuring a prosperous and growing world economy, and that if the United States is to have access to markets abroad, it must maintain the openness of its own market.

In his latest State of the Union Address, President Reagan discussed the issues of international competitiveness and trade and launched a program that has been presented to the Congress in the form of the Trade, Employment, and Productivity Act. In general, this act is designed to encourage the competitiveness of U.S. industry. A key part of the President's program includes three major areas of activity that are designed to shape the international economic environment to further facilitate free trade. The first is the strengthened debt strategy, which we discussed in some detail last week. The second is a commitment by the United States to a continued strengthening of economic cooperation on a global scale to achieve improved and more balanced growth, together with the reduction in external imbalances that is needed for greater exchange market stability. Progress in this area may well be a key in the effort to mitigate protectionist pressures not only in industrial countries, but also in developing countries, particularly the newly industrialized economies. These economies must assume greater responsibility, including opening their markets, which are still closed in many respects, and they should maintain exchange rate policies that more accurately reflect current underlying economic fundamentals.

The third part of the President's program has to do specifically with trade. The President's initiative seeks to enhance U.S. efforts to open foreign markets through bilateral and multilateral negotiations that should improve commercial opportunities for all. It also seeks to ensure that the laws of the trading system as embodied in the GATT are updated to reflect current commercial realities. Finally, the trade part of the initiative involves statutory changes to improve U.S. trade laws in ways that will enhance the ability of the United States to compete without introducing protectionist barriers. It might have been useful to cover some of these issues in the staff paper.

In the wake of continued protectionist pressure in the U.S. Congress, the Administration has urged the Congress to measure its proposals against several considerations--especially the need to conform to U.S. international obligations in the area of trade policy and the need to continue to try to foster an environment of free trade and to avoid the growth of protection. The Administration believes that many of the congressional proposals on the table--such as a general import surcharge, sector-specific protection, and mandatory retaliation--are counterproductive. Many other trade bills are currently being discussed in the Congress. These bills are different from the ones that I have just described. It is far too early to say what, if anything, the legislative process will produce in the United States in the trade area. I believe that the tendency toward protection can be restrained in the United States if markets in other countries become more open, and if we can see some signs of progress from our efforts at multilateral cooperation, including increased growth abroad and a reduction of imbalances.

Mrs. Ploix made the following statement:

I will comment first on the general framework within which the debate on protection has taken place. The members of the GATT have launched a new round of trade negotiations on the basis of a solemn commitment to resist protection and to roll back the recently adopted protectionist measures. At the meeting in Paris on February 19, 1987, the major industrial countries reaffirmed their commitment not to adopt protectionist measures. They agreed that dealing with economic problems by erecting trade barriers is self-defeating. France has a positive attitude on these matters: my authorities still consider that further openness and liberalization will lead to an increase in the efficiency of the economy, and they are eager to advance reforms in this direction; to this end, they are participating actively in the new GATT round.

We fully agree with the opinions expressed in the OECD report in the spring of 1985 and adopted in the communiqué of the ministerial meeting of April 12, 1985 concerning the drawbacks of protection. The report stressed the principal negative effects of protection. Protectionist measures have repercussions that are difficult to define and foresee, but they clearly have inflationary effects. In addition, although protectionist measures preserve jobs in the protected industries, they destroy more jobs in the whole economy, because of their adverse effect on competitiveness. Protectionist measures clearly have a negative effect on investment, because they increase uncertainty facing firms that must evaluate potential demand in making their investment decisions. In addition, it is clear that improvement in the situation of the developing countries will depend crucially upon the opening of the markets of industrial countries.

I will now comment on the issues raised in the staff paper. A stable and effective international monetary system is required to maintain an open system of commercial and financial transactions. As was stressed by Mr. Ortiz and other speakers, exchange rate misalignment and instability have the obvious negative effect of increasing protectionist pressures.

Developing countries have a legitimate right to protect infant industries. Nevertheless, a number of newly industrialized countries are playing an increasingly important role in world trade; some of them have reached the stage at which their economies are less fragile and are in a position to assume greater responsibility for preserving an open world trading system.

The argument about the comparative advantages and drawbacks of restrictive measures compared with a devaluation, is a central one. However, the analysis must be made in a nondogmatic way and on a case-by-case basis. In certain cases, imports have already been curtailed to the maximum possible extent, and the adjustment efforts that have already been made do not leave much room for introducing restrictive measures or devaluing the currency. Other solutions must be explored. In other cases, there might be a need some for selective demand-management policies and, therefore, selective import policies.

At least two conditions must be met to undertake gradual trade liberalization. First, the measures that could create an environment that is conducive to investment should be credible. Second, these measures should be accompanied by adequate financing, since the fragility of an economy typically increases during a liberalization period.

I agree with the conclusions that the staff has drawn in its paper, especially the main conclusion, that an increase in protection does not improve the external current account.

Mr. Sengupta made the following statement:

The staff paper raises several interesting issues that have a bearing on the design of policies in the context of Fund-supported programs. I welcome the way in which the various arguments have been developed in the staff paper; they have been presented in a general equilibrium framework, and the interactions between the different variables are clearly spelled out. A similar paper should be prepared on multiple exchange rate practices. It is necessary to discuss the full implications of the Fund's favorite prescriptions in Fund-supported programs. Executive Directors may differ in their views on such prescriptions, but there must first be a full understanding of what the Fund typically prescribes.

The world sometimes has the impression from the Fund's policy prescriptions that the Fund believes that protection should always be avoided and that full liberalization should always be implemented. The staff does not support that position, and I agree with its general message that protection is costly and should be avoided in industrial countries, which have developed production structures. There may be a case for protection in developing countries, but protectionist measures should be implemented with caution, because of their costs and because of the favorable effect of liberalization on efficiency and optimal resource allocation. I agree with the staff that even if protection in industrial countries increases, damaging the interests of developing countries, it would not be in the developing countries' interest to use that development as a reason for forgoing their own liberalization. However, it must be noted, and the staff paper should have highlighted the point, that it would be extremely difficult for developing countries to sustain their liberalization policies if there is an increase in protection in industrial countries. Such an increase not only sets a bad example; there is also some question whether a policy of liberalization in developing countries can be viable if liberalization is not also undertaken in the industrial countries. Liberalization in developing countries stands or falls on the ability of those countries to increase their exports, which, in turn, requires the opening up of industrial countries, particularly the markets of exports for which developing countries enjoy a comparative advantage.

Protection has been prevalent in all periods and countries. Yet economic theory and the staff paper argue that free trade leads to the most efficient resource allocation and to maximum economic welfare. The gap between theory and reality is often attributed to the limited knowledge of policymakers, or to producers and workers who seek protection and consumers who are unaware of the costs of protection. However, this is not a complete explanation. In reality, the "first-best" assumptions on which the superiority of free trade over restricted trade is built do not exist. Markets are not perfect. They are subject to imperfect competition that distorts relative prices, and there are considerable costs of information and transactions. Therefore, it is difficult to undertake the redistribution of resources that is necessary in the context of Pareto-optimal measure of trade liberalization.

Once this is recognized, political aspects enter the picture. If there are externalities--involving consumption or production--that frustrate the achievement of what may be considered in theory a social optimum by the imperfect markets, there may be a good case for government intervention to correct the situation. It is always possible to devise policies that are efficient enough to remove distortions, while minimizing so-called bi-product distortions. I agree with the staff that actual policies are not necessarily determined by sound 'second best' logic from a national interest point of view. This is particularly true in the industrial countries, and the staff paper clearly shows the weakness of all the arguments in favor of increasing protection in industrial countries; this applies equally to the importsurcharge argument for improving the U.S. external current account. Indeed, the argument for an import surcharge to reduce the budget deficit, which in turn would improve the external current account, cannot be even a second-best argument where there is no case for protecting against imports or biasing the production structure in favor of import-competing industries.

No viable argument can be made in support of protection in industrial countries. The only valid argument for protection, besides the optimal tariff argument, which is exceptional, and keeping aside the case for a temporary measure to tide an economy over during short-run adjustment problems, is the infant industry argument. That argument is based on structural factors, including the existence of external economies that cannot be captured by the expected rates of return on investments in an imperfect capital market characterized by rigidities in factor movements. This argument hardly applies to industrial countries, and most of the second-best arguments that are made in these countries are basically political, reflecting the strength of pressure groups that are adversely affected by the first-best measures. Even the so-called Cambridge argument for short-term protection is difficult to support in a highly industrial country like the United Kingdom. If unemployment is not Keynesian in nature, and is due instead to high real wages, those wages will have to adjust, and wage rigidities should be removed. Protection cannot help, although it may reduce imports and improve the current account in the short run, unless it is established that import controls would increase the profitability of the domestic industries that would attract investment and increase productivity. Even in that situation, it is not clear whether it might not be better to encourage export industries to attract such investment, and whether a devaluation would not be a better policy than import restrictions.

The point that there is no valid basis for protection in industrial countries should be stressed in all the Article IV consultations with industrial countries. Each of the relevant staff reports should contain a section analyzing protectionist trends--both tariff and nontariff barriers--and highlighting the inefficiency and cost of the policies for the country concerned as well as the international implications of those policies. This approach would be consistent with the spirit of international surveillance and the mandate of the Fund.

However, the case for protection in developing countries is different. The terms of trade argument does apply to a number of primary producers, especially if a few major ones act in a concerted manner. The elasticity of demand for primary products is, given the presence of substitutes, such that there may not be much scope for increasing prices and revenues through joint action. The OPEC experiment is unique and cannot be copied. However, joint action can prevent a precipitous fall in prices as a result of excess supply. There is considerable literature on the subject of benefits of price stabilization in commodity markets. I have in mind "supply management" in the commodity markets through what General de Gaulle described as "concertation," not "cartelization."

The infant industry argument is fully applicable to developing countries. Capital market imperfections, which are at the root of this argument, are a basic consequence of underdevelopment, and subsidization of loans, even if feasible, is not the answer. The basic rationale for such protection is dynamic in nature, as it is associated with external economies and learning by doing. I agree with the staff that the logic of the argument would call for import substitution to be extended to export promotion, because the domestic markets of the countries concerned are often too small, and the process that is expected to reduce unit costs would also make the protected activity externally competitive. Accordingly, if necessary, tariffs may have to be combined with export subsidies.

If the basic case for import protection is accepted, the argument for an import surcharge may gain some validity. A uniform ad valorem import duty on, say, manufactures would be similar to a dual exchange rate, especially if the revenues are disbursed to provide a uniform subsidy to exports of manufactures. However, tariff subsidy measures have the advantage that they can be more discriminatory and, therefore, fine-tuned. This goes against the spirit of the neoclassical paradigm, which advocates a neutral policy regime that is not selectively discriminatory. The history of industrialization of the past and present periods, including the industrialization of Japan, South Korea, and newly industrialized countries, does not support the argument that a neutral policy regime is a necessary condition for successful development.

The short-term arguments for protection apply with greater force to developing countries, and the short term occasionally may be extended beyond a clearly initially temporary period because of the rigidities in the economic structure that make the countries concerned underdeveloped. This aspect is well recognized in the staff paper's discussion on the timing of trade liberalization and exchange rate adjustment and in its examination of the question whether short-term problems of liberalization should be added to the efforts of restoring macroeconomic stability. I fully accept this argument in the case of developing countries, but I have difficulty in accepting Mr. Zecchini's contention that, in general, a case can be made for not compounding balance of payments problems by removing import restrictions for all countries. This argument probably does not apply to industrial countries.

The staff paper clearly describes the problems related to the sequence of import liberalization, capital market, and current account liberalization, the association of exchange rate measures with liberalization, and the relationship between tariffs and revenue mobilization. It is clear that there cannot be a uniform prescription for all countries; specific recommendations have to be tailored to the particular conditions of each country. Indeed, this is the most important message of the staff paper, and I hope that it will be appropriately reflected in all the Fund's policy prescriptions and its conditionality.

The staff paper raises an important practical question concerning developing countries. I agree that real exchange rate adjustment is the appropriate instrument to equilibrate the foreign exchange market, taking into account the fundamentals underlying a given economic situation. In practice, exchange rate depreciation has to be associated with import liberalization, but there is a question of the sequence of those developments. Depending upon the elasticities involved, the removal of trade restrictions may have to be gradual; indeed, some of the restrictions may have to be retained for some time. Similarly, one could argue that multiple exchange rate practices may also have to be retained occasionally. I am not arguing in favor of introducing multiple exchange rates. I am only saying that there should not be a dogmatic approach to them, and that this matter should be explored further.

Mr. Santos made the following statement:

The staff paper shows that none of the economic arguments that are used by industrial and developing countries to justify protectionist measures are justified.

Economists have preached the advantages of free trade since the time of Ricardo. However, barriers to trade still exist in one form or another. The reasons for this behavior are generally political, social, and strategic in nature, and no amount of economic arguments will make them disappear overnight. While it is true that, in the long run, the elimination of protectionist measures will benefit everyone, we should bear in mind that their introduction by an individual country can have some positive effects for that country in the short run, such as avoiding unemployment or protecting the external position. In those cases, the aim is to prevent sudden losses rather than to achieve certain gains. As Mr. Ortiz stressed, exchange market instability also is often a source of protectionist pressure.

The issues raised by the staff are important. Many Executive Directors have already commented on them, and I have nothing new to add. I will comment on possible contributions by the Fund to the effort to reduce trade barries. The Fund should continuously raise trade and protectionist-related issues during Article IV consultations and world economic outlook discussions. The cost of protection and the benefits of freer trade should be emphasized. In addition, the Managing Director could make regular public statements on these issues, and the Fund could publicly express its concern whenever there is mention of additional protectionist measures in member countries. Special discussions, like the present one, also contribute to a better understanding of the harm that trade barriers can cause.

Industrial countries, which are more capable than other countries of bearing short-term costs, have a responsibility in the trade area. They can make an important contribution to free trade by continuing to coordinate their macroeconomic policies, thereby bringing some stability to the international monetary system. A stable system does eliminate many of the reasons for protection. The adoption of reference zones and the use of indicators could help to achieve the stability.

There has been a noticeable trend toward liberalization in many developing countries, especially those with Fund-supported programs. Furthermore, this liberalization is being undertaken under very difficult balance of payments conditions. This behavior contrasts with that of industrial countries, where protectionist pressures have increased over the previous several years. Of course, an increase in protection in industrial countries should not mean that developing countries ought to follow the same path. Developing countries need to be encouraged to continue in the direction of free trade; strong signals from industrial countries could help developing countries to stay on that path. The fewer barriers there are to the exports of developing countries, the easier it will be for them to open their markets to the exports of industrial countries. A more vigorous approach in this direction by industrial countries will certainly set a good example for developing countries.

Mr. Hassan made the following statement:

While the major arguments against protection rest mainly on the international implications of imposing trade barriers, the staff paper has successfully made a strong theoretical argument that, even from a national viewpoint, protection is harmful and results in welfare losses.

The persistence of protectionist pressures in industrial countries is due to the desire, from a national viewpoint, to reduce current account deficits, improve the alignment of exchange rates, and/or expand employment. While these objectives should be pursued, the correct approach is to adopt appropriate macroeconomic and structural adjustment policies to change the underlying conditions rather than to impose trade restrictions. The staff paper argues convincingly that under a system of floating exchange rates, increased protection in industrial countries is not likely to result in an improved current account position and will not provide an effective solution to the problem of exchange rate misalignment. Moreover, it is doubtful whether increased protection will result in a reduction in the high rates of unemployment in industrial countries by diverting demand from foreign goods to local products. The persistence of high levels of unemployment in industrial countries may well be a reflection of the existence of structural rigidities in those countries. Whether those rigidities are in the labor market or are related to production and efficiency, they cannot be eliminated by an increase in protection. Indeed, intensification of protection would perpetuate these rigidities. Even more important from the national viewpoint, the intensification of trade restrictions would protect inefficient production, thereby encouraging continued resource misallocation that would in turn cause potential losses of output and employment. Therefore, industrial countries stand to gain from trade liberalization through more efficient resource allocation and improved competitiveness.

Nevertheless, protection in industrial countries has continued to increase since 1980, and a higher proportion of imports are covered by nontariff barriers of some kind that have resulted in a shrinking of the market share of exports from developing countries. The adverse implications of these developments for developing countries and their debt-servicing capacity cannot be overemphasized.

In contrast, many developing countries have been moving to liberalize their trade under the Fund's supervision and are being advised to maintain outward-looking strategies. These trends have occurred in countries facing fiscal and balance of payments crises. The staff's argument that developing countries facing fundamental disequilibria in their economies should pursue a policy of rapid liberalization to achieve adjustment is too theoretical and has not yet been tested in the real world. In a world that is full of imperfections, second-best solutions can be chosen. Therefore, if the Fund's advice is to be useful, it must be guided by realism, so that the theory of the welfare benefits of free trade can be relevant to the particular circumstances of developing countries. A strategy based on liberalization and outward-looking development would work only in a stable external and internal environment. It does not make much sense to advise a low-income developing country facing a payments crisis, a serious foreign exchange shortage, and serious internal imbalances to make rapid liberalization before stabilizing its economy; the requirements of stabilization and liberalization are mutually inconsistent.

The staff also advises developing countries facing a macroeconomic crisis to address the external payments problem through massive devaluations. Apart from the lag with which a devaluation usually works and the problem of real wage rigidity, other structural bottlenecks and the narrowness of the production base, particularly in the low-income countries, many of which are in Africa, present more significant challenges to the policy of using massive devaluations as an effective solution to balance of payments difficulties. In a one-crop economy, where production is constrained by the unavailability of basic inputs, a shortage of foreign exchange and an inadequate infrastructure, it is not likely that there will be a positive response to changes in relative prices; and a devaluation would probably do little more than intensify the already significant domestic price pressure. In such situations, massive exchange rate adjustment does not appear to be a viable option. Moreover, it is difficult to understand how collective massive devaluation by a number of countries producing the same commodity and competing in the same markets will promote their exports. Indeed, their export proceeds are likely to fall; buyers of commodities and raw materials--rather than the exporting countries--would be the main beneficiaries of collective devaluations.

A major reason why most low-income countries resort to trade restrictions is that they face a serious foreign exchange shortage and a lack of external financing. Because of their limited access to private financial markets and the decline in official inflows, these countries are left with no choice but to further compress their imports. This is not an argument for increased protection in these countries; rather, I wish to stress that meaningful trade liberalization in low-income countries can occur only after a viable solution to their macroeconomic and debt crisis and a reduction in the severe constraints on an expansion of domestic production.

As is recognized in the staff paper, many developing countries use tariffs and export taxes for fiscal purposes. Because of administrative and technical difficulties associated with taxes on income, output, and consumption, foreign trade is a convenient and, in some cases, the only viable tax base in many low-income countries. Liberalization is possible only if there are alternative tax sources, which, in turn, depend upon the expansion of the production base and the diversification of the economy.

All these comments suggest that there is a logical correlation between trade liberalization and a country's level of economic development. The infant industry and terms of trade arguments further strengthen this conclusion. The logic of this conclusion suggests that the more developed a country is, the easier it should be to liberalize its trade. However, actual current developments suggest that the opposite is happening.

The staff representative from the Research Department remarked that the central question raised in the discussion was why protection had persisted in the face of arguments that clearly showed that free trade and liberalization were obviously desirable. There was clearly a widespread feeling among Executive Directors that a significant movement toward free trade would be beneficial, and an answer to that question was that sectoral interests were one of the main underlying causes of persistent protection. In addition, policymakers around the world continued to believe that, in many respects, protection was desirable from a national viewpoint. In making recommendations to individual member countries, the Fund often encouraged national leaders to liberalize their economies to further the national interest and despite the existence of sectoral interest groups that favored protection. It was therefore important for the Fund to have a clear idea why freer trade was in the national interest.

It had been noted by Mr. Foot that the liberalization of the U.K. capital market was conditional upon reciprocity by other countries, the staff representative recalled. That strategy fitted the general theoretical approach to trade policy and the approach of the GATT, whose member countries, particularly the major industrial countries, tended to liberalize on a reciprocal basis through international negotiations. The theory was that the liberalization by one country of its market was beneficial both to the country itself and its partner countries, and that liberalization by those partners at the same time made the liberalization particularly beneficial to all concerned.

The question had been raised whether misaligned exchange rates had contributed to the protectionist pressures in some countries, the staff representative noted. It was widely believed that the U.S. dollar exchange rate had not been correctly aligned for several years, and that perception had generated protectionist pressure in the United States. That was not to say that the misalignment had actually caused protection; it had created protectionist pressure that could have been resisted.

Gaining adequate access to export markets was crucial for the liberalization efforts of developing countries, the staff representative stated. The empirical work of the World Bank staff showed that the industrial countries' markets for manufactured imports were still relatively open, with the well-known exception of clothing and textiles. At the same time, developing countries still had a very small share of total export markets. Hence, there seemed to be considerable scope for expansion of exports of manufactures in developed countries, despite the restrictions in those countries. Executive Directors seemed to agree that market access for developing countries was crucial, and that there was little, if any, basis on which industrial countries could successfully argue for protection in their economies.

One Executive Director had asked why the staff had made a distinction between industrial and developing countries in analyzing the arguments for and against protection, the staff representative from the Research Department recalled. The staff had made the distinction for three reasons. The first was the difference between the exchange rate arrangements of the industrial and developing countries. The main industrial countries had a system of more or less floating exchange rates, while many developing countries maintained a system of fixed but adjustable rates. The second reason was the existence of the infant industry argument. In certain carefully specified circumstances, an argument could be made for infant industry protection in developing countries; the same argument could not be made for developed countries. The third reason was the overall situation in the developed and developing countries. On the whole, the developed countries were already fairly liberalized, and, in the context of the issues at hand, the aim should be to prevent increases in protection. Further liberalization in developed countries need not cause massive structural changes in those countries; instead, it should be limited to certain parts of each industrial country's economy. However, developing countries still maintained a high degree of protection of all kinds; therefore, the developing countries had a different starting point for the examination of the proper role of trade liberalization in their economies.

The Deputy Director of the Research Department remarked that the staff would explore Executive Directors' various proposals to undertake additional studies. A number of studies in the area of protection had been provided in the past. For example, as several Executive Directors had suggested, additional work on the quantification of some of the costs of protection would certainly be helpful; on a number of occasions in the past, the staff had made such estimates, most recently in the context of the 1986 Article IV consultation with the United States, for which the staff had made a fairly detailed study of the cost of voluntary export restraints. In addition, the staff had recently prepared a study of multiple currency practices, although, as Mr. Sengupta had suggested, additional work on that subject could usefully be undertaken.

As Mr. Salehkhou had suggested, the word "cartel" had acquired an emotive connotation, the Deputy Director continued. The staff had used the term in a neutral sense in its paper, but in future the staff would try to avoid words that could be interpreted in ways that were not intended.

The Executive Board had decided that membership in OPEC would not create either a negative or positive presumption with respect to a member's eligibility to use the compensatory financing facility, the Deputy Director of the Research Department said. The staff continued to adhere fully to that decision.

The staff representative from the Exchange and Trade Relations Department noted that the first trade information notice had been circulated in late 1985. The number of such notices that had been circulated subsequently was fairly small. Quite apart from the difficulty in distinguishing between major and minor trade actions, there were two additional constraints on circulating trade information notices. The first was the constraint on staff resources. The second, more important factor was that the notices were never intended as a substitute for greater coverage of trade actions in Article IV consultation reports; accordingly, the staff had faced the choice of either dealing with a particular trade issue separately in an information notice or covering the issue in the relevant Article IV consultation report, and the staff had tended to prefer the latter approach. The suggestion to issue biannual fact sheets on major trade policy decisions was welcome, and the staff would explore the possibility of implementing the suggestion in the near future. While such six-monthly fact sheets would probably reduce the need for individual trade information notices, such notices might still be required on a case-by-case basis for major trade decisions; the Executive Board would need to know about such decisions quickly, rather than wait for the next six-monthly fact sheet. Finally, the staff would consider the suggestion to prepare a new paper on multiple exchange rates.

Mr. Salehkhou remarked that he continued to be concerned that the implicit practice of the staff was to exclude OPEC members from gaining access to the compensatory financing facility.

Mr. Zecchini considered that all arguments in favor or against protection applied with equal force to industrial and developing countries The substance of the case for infant industry protection was applicable to both industrial and developing countries; the only difference in the application of that argument to industrial countries, as opposed to developing countries, was in the degree of applicability. The staff had suggested that, since financial markets were relatively well developed in industrial countries, infant industry protection was not warranted in those countries. However, financial market development did not necessarily go hand in hand with real economic development; there were several cases in economic history in which there had been enormous gaps between financial market development and the development of the real economy. Moreover, at present, there were significant examples of gaps between financial and economic developments in Europe and Asia, including Japan The most important aspect was the size of the economy concerned, and particularly the size of its markets. The magnitude of markets could make infant industry protection appropriate in some industrial and developing countries.

Mrs. Walker said that she wondered whether the trade fact sheets would be limited to a simple statement of major trade developments. Presumably the manpower resources required to analyze those developments would be better spent in the context of Article IV consultations than on separate trade fact sheets.

The staff representative from the Exchange and Trade Relations Department responded that the staff would wish to give further careful thought to the possible content of the trade fact sheets. Presumably a mere list of major trade developments over a six-month period would not be particularly helpful to the Executive Board. Some overall assessment of the developments--for example, whether the general trend was toward greater or less liberalization--would probably be appropriate. That kind of assessment would require fewer resources than an assessment of each trade development.

The Chairman made the following summing up:

Executive Directors clearly agreed that trends in trade policy and the issues discussed in the staff paper are long-standing and basic concerns of the Fund. In view of the Fund's consistent position in favor of trade liberalization and, more generally, of an open trading system, it is particularly important to understand and carefully analyze the various arguments that are used to justify protectionism. The Fund should continue to take the position of favoring trade liberalization. Indeed, a number of speakers urged the Fund to be even more forthright in future in publicizing its views on this matter, and I will take this into account in preparing my speeches in the future.

Several Directors consider that Article IV consultation reports should include thorough and vigorous coverage of trade issues. It was stressed that the treatment of industrial countries in this respect should be comparable with the treatment of developing countries. In fact, the Board's wish to have these issues covered is one reason why the reports have become longer and more staff time has been allocated to preparing the trade sections. This raises, of course, the difficult and worrying question of the allocation of scarce staff time.

I noted the suggestion of Mr. Wijnholds, supported by several other Directors, that the staff might prepare a biannual fact sheet on trade policy developments. The staff will consider this recommendation, including the implications for staff resources as well as for reporting by national trade authorities.

Turning now to the substantive issues raised by the paper, Directors agreed that there has been a worrisome increase in protection in industrial countries in recent years and that further increases would have serious adverse effects. Many Directors were particularly concerned about the adverse effects of such protection on developing countries; protection by industrial countries can only make it more difficult for heavily indebted countries to expand their exports. Most Directors agreed that industrial countries' markets for manufactured goods were still fairly open, but some stressed the extent of present obstacles. At the same time, Directors agreed with the point stressed in the paper that protection imposes costs--often large costs, especially for consumers--on the country that actually engages in protection.

With regard to arguments for protection, most Directors agreed that, with flexible exchange rates, protection would not necessarily reduce the current account deficit while liberalization would not necessarily reduce a surplus. Protection can reduce an imbalance only insofar as it changes public or private savings or investment. Hence, an increase in protection could not be justified by the existence of a current account problem.

However, Directors noted that if protection takes the form of a tariff and the revenue from the tariff were not spent, there could be an effect on the current account through the improved fiscal position.

Not only is protection clearly not in the interest of the world trading system, it is also generally not in the national interest, even though it may yield benefits to particular sectoral interests. It was widely agreed that the threat of a revival of protectionism strengthens the arguments in favor of real exchange rate stability for the major currencies. Many Directors underlined that instability of industrial countries' exchange rates led to pressures for protectionism both in industrial and developing countries. This was seen as a further argument for strengthened policy coordination among the major countries.

Directors agreed that, in general, protection does not increase overall employment, and liberalization need not increase unemployment, provided some time for adjustment is allowed and the exchange rate is set appropriately. Some Directors particularly stressed the problem of adjustment costs and felt that the difficulty in accomplishing trade liberalization, especially in developing countries, should not be underrated. The fiscal burden that adjustment measures might impose should also be noted.

Directors stressed that the high protection of agriculture, clothing and textiles in developed countries was a matter of particular concern and that strong arguments for such protection could not be made. Some stressed the difficulty in reducing protection in these fields and the special problems these areas presented. They noted that in industrial countries there is a need to overcome structural rigidities in order to reduce protectionist pressures.

With regard to protection by developing countries, Directors considered tariffs and export taxes at modest levels to be sometimes acceptable for fiscal reasons but noted the danger that they would lead to undesired trade-restricting effects and that tax structures that did not discriminate against imports or exports would be preferable.

Some Directors felt that there was still a case for infant industry protection in developing countries but agreed that, in general, protection of infant industries, insofar as it was justified, should not be biased in favor of sales to the home market. Other Directors stressed the danger that infant industry protection would not prove to be temporary. Some Directors noted the case for infant industry protection in developing countries on the grounds of capital market imperfections, but one Director pointed out that the incurring of temporary losses is no different from any other kind of investment cost. Most Directors agreed that outward-looking policies in developing countries seemed to have had favorable effects on growth rates. It was noted that outward-looking policies did not imply absence of government intervention, but rather the absence of a bias against exports.

Most Directors agreed that exchange rate adjustment, rather than tariffs or import quotas, was appropriate for a developing country needing to improve its current account, and they supported the Fund's general practice of opposing the imposition of new restrictions at a time of balance of payments difficulties. But some Directors noted that in particular circumstances there may be an argument for temporary restrictions--for example, sometimes a devaluation may run the danger of provoking a wage-price spiral. Of course, appropriate aggregate demand policies must also be maintained.

The timing and sequence of trade liberalization--whether it should be gradual or sudden, and how it should be related to capital market liberalization--was a complex matter. Most Directors regarded gradual liberalization as being preferable, and they agreed that any major liberalization required prior or simultaneous adjustment of the exchange rate. Some Directors had reservations about undertaking trade liberalization during periods of balance of payments difficulties.

Several Directors commented on the relationship between trade liberalization and capital market liberalization. Some Directors felt that this required further study. They noted that in many countries a revival of trade protectionism had occurred at the same time as a rapid liberalization of the capital market. Some agreed that capital market liberalization can be a problem for a program of large-scale trade liberalization through the effects on the exchange rate.

Directors agreed that protection by industrial countries does not justify protection by developing countries, or vice versa, although some of them noted qualifications. They emphasized that any revival of protectionism in industrial countries would certainly set back the cause of liberalization elsewhere.

2. OECD WORKING PARTY NO. 3 AND DEPUTIES OF GROUP OF TEN - MEETINGS - REPORT BY STAFF

The Director of the Research Department noted that the OECD Working Party No. 3 met in Paris on March 19-20, 1987, and that the G-10 Deputies had also met in Paris, on March 20, 1987.

The discussion in the Working Party focused on the short-term and medium-term outlook, the Director continued. The discussion on the medium-term outlook was focused on a baseline scenario and two alternative scenarios presented in a paper prepared by the Secretariat. The projections in the baseline scenario were similar to those in the latest World Economic Outlook report, and the Working Party's discussion on the scenarios was similar to the latest Executive Board discussion on the world economic outlook.

One of the alternative scenarios in the paper before the Working Party was based on the so-called market adjustment of the exchange rate, while the second scenario held the exchange rate nearly unchanged, thereby focusing adjustment on fiscal policy, the Director explained. There was unanimous agreement that the projections in, and the outcome of, the scenario based on further exchange rate adjustments were inferior to those in the other scenarios. According to the relevant scenario, the consequences of further exchange rate adjustments included very low rates of economic growth in industrial countries other than the United States, and a significant danger of new inflationary pressures in the United States. The participants in the Working Party's meeting favored the scenario that focused primarily on coordinated fiscal policy adjustment.

The bottom line of the scenarios that were discussed by the Working Party was that external imbalances were likely to remain large and, therefore, greater efforts at making fundamental policy changes would be required, the Director noted. In that connection, the participants in the meeting seemed to prefer making adjustments in the fiscal policy area. At the same time, the discussion on which countries should take the first steps toward fiscal adjustment was inconclusive.

The Secretariat of the Working Party had revised downward its growth forecasts for the short term in view of the movements in exchange rates after November 1986; those projections were also similar to the Fund staff's, the Director said. The participants in the meeting agreed that the downward revision in the estimates was appropriate. At the same time, each delegate saw the short-term prospects for his country in a somewhat more optimistic light than was suggested by the data in the Secretariat's paper. The delegates agreed that steps must be taken to improve the balance of payments prospects, but there was no clear agreement on which country should take the lead to move forward. Some argued that considerable adjustment had already taken place in their countries, or that the imbalances in a particular country were structural in nature and could not be reduced in the short term. In sum, the discussion of the Working

Party was remarkable both for the degree of agreement on the diagnosis of the issues and for the general hesitancy to take drastic steps, at least in the short run, to deal with the imbalances.

The G-10 Deputies had had four items on their agenda, namely, the world economic outlook, indicators, the debt strategy, and the compensatory financing facility, the Director remarked. In fact, most of the discussion was centered on the debt strategy. The G-10 Deputies had had before them a summary of the Managing Director's summing up of the latest Executive Board discussions on the world economic outlook and indicators. Some interest was expressed in indicators, particularly the idea of greater quantification of indicators. There was also some discussion of the possibility of providing special treatment in the context of the compensatory financing facility to the countries that qualified for IDA assistance.

The Director of the Exchange and Trade Relations Department noted that by the end of the Working Party's discussions there had been little time left for the meeting of G-10 Deputies, who concentrated their discussion on a fairly quick survey of the debt strategy. The Deputies' comments covered much of the same ground that was covered in the opening statements by the Fund staff representatives; the discussion was similar to recent Executive Board discussions on the debt strategy. There was general support for the present framework of the debt strategy. The main new element was the emphasis on permitting the strategy to evolve over time, so that there would be room to explore new ideas, such as debt/equity swaps. There was some emphasis by the G-10 Deputies on the poorest countries, in general, and on possible debt relief for them, in particular. There was some suggestion that the conditionality used for structural adjustment arrangements could usefully be applied to purchases under the compensatory financing facility.

The Executive Directors took note of the statements by the staff.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/87/52 (3/23/87) and EBM/87/53 (3/23/87).

3. EXECUTIVE BOARD - INFORMAL RECESS

The proposed period for the Executive Board's informal recess, as set forth in EBAP/87/56 (3/18/87), is approved.

Adopted March 23, 1987

APPROVED: October 28, 1987

LEO VAN HOUTVEN
Secretary