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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/72

3:00 p.m., May 8, 1987

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	Jiang H.
C. H. Dallara	M. Lundsager, Temporary
	L. Hubloue, Temporary
A. Donoso	
	T. Alhaimus
	B. Goos
	J. Reddy
	J. Hospedales
	M. Foot
H. Lundstrom	
M. Massé	O. S.-M. Bethel, Temporary
Mawakani Samba	
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	L. Filardo
H. Ploix	
G. A. Posthumus	
	C.-Y. Lim
	I. Sliper, Temporary
G. Salehkhou	
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present
Administration Department: D. S. Cutler, R. H. Floyd, N. S. Jackson. African Department: R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director. Central Banking Department: D. R. Khatkhate. European Department: P. B. de Fontenay, Deputy Director; A. Lopez-Claros, H. O. Schmitt. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; E. Brau, D. Burton, G. G. Johnson, S. Kanesa-Thasan, C. Puckhatikom, M. H. Rodlauer, P. J. Quirk. External Relations Department: P. J. Bradley, P. C. Hole. Fiscal Affairs Department: V. Tanzi, Director; A. Cheasty. IMF Institute: O. B. Makalou. Legal Department: R. H. Munzberg, S. A. Silard. Research Department: A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; R. R. Rhomberg, Deputy Director; N. M. Kaibni, I. Otani. Secretary's Department: C. Brachet, Deputy Secretary; A. P. Bhagwat. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock. Western Hemisphere Department: S. T. Beza, Associate Director. Advisors to Executive Directors: E. Ayales, L. P. Ebrill, S. M. Hassan, G. D. Hodgson, K. Murakami, G. Pineau, I. Puro, A. Vasudevan, J. E. Zeas. Assistants to Executive Directors: F. E. R. Alfiler, F. Di Mauro, W. N. Engert, S. K. Fayyad, V. J. Fernandez, M. A. Hammoudi, G. K. Hodges, V. K. Malhotra, C. Noriega, J. K. Orleans-Lindsay, S. Rebecchini, G. Schurr, B. Tamami, H. van der Burg, I. Zaidi.

1. WORK PROGRAM

The Executive Directors continued from the previous meeting (EBM/87/71, 5/8/87) their consideration of the Managing Director's statement on the work program until the 1987 Annual Meetings and the schedule of meetings for the same period.

Mr. Mawakani made the following statement:

I can go along with the work program, which I broadly endorse. It is appropriate that the Executive Board's agenda will give priority to discussion of the policy matters that were proposed by the Interim Committee.

In the area of surveillance, I support the proposed modification and updating of the principles and procedures contained in the 1977 surveillance document in order to reflect the evolution of economic variables in the world economy. I hope that the staff paper will include a thorough examination of the concerns of developing countries about the asymmetry of surveillance and that it will include concrete proposals to address those concerns. I welcome the additional technical work that is being undertaken on ways in which to strengthen the use of indicators for multilateral surveillance. I am pleased to note that the next updating of the world economic outlook will continue to provide valuable information in the manner that has been suggested, particularly on the assessment of the impact of industrial countries' policies on developing economies, the means of strengthening growth in developing countries, and a review of progress in dealing with the debt situation. I hope that the assessment of the impact of industrial countries' policies on developing ones will pay due attention to the industrial countries' agricultural policies. I accept the Chairman's suggestion that his summings up of the Executive Board discussions on the world economic outlook, surveillance, and indicators should form the basis for reporting to the Interim Committee.

With respect to the role of the Fund, we are anxiously awaiting the formal issuance of the G-24 report, since its suggestions cover several important matters that should be reviewed by the Executive Board. In this connection, I am referring to the call that has been made to schedule the next comprehensive review of conditionality as called for under Guideline 12 on conditionality.

As to policies on the use of Fund resources, I favor maintaining the practice of having the Executive Board hold a preliminary discussion on the policy on enlarged access and the access limits before the Annual Meetings so that the Interim Committee could provide guidance on that subject. The proposal to discuss a paper entitled "Approval in Principle of Fund Arrangements" is most welcome, given the recent uncertainty surrounding financial commitments by commercial banks to ensure the total financing required for Fund-supported adjustment programs. There have been legitimate concerns about the extensive delays and disruptions that could occur in the implementation of agreed programs owing to a lack of additional financing. The guidelines on the use of this procedure call for a re-examination, since the Fund's catalytic role with respect to mobilizing resources from commercial banks seems to have been eroded.

The attention that has been given to the plight of low-income countries in the context of additional financial support for the structural adjustment facility and the implementation of the UN Program of Action for African Economic Recovery and Development is a step in the right direction. The inclusion of a discussion on low-income countries in the proposed work program is an encouraging reflection of the Fund's determination to collaborate with other institutions to deal with the exceptional difficulties of low-income countries caused by the structural nature of the problems facing those countries. While the Baker plan has had some success, it is fair to recognize that much more remains to be done to find a satisfactory solution to the debt problem. I look forward to discussing the staff paper entitled "Further Strengthening of the Debt Strategy." New and imaginative recommendations for dealing with the debt problem should be put forward to supplement the new debt strategy.

I support the Chairman's suggestion that he should conduct consultations to ascertain whether the broad support needed to propose SDR allocations exists. I hope that he will be able to elicit the necessary broad support.

Mr. Reddy said that the proposed work program was ambitious. It encompassed all the subjects that were of interest to his chair, and it fully complied with the guidance that had been given by the Interim and Development Committees at their spring meetings. While he fully endorsed the proposed work program, the schedule of work in the period up to the fall meetings of the Interim and Development Committees was tight. For example, approximately 65-70 staff reports for Article IV consultations were to be discussed. He wondered whether some of the discussions on Article IV consultation reports, especially for smaller countries, could not be delayed until after the 1987 Annual Meetings in order to ease the pressure on the Executive Board during the coming months. That objective could be achieved either by postponing or delaying staff missions, or by a more flexible application of the 90-day rule, or through some combination of those measures. The problem of a heavy work schedule resulting from discussions on consultation reports was unlikely to recur in coming years, as the two-year consultation cycle was to be phased in for the majority of member countries.

Mr. Goos made the following statement:

I support the proposed work program, although the heaviness of the work load for the Executive Board and management--and especially for the staff--is worrying. However, apparently the Chairman had little leeway in designing the program, given the largely predetermined pipeline of topics, including the specific requests of the Interim Committee that have to be addressed prior to the 1987 Annual Meetings.

However, I am worried about the extraordinary bunching that will occur in the period between the end of the Executive Board recess and the 1987 Annual Meetings. During that period, the Executive Board will have to deal with such weighty subjects as the world economic outlook, international capital markets, the compensatory financing facility, the G-10 and G-24 reports, and other related adjustment matters. In addition to the Article IV consultation with the United States, the Executive Board will have to deal with topics related to low-income countries and the design of adjustment programs that are very important and warrant consideration prior to the 1987 Annual Meetings. I would welcome any effort that would enable the Executive Board to discuss as many of those topics as possible prior to the Executive Board recess. Moreover, the proposed papers on SDR matters, especially the two papers that are tentatively scheduled for discussion at the end of August, could be further postponed, until after the 1987 Annual Meetings. However, the paper on further strengthening of the debt strategy might well warrant consideration by the Executive Board prior to the 1987 Annual Meetings in view of the ongoing critical debt situation and the unabated interest of the Interim Committee in the subject. I agree with Mr. Dallara that the discussion of the debt paper should be combined with the discussion on capital markets and, perhaps, conditionality.

I have no basic difficulty in accepting the proposals concerning the world economic outlook, surveillance, and indicators. However, I continue to doubt the usefulness of further informal exchange rate discussions, particularly if they are to take place on a fixed, quarterly basis. If such discussions are to be held at all, they should take place on an ad hoc basis, in response to exceptional developments in the markets. Moreover, exchange rate discussions would be useful only if they include consideration of at least the main underlying economic trends and policies, which would necessitate comprehensive documentation similar to that provided for the world economic outlook. Of course, such documentation could concentrate on the fundamentals in the major countries consistent with the likely focus of the discussion on the major currencies, but this would undoubtedly lead us directly into a full-fledged discussion of policy adjustment and coordination among those countries; I doubt whether the kind of informal meetings that are being contemplated would be the right forum for such full-fledged discussions.

As to the forthcoming work on indicators, the staff paper exploring the criteria for reaching judgments about the "desirability and sustainability of the evolution of selected economic variables" is welcome. However, I hope that this exploration will not lead us into the development of normative indicators and acceptance of the corresponding idea of automatic policy adjustments. This chair has expressed the same concern on a number of previous occasions.

I doubt whether it would be advisable and practicable to hold separate discussions on the major industrial countries in the context of the world economic outlook exercise. After all, previous discussions on the world economic outlook have always concentrated on, or strongly emphasized, developments in the major industrial countries, including their interactions and their repercussions on world economic developments; therefore, if we were to split the world economic outlook discussion, we would have a normal world economic outlook discussion that would concentrate only on the problems of developing countries.

The proposal to use the summings up of the relevant Executive Board discussions as the means of reporting to the Interim Committee on indicators is appropriate. In addition, I agree that a preliminary Executive Board discussion on access limits prior to the 1987 Annual Meetings would be helpful.

I welcome the proposal to have the Chairman consult Executive Directors to ascertain whether there is sufficient support for SDR allocations. I do not see the need for another Executive Board discussion on the subject in the absence of new substantial developments. However, if the Executive Board wished to hold a discussion, it should take place on the basis of a staff paper concentrating on the criterion that is exclusively relevant to the issue, in accordance with Article XVIII, namely, the prospect for a long-term global need for liquidity. Accordingly, I do not accept the proposal to narrow the discussion to only some aspects of the problem, such as the cost of holding international reserves, because this would draw attention away from the critical criterion for SDR allocations. Previous discussions have clearly shown that the divergence of views on possible allocations cannot be bridged by such basically biased considerations.

Mr. Nimatallah made the following statement:

I generally agree with the proposed program. I welcome the staff's intention to look into the impact of industrial country policies on developing countries, and particularly on adjustment efforts, when preparing the papers on indicators and the next world economic outlook exercise. The main world economic outlook survey paper will include prospects for reducing payments imbalances among the largest industrial countries; I wonder whether the staff could also look into the possible trade-off between the pace of fiscal retrenchment and the rate of economic growth. It has been difficult to identify the right rate of reducing fiscal deficits, owing to the difficulty in predicting the pace at which the private sector will take up the slack.

I am pleased that informal discussions on exchange rate developments are becoming a regular feature of the Executive Board's work. All Executive Directors should participate actively in those discussions. At the same time, Executive Directors representing major industrial countries should convey the sense of these discussions to their authorities.

Recent papers on compensatory financing requests by oil exporters have included estimates of capacity utilization to assess whether shortfalls were beyond the control of the authorities. I doubt whether this concept of capacity utilization is relevant to this matter, because appropriate levels of capacity utilization can be different in different countries at different times. Furthermore, exporters sometimes increase their production capacity in response to growing demand for their product; this is an appropriate response to market conditions. Naturally, at other times, demand may be much lower, thereby leading to lower capacity utilization. For example, Saudi Arabia built a large oil production capacity in the late 1970s to supply more oil to the market in response to the prevailing scarcity, which was pushing prices to undesirable heights. Therefore, it would be inappropriate to expect Saudi Arabia to use that capacity fully today, when the demand is low. Should Saudi Arabia need to request compensatory financing, requiring Saudi Arabia to be operating at full capacity would fly in the face of the efficient working of the free market. Accordingly, this concept of capacity utilization in the context of the compensatory financing facility should be dropped completely. It is not only inappropriate on a technical basis, but it might also give the impression that the Fund was taking a position against a particular group of members, namely, the oil exporters. The staff paper on the compensatory financing facility should not deal in any way with the concept of full capacity.

It is important for the Fund to identify ways in which to strengthen the design of Fund-supported, growth-oriented adjustment programs. Therefore, I welcome the proposed paper on this matter, which is to be prepared in the light of previous Executive Board discussions and the Fund/World Bank Symposium.

I can go along with the Chairman's proposal to consult Executive Directors to ascertain whether or not there is sufficient support for him to make a proposal for SDR allocations.

I welcome the continued search for ways and means to solve the problem of overdue payments to the Fund. The papers that the staff is preparing as a part of the continued efforts in this area are welcome. They should be discussed in sequence; there should be no interruption of the discussions on the various papers.

Saudi Arabia attaches special importance to, and therefore welcomes, the report assessing the impact of the industrial policies of the developed countries on developing countries. The intention is to identify the present and potential problems and to consider what the Fund and the World Bank can do to solve these problems. There is a potential danger in this area, and early attention should be given to it by the Fund and World Bank Executive Boards, so that matter can be considered by the Development Committee at its fall 1987 meeting.

I welcome the paper that the staff is preparing to assess the feasibility of changing the timing of the Fund's financial year.

A subject that is not included in the proposed work program, but which has been mentioned repeatedly by Executive Directors, is the need to strengthen the Fund's image abroad. This matter has taken on great urgency over the previous several days; I am dismayed by the Zambian authorities' recent comments on the Fund. I wonder whether the Chairman might wish to involve the Executive Board in formulating a program of action to improve the Fund's image. One could start with a paper prepared by the External Relations Department to study the options that are available to the Fund in this area.

Mr. Ortiz made the following statement:

The proposed work program faithfully reflects the mandate of the Interim Committee and presents a well-balanced overview of the various issues.

This chair attaches great importance to the Fund's surveillance function. In the area of indicators, apart from the continuing technical work on the selection of indicators and their usefulness in assessing the effects of policy interactions, the staff should explore possible triggering mechanisms for consultations and other measures that will make indicators significant in an operational sense. In addition, during the previous discussion on this subject, some questions were raised about the usefulness of the saving/investment framework, particularly whether it should be viewed as an accounting identity and whether it was useful mainly to identify tensions emerging from domestic policies or as a policy-simulating device that takes into account behavioral relations of variables. During the discussions, several Directors welcomed the staff's proposed research program. The staff paper that is tentatively entitled "Enhancing the Use of Indicators" should include an appendix explaining the thrust of ongoing research as well as the possible applications of the savings/investment framework. This appendix could also serve as background material for the staff paper on possible avenues for modifying and updating the principles and procedures of surveillance.

The planned world economic outlook exercise is adequate. It might be useful to explore in greater detail the significance of the debt overhang for the adjustment process and the economic performance of debtor countries.

The G-24 report is expected to include proposals in a number of areas, and I doubt whether a meaningful discussion of all the issues covered can take place in a single Executive Board session. Of course, the Executive Board faces a time constraint, and the staff paper probably cannot be completed before July, thereby making it difficult to hold several sessions on the G-24 before the 1987 Annual Meetings. However, one way in which to examine more closely the issues raised in the G-24 report is to include the views expressed in that report in some of the documents that will be prepared for discussion prior to the 1987 Annual Meetings. In this context, I particularly have in mind the papers on the desired growth-oriented adjustment programs, which are expected to deal with the issues that were identified during the recent Fund/World Bank Symposium but which include the relevant points that were made in the G-24 report. The same approach could be used with respect to the papers on the debt situation.

This chair attaches particular importance to the coming comprehensive review of the compensatory financing facility and the examination of the access policy. The proposals on those topics are appropriate.

Issues related to the debt situation and strategy will be treated in four different staff papers: the world economic outlook paper will include a section on debt; there will be a separate paper covering low-income countries; the paper entitled "International Capital Markets - Recent Developments and Prospects" will focus on financial aspects of the debt situation, presumably with reference mainly to middle-income countries; and there will be a paper entitled "Further Strengthening of the Debt Strategy," which is scheduled for discussion after the 1987 Annual Meetings. I agree that there is a need to include a special section on debt in the world economic outlook paper and that the discussion on the low-income countries is particularly warranted. However, the papers on capital markets and the debt strategy should preferably be dealt with in the same session, at the beginning of

September, rather than in separate sessions. It will be particularly important to discuss the strengthening of the debt strategy before the 1987 Annual Meetings.

During the previous discussion on the debt strategy, considerable attention was paid to the secondary market for developing countries' debt. However, not much information is readily available on the size, pricing, and operating mechanisms of this market, and it would be useful for the staff to examine the subject; the staff should evaluate both the effects on investment of existing discounts on debtor countries' debt, as well as ways in which this market could be used to alleviate some of that burden and to eliminate the difficulties in arranging concerted lending packages.

The work leading to the Ninth General Review of Quotas should proceed without delay, but an additional discussion on the general considerations regarding a further allocation of SDRs seems unnecessary. I am confident that the Chairman will be able to ascertain quickly whether Executive Directors' positions on allocation have changed, and whether a discussion on the size of the allocation would be warranted.

Mrs. Ploix made the following statement:

I broadly agree with the proposed work program. It is heavy, but this seems unavoidable in light of the important matters that must be reviewed before the 1987 Annual Meetings.

The Executive Board should be able to make significant progress on indicators during the coming discussion on that subject. Three features seem to be of particular interest, namely, the focus on a limited set of indicators, the presentation of alternative scenarios for exchange rates and economic policies, and the use of indicators in Article IV consultations.

My authorities believe that a specific discussion on the role of the Fund should help to clarify subsequent discussions on the various aspects of this broad topic. The inclusion of the role of the Fund in the proposed work program is therefore welcome.

I look forward to examining the initial papers for the Ninth General Review of Quotas. The time is right to think of the best ways in which to endow the Fund with the resources that it will need to tackle the economic problems of the next decade.

My authorities attach considerable importance to conducting a thorough review of the compensatory financing facility. The cereal decision should be included in the coming comprehensive review. It is my understanding that the staff will thoroughly examine the means by which to soften the terms of compensatory financing purchases for the poorest countries that are dependent on one or two commodities along the lines of Mr. Balladur's proposal to the Interim Committee. My authorities were surprised that this proposal was not included in the proposed work program.

It seems difficult to proceed with the proposed "thorough review of adjustment programs" before scrutinizing all the relevant components of the Fund's credit policy, such as the structural adjustment facility and the compensatory financing facility. Since the further review of the compensatory financing facility is scheduled for the end of August 1987, I wonder whether the discussion on conditionality and Fund programs can take place in September. However, there seems to be a risk of concentrating important discussions within a short period, as Mr. Goos has stressed.

The proposed program does not include a specific date for the discussion of arrangements approved in principle. I would prefer to consider this matter in connection with the regular review of the debt strategy.

I have no difficulty in supporting the proposal that the Chairman will consult Executive Directors about a possible SDR allocation. I agree that the relevant staff paper should focus on certain specific considerations, such as the carrying cost of holding reserve assets. This new focus should not preclude the provision of data and analysis on recent developments and international liquidity. The existence of the need for reserves continues to be the criterion on which any new allocation must be based.

Mr. Foot made the following statement:

The proposed work program is comprehensive. I agree with previous speakers that we should try to smooth the heavy work load that is in prospect for August and September 1987, perhaps by agreeing to some shortening of the circulation period for Article IV consultation reports. However, the paper on the strengthening of the debt strategy should preferably be discussed before the 1987 Annual Meetings, rather than after, as this subject is of potential relevance to those Annual Meetings. I hope that the paper will be relatively short; it need not contain the usual description of the causes of the debt problem.

The next discussion on the compensatory financing facility should be discussed as soon as possible. The suggested date of August 31, 1987 seems to be fairly late, especially as the suggested discussion might well not be the final stage in the review of the compensatory financing facility. I hope that the discussion can be brought forward. In addition, I would prefer to hold the preliminary discussion on access limits before the next Interim Committee meeting.

I welcome the proposal to save an Executive Board meeting by having the Chairman take informal soundings of support for an allocation of SDRs. In addition, I agree that some of the papers on SDR matters should be discussed by the Executive Board before the 1987 Annual Meetings only if time permits.

The proposed date of June 19, 1987 for the discussion on the structural adjustment facility seems to be inappropriate. The discussion is likely to be lengthy, and it seems best to hold it on a working day other than a Friday. Holding the discussion earlier in the same week would be more appropriate.

I wish to stress the importance that I attach to finding early savings of Executive Board and staff resources through the use of the bi-cycle that Mr. Lundstrom has proposed.

I have some doubts about the coverage of two of the papers mentioned in Section 4 of the Chairman's opening statement. Presumably the paper on export credit agencies will respect the confidentiality of material recently given to the Fund on specific cases by some agencies, including the agency in the United Kingdom. However, if such confidentiality is fully observed, I wonder what useful information the staff paper could conceivably contain. In addition, I am surprised that the description of the proposed paper on the problems facing low-income countries makes no mention of the initiatives that are being discussed in the Paris Club. In my view, the structural adjustment facility and the initiatives in the Paris Club are the two key issues in the examination of the problems facing low-income countries, and the content and, possibly, the timing of the staff's paper on this matter might be somewhat dependent upon the progress that is made on both of those initiatives.

I was also surprised to see that no mention is made under the discussion of operational matters of a paper on delaying quota increases for members that have been declared ineligible to use the Fund's resources. It was my understanding that the staff had promised to provide such a paper, although I am not suggesting that the paper need be circulated before the 1987 Annual Meetings.

Mr. Hospedales made the following statement:

The general thrust of and priorities reflected in the proposed work program are adequate. The proposed agenda is heavy, but it reflects the tasks that were defined by the Interim and

Development Committees as well as the challenges that are posed by the present world economic situation. However, I do not see how the staff will be able to perform adequately all the work that is expected of it, given the very low--nearly zero--hiring ceiling.

The world economic outlook exercise will continue to remain the central framework in which to strengthen multilateral surveillance. The papers being prepared on indicators should extend the progress that has already been made in this area. Of course, as the Interim Committee has advised, indicators should be used in such a way as to capture the impact of industrial countries' behavior not only on each other, but also on developing countries. In this exercise, exchange rates should be an important economic variable, and for this reason I support the three proposed Executive Board discussions on exchange rate developments.

I look forward to the survey of issues that are raised in the G-10 and G-24 reports on the role of the Fund, especially in the light of the broad acceptance that has been given by the Interim Committee to the general applicability of the notion of growth-oriented adjustment to efforts to solve problems facing developing countries, including the debt problem. The staff papers on the design of growth-oriented adjustment programs should ensure that the programs will be appropriate to the conditions facing member countries. Resource availability, access limits, and the manner in which the Fund deals with arrears and repurchases also should be taken into account in assessing the problems facing developing countries, the need for growth-oriented adjustment, and the role of the Fund.

In the light of the steady decline in the average and maximum access to Fund resources, reviewing the enlarged access policy, as well as the access limits under the compensatory financing and buffer stock financing facilities, prior to the 1987 Annual Meetings is of crucial importance. We look forward to the comprehensive review of the compensatory financing facility, which has been transformed unjustifiably into a highly conditional source of finance, in contradiction with the purposes of that facility. The time has come to review the policy on emergency assistance; the previous review took place some five years ago. Rapid progress should be made on the Ninth General Review of Quotas, especially as quotas have lagged behind requirements, as measured by the relationship of quotas to world trade and external financing. The staff papers on overdue financial obligations to the Fund--rescheduling of purchases and payments in domestic currency--should contribute to the process of improving the manner in which the Fund deals with this problem.

The discussion of the debt strategy should be an integral part of the annual survey of recent developments and prospects in international capital markets. The Interim Committee's conclusion that the debt strategy has been largely effective is puzzling. While the international financial system has not collapsed, the other objectives of the strategy clearly have not been achieved; there has been no resumption of normal relations between creditors and debtor countries, and there has not been an adequate recovery of growth in debtor countries. If the debt crisis is to be resolved, these objectives must be realized. The paper on further strengthening of the debt strategy should address these issues in a comprehensive manner and before the 1987 Annual Meetings.

I deeply regret the continuing failure of the international financial community to reach a consensus on an allocation of SDRs. Nevertheless, I look forward to considering, in response to the Interim Committee's request, the papers relating to the question of an allocation of SDRs, in keeping with the Fund's ongoing pursuit of the dual objectives of meeting a clearly established long-term global need to supplement existing reserve assets and to make the SDR the principal reserve asset of the international monetary system.

Mr. Salehkhou made the following statement:

The mandate that was given to the Executive Board by the Interim Committee to strengthen multilateral surveillance through further development of the use of economic indicators and the design of selected key indicators for "use in the assessment of world economic developments, including the impact of industrial countries' policies on developing economies," as well as to appraise the international interactions of domestic policies and performance will involve a heavy work load in the coming months for the Executive Board as well as for management and staff. I hope that this work will prove to be worthwhile, and that the key players will have the political will to implement the findings of the various studies and discussions. It is regrettable that experience thus far provides little evidence of the existence of such political will, which is the essential ingredient of any type of international cooperation.

I agree with the proposed emphasis in the main world economic outlook survey paper on further developing the use of indicators as well as the assessment of the impact of industrial countries' policies on developing countries as requested by the Interim Committee. In this connection, however, I cannot help but remain skeptical, given the recent report by the staff who attended the latest G-10 Working Group meeting in Paris. It was true that we were told that there was no difference of opinion about the need for all participants in that meeting to adopt fiscal measures, but none of the participants had offered to take the initiative. Furthermore, the world economic outlook, which is a costly but valuable exercise, is favorably regarded and widely cited by the international financial community. The Chairman's statement and summing up on the world economic outlook discussions provide the basis for the Interim Committee's deliberations and policy recommendations. It is therefore essential that once the Executive Board agrees on world economic outlook findings, the facts and figures that are contained in the Chairman's statements should be as accurate as possible. I mention this matter because the industrial countries' terms of trade gains in 1986 were underestimated to the tune of $18 billion in the latest communiqué of the Interim Committee, despite my last-minute effort to request a correction.

I welcome the proposed discussion on the new bi-cyclic procedure for Article IV consultations. However, the proposed date would not be convenient for Executive Directors who plan to attend the G-24 Deputies' meeting on June 4-5 to consider the Working Group's draft report.

I look forward to the discussion of the proposed paper on "The Role of the Fund - A Survey of Issues Raised in the G-10 and G-24 Reports." I hope that the discussions will significantly contribute to the improvement of Fund-supported adjustment programs. During the discussions prior to the introduction of the structural adjustment facility, this chair expressed a number of reservations on the issue of Fund-World Bank collaboration and the possibility of cross-conditionality. The recent experience of a member of my constituency that is eligible to use the structural adjustment facility clearly indicates that the World Bank is not willing to collaborate with the Fund on this country's request to use the structural adjustment facility. The World Bank refused even to send a staff representative to attend the Article IV consultation discussions, despite the authorities' specific request and the Fund's invitation. I hope that we will address this as well as other crucial issues during the discussions on this subject scheduled for May 29, 1987. Should this date not be convenient for some Executive Directors, it could be rescheduled immediately after the G-24 Deputies meeting on June 4-5 or could be taken up in May, sometime before May 29. As to the compensatory financing facility, I wish to associate myself with the remarks on that matter by Mr. Nimatallah and Mrs. Ploix.

As to the review of the design of Fund-supported adjustment programs, and the request by the Interim Committee to improve their quality and enhance their growth orientation, my latest comments on conditionality remain valid. As I have stated on previous occasions, the Fund should create an independent evaluation unit within the institution.

I hope that in preparing the paper entitled "Approval in Principle of Fund Arrangements" the staff will pay sufficient and balanced attention to both the spirit and the letter of the guidelines on the use of the procedure of approval in principle that was endorsed by the Executive Board in 1984. In that connection, the most recent experience with Argentina was clearly not in the best interest of Argentina or the Fund.

The staff should formulate imaginative solutions to the persistent problem of external debt, which, according to many experts, is potentially explosive and seriously threatens the stability of the international monetary and financial system. In this connection, the Group of Twenty-Four has made a number of suggestions, and I hope that the staff will take them into account. The role and attitude of commercial banks, which leave much to be desired, deserve particular attention and emphasis. The Executive Directors should hold a comprehensive discussion and find new ways and means to deal effectively with this growing problem.

In the area of concessional assistance, especially in connection with the use of the structural adjustment facility, I recall that some industrial countries promised to make additional resources available to this facility; at the time the promises were made, I expressed my skepticism about them. Unfortunately, my reservations appear to have been justified. I welcome the preparation of the staff paper on the problems of low-income countries facing exceptional difficulties, taking into account an assessment of the implementation of the UN Program of Action for African Recovery and Development and the review of the ongoing efforts of the Fund, the World Bank, and aid agencies to assist the poor countries to implement growth programs. However, I strongly hope that consideration of possible additional actions will not involve additional conditionality in connection with the use of the structural adjustment facility. Without additional financing this facility is more of a burden than a source of relief, not only for the member countries concerned, but also for the staff, who has to undertake the tedious task of preparing comprehensive policy framework papers.

I welcome the preparation of relevant papers on the Ninth General Review of Quotas but I do not wish to prejudge the calculations. Still, since the calculations have a bearing on the distribution of quotas and are relevant in the consideration of the overall size of the Fund, I hope that in making those calculations we do not underestimate the projection of global need for conditional liquidity in the form of Fund quotas, particularly given the comfortable level of the Fund's income. My concern has been heightened by the statements of some of the participants in the latest Interim Committee meeting, who seemed to have already decided that there should be little or no increase in the size of the quotas. They feel that the scheduled review is merely a tactical exercise. I look forward to the relevant discussions, which I prefer to hold sometime during the first half of June 1987, as I expect to be away from Washington during the second part of the month.

Although I continue to doubt the necessity of still additional studies on an allocation of SDRs, given the absence of the political will of the blocking minority of member countries, I would nevertheless participate in any discussions. The Chairman's proposal to conduct consultations to ascertain whether or not there is the necessary broad support to enable him to make a proposal for an allocation is the most preferable course of action. Alternatively, as the Chairman has suggested, the preparation of a paper on a specific topic having a bearing on the question of SDR allocations would promote the role of the SDR and would, I hope, lead to some regular allocations.

In view of the discussions that we have already had on provisioning, that issue need not be discussed further. However, since the preparation of another paper on provisioning is already in the final stages, its discussion should be advanced to some time in May or postponed to July, for the reasons I have mentioned.

I welcome the preparation of the legal papers on overdue financial obligations that are to be issued by the end of May, and I hope that we can discuss them in July. These studies are timely, and the staff should be pragmatic and flexible in evaluating the legal issues in question.

I also welcome the review of the tax allowance system and the assessment of the implications of the U.S. Tax Reform Act of 1986. I hope that the discussion will be postponed to early July, and that before the discussion takes place, the Administration Department will provide me with the information on temporary staff members that I requested during the discussion on the budget.

I was pleased with the very interesting seminar on Islamic banking that was recently held at the Visitors' Center. Experts from the banking and academic sectors and from the media were among those who enthusiastically participated in the seminar, actively discussing theoretical and empirical aspects of Islamic banking. It is surprising that the anticipated work on several issues related to the Islamic financial system is not mentioned in the Chairman's otherwise comprehensive statement on the work program. In his summing up in December 1986 of the discussion on the midyear review of administrative expenses in FY 1987 and the budgetary outlook for FY 1988, the Chairman envisaged further work on the Islamic banking system in the current year.

At a time when the Fund's image in developing countries badly needs improvement--I fully agree with Mr. Nimatallah's comments on this matter--the limited research that has already been undertaken by the Fund in this area has been most productive and welcome, especially in the Muslim world, which comprises nearly one third of the Fund's membership. My office has been overwhelmed by requests from various academic, financial, and other quarters as well as from parliamentary and high-ranking government officials for the recently published Occasional Paper on Islamic banking. I hope that the staff will soon circulate the several studies on the Islamic banking and financial system on which the Executive Board reached agreement in August 1986.

Mr. Sliper made the following statement:

The proposed program includes many interesting topics that will keep both the staff and the Executive Board fully occupied in the coming period. The program is a manageable one, and there is little room in which to defer or cut out particular topics. I wonder when management and staff expect to circulate the paper entitled "Approval in Principle of Fund Arrangements." The Chairman's statement indicates that the staff is in the process of preparing a paper, but I could not find an indication of the timing. As to administrative matters, I was somewhat surprised by the wording on the comprehensive review of technical assistance. It is suggested that "management intends to initiate" such a review, but it has been my impression that work was somewhat more advanced, and that the Executive Board might expect an earlier discussion than seems to be foreshadowed by the wording in question.

I support the suggestion that the Chairman should explore the question of an SDR allocation with Executive Directors rather than have the staff prepare an additional paper on the subject. I also support the proposal by a number of Executive Directors that the scheduled technical papers on SDRs could be deferred if this should prove necessary to make way for papers of a higher priority.

The proposed timing of the two papers on quotas is acceptable. The consideration of quotas should be a matter of priority. I have no objection to Mr. Dallara's proposal to discuss the quota formulas, but this discussion should not slow up the general discussion of quotas.

I am inclined to share Mr. Goos's views on the usefulness of regular discussions on exchange rate developments. If priorities have to be reassessed, I would tend to favor reducing these discussions or having discussions on exchange rates only as the need arises, rather than on a regular two-monthly basis, as seems to have been proposed at this stage.

Mr. El Kogali made the following statement:

I endorse the proposed work program. The Chairman's statement conveys the sense of urgency that was characteristic of the Interim Committee's discussions on the plight of the poor countries in the context of the present world economic outlook. The G-24 report will include additional recommendations on the role of the Fund, including such areas as the use of Fund resources and problems facing debtor countries. The staff intends to consolidate the recommendations in the G-10 and G-24 reports into a single paper for the Executive Board's consideration in July; the staff paper should help Executive Directors to reassess the Board's work program priorities. The debt problem still should be given a high priority, and the staff paper on the debt strategy should be scheduled for discussion soon after the consideration of the G-10 and G-24 recommendations, sometime in July or August, rather than after the 1987 Annual Meetings. The heavily indebted countries are anxious to find solutions to their debt problems in order to pave the way for new capital inflows for economic development. The staff papers on the debt strategy must give greater attention than hitherto to the problems facing the poor countries. The paper should fully examine the various proposals that were made during the Interim Committee's meeting, including proposals by the United Kingdom, France, and Belgium. I look forward to considering concrete proposals in such areas as the conversion of some official debt to grants and the conversion of commercial debt to equity. I strongly hope that the Executive Board will be able to recommend a practical solution to the debt problem for consideration by the Interim Committee at its next meeting.

I agree with the Chairman that the staff papers on the use of Fund resources should be brought to the Executive Board's agenda by early September, so that the issues concerned can be discussed by the Interim Committee at its next meeting.

The numerous staff papers on an allocation of SDRs which have been discussed by the Executive Board have clearly made the case in favor of an allocation. What is lacking is the political will on the part of some member countries. Therefore, I see no need at present for additional papers on the subject, but I welcome the Chairman's suggestion to consult Executive Directors to determine whether the necessary support for an allocation exists. Indeed, I would encourage the Chairman to use his good offices to convince some authorities of the need for an allocation.

I greatly look forward to the discussion of the legal papers entitled "Postponement of Repurchase Obligations" and "Payment of Charges in Domestic Currency," which are to be issued by the end of May 1987.

Mr. Sengupta made the following statement:

The world economic outlook, surveillance, and indicators are closely interrelated. Indicators are a kind of instrument of surveillance, and consideration has been given to using them to update the surveillance procedure. I hope that the proposed paper on surveillance will examine the basic question that this chair has raised repeatedly about the asymmetry of the current surveillance, with a view to introducing methods that will extend surveillance to surplus countries as well as to deficit countries. Although surveillance initially was limited to exchange rate policies, it has been extended to include the whole range of members' policies.

The usefulness of indicators as an instrument of surveillance will depend on not only the analytical properties of the indicators, but also the procedures of surveillance, including the use of indicators. I look forward to the paper entitled "Enhancing the Use of Indicators--Analytical Issues," and I hope that it will deal with the procedures of surveillance that will enable the use of indicators to be enhanced. Mr. Dallara usefully suggested the need to work out a desirable path of indicators. The Group of Twenty-Four has already produced a report favoring the introduction of multilateral surveillance supported by a bilateral surveillance process and including agreement on the desirable path of certain objective indicators and the policies to be adopted to keep the member countries concerned from deviating from the desired magnitudes. Agreement on that path of indicators could be reached at the multilateral level, and bilateral consultations could be used to monitor policy developments and actual outcomes in the various industrial countries. I strongly support Mr. Dallara's suggestion to hold a special discussion on the interaction of policies among the industrial countries; an understanding could be reached during such discussions on the desirable path of indicators for the various industrial countries.

I welcome the suggestion to formulate medium-term scenarios, or alternative assumptions, with respect to member countries' economic policies. It is regrettable that the latest published version of the world economic outlook did not contain some available telling data on the medium-term outlook, particularly the outlook for 1988-91; the data in the published version did not go beyond 1988. This problem should be examined, as much of the thrust of the policy discussion in the Executive Board is lost when the published version of the world economic outlook fails to contain some of the most significant data that were discussed.

I welcome the proposed discussion of exchange rate developments in May, July, and August. It would be helpful to have the staff prepare a short paper discussing whether or not exchange rates are misaligned. That paper could be the background document for the proposed discussions.

I look forward to considering the staff paper on the role of the Fund. However, the precise nature of the paper is unclear to me, and the description of it in the Chairman's opening statement is somewhat troubling. He mentioned that the paper is expected to include additional suggestions concerning the role of the Fund in several areas, including the use of Fund resources, problems facing debtor countries, the role of the SDR, the Ninth General Review of Quotas, and burden sharing and overdue financial obligations. I hope that the staff paper will also pay sufficient attention to other important issues, including the design of growth-oriented programs, implementation of those programs, conditionality, performance criteria, and contingency mechanisms.

Use of the compensatory financing facility should not be limited to low-income countries; it should be available to all the countries that are eligible to use the structural adjustment facility. In addition, the requirement of cooperation with the Fund should be the subject of a comprehensive review that should include an examination of how that criterion has been enforced, the intention of the criterion, and the elimination of any ambiguity about the criterion in the relevant portion of the decision on compensatory financing. That criterion should be examined comprehensively; the Executive Directors should consider whether it might be necessary to amend the decision on the compensatory financing facility.

I welcome the proposed paper on Fund-supported adjustment programs and income distribution. I do not agree with Mr. Dallara that it would be helpful to have a joint Fund/World Bank paper on possible ways in which to tackle the problems facing low-income countries. The Fund should consult the World Bank in preparing its own paper, but it would be desirable to have two separate papers. In any event, my knowledge of how the two institutions operate suggests that it probably would not be feasible to have a joint paper.

I have no difficulty in accepting the proposals with respect to the Ninth General Review of Quotas. However, I doubt whether it will prove useful for the Chairman to consult Executive Directors about a possible allocation of SDRs; he is unlikely to find the necessary support for an allocation. However, the staff should prepare the usual paper presenting the case for an allocation. That paper is valuable--and should be produced again--as it shows that, in practice, the reasons why a further allocation has not been made are political rather than economic. I hope that at some future stage political circles in industrial countries will be persuaded of the logic of the economic necessity for an allocation. In addition, the staff should prepare the suggested paper on the net carrying cost of holding international reserves. That paper probably should not be very difficult to prepare.

I support Mr. Salehkhou's request concerning studies on Islamic banking. I would greatly benefit from such studies, which would probably appeal to a large section of the membership.

Mr. Alhaimus made the following statement:

I fully endorse the proposed work program.

As to the paper on enhancing the role of indicators, I, like previous speakers, look forward to a careful consideration of the design of indicators for use in assessing the impact of industrial countries' policies on developing countries' economies. This aspect, which has been stressed by many both in the Executive Board and in the Interim Committee, should also be discussed in the coming world economic outlook papers.

The other related work is the review of the principles and procedures of surveillance. This work should be highly useful, as it provides an opportunity to examine practices that were established ten years ago. One major issue that has been raised on numerous occasions, and which now may be taken up in the context of the planned updating and possible modification of the 1977 document, is the need for surveillance principles to focus more on the major currency members that have a dominant role in the world economy. A focus on the more important cases will contribute to a more effective role for the Fund and a more optimum use of its capacity for surveillance, a capacity that is not unlimited.

With respect to work on policies on the use of Fund resources, it might be useful to continue the practice of having a preliminary Executive Board discussion on access prior to the Annual Meetings.

The issues of substantive importance with respect to the use of Fund resources are the review of the compensatory financing facility and the review of adjustment programs. As to the compensatory financing facility, I hope that concern about the specific issues listed in the Chairman's opening statement will not lead us to lose sight of the broad objectives of the Fund in the present circumstances. At a time when so many producers of primary products are facing the devastating effects of falling prices and are encountering serious disruptions of their adjustment programs, it is highly unfortunate that the compensatory financing facility will be reviewed in a way, as it appears to us at least, which might impose additional constraints on the facility's use. I hope that the coming review papers will keep the broader issues of the Fund's role in mind in addressing the specific issues that were raised by some Executive Directors. However, I continue to believe, like many other Executive Directors who participated in the previous discussion on the compensatory financing facility, that the facility has served the Fund and member countries well and is in no need of any overhaul. I wish to associate myself with Mr. Nimatallah's remarks on the use of the compensatory financing facility by oil producing countries. This chair had an opportunity to make some remarks on these issues during the Executive Board's discussion on requests for compensatory financing by Ecuador and Indonesia.

As to the review of adjustment programs, I welcome the emphasis on the issues related to the design of growth-oriented programs, an issue that is of immense current interest, as was shown during our recent discussion on conditionality. It is also central to the G-24 report, which will be the subject of further work by the staff.

In the area of future work on the debt problem, I particularly welcome the paper on the problems of low-income countries that is to be prepared in response to the interest expressed by participants in both the Interim and Development Committees in some proposals for action in this field. I hope that the paper will include specific suggestions. Some interesting ideas were put forward during the Executive Board's recent discussion on conditionality.

I noted management's intention to conduct a comprehensive review of technical assistance. I hope that staff and management will keep in mind the almost unanimous support that was shown during a recent Executive Board discussion on the administrative budget for efforts to enhance the Fund's technical assistance program. The planned review of technical assistance should be conducted in this spirit.

Mr. Posthumus made the following statement:

The proposed work program is wide ranging and substantial, and consideration should be given to how best to handle it. It is the Executive Board's responsibility to consider the best way in which to organize the Board's own work. There seems to be a widespread feeling that the organization of the Board's work is unsatisfactory--indeed, unworkable. The record of attendance at Board meetings shows that most of the time chairs are occupied by Advisors and Assistants to Executive Directors. This can be happening for only one reason, namely, Executive Directors and Alternate Executive Directors generally do not have time to attend all the meetings of the Board. A few chairs, including my own, follow the practice of having only the Executive Director or the Alternate occupy the chair, with few exceptions. As a result, those Executive Directors and their Alternates feel the full burden of the heavy schedule of meetings, which often are clearly unnecessarily long, as a series of speakers give the same opinions in full detail; many speakers do not realize that they are merely repeating previous speakers, because they attend a discussion only to deliver their own statement. There is no blame to assess for this situation. Participants in Executive Board meetings clearly are dedicated to producing high-quality work, but the quality does suffer because Executive Directors and their Alternates cannot hope to sit through long Board meetings and make adequate preparation for all the discussions at the same time. It is clearly important to discuss at length and in detail some of the items that are brought to the Executive Board's agenda before final decisions on them are made. For example, it is not sufficient to consider the role of the Fund merely by having each chair make a statement followed by a summing up by the Chairman.

Decision-making bodies around the world have faced the same problems of organization and have solved them. In my view, there is need for discipline, courtesy, and self-imposed restrictions. The Executive Board should further discuss its work procedures, perhaps in a restricted session.

The Chairman remarked that Mr. Posthumus's points were well taken. The proposed work program on policy matters alone was very heavy and would leave little time in which to give adequate attention to country items. There was an urgent need to review the Executive Board's working methods with a view to increasing the Board's efficiency. It might be helpful to hold an informal luncheon or dinner meeting in the near future to consider how the Executive Board's work procedures could be made more efficient.

Mr. Zecchini noted that the related problems of a heavy Executive Board work load and Board work procedures had been raised a number of times in the past. The fact that the Executive Directors had been unable to find appropriate solutions to the problems was a clear reflection of the difficult nature of the problems, which stemmed significantly from the fact that the Executive Board was at the core of the Fund's work; few decisions were taken outside the Board. Indeed, according to the Articles, the Executive Board was "the Fund." Before undertaking to make and review innovative proposals with respect to the Board's procedures, it would be helpful to take stock of what had been accomplished thus far and to continue to be highly pragmatic in order to avoid undermining the Fund's established institutional framework, which placed the Executive Board at the center of the Fund's decision-making process.

Mr. Zecchini then made the following statement:

I broadly agree with the proposed work program and will not make specific suggestions on the contents of the proposed papers. The proposed program is extensive, comprehensive, well balanced, and based on a good choice of priorities.

Emphasis should be placed, in order of importance, on surveillance and indicators--with a view to moving toward normative scenarios--the debt strategy, in order to enlarge the Fund's approach and instruments, and the design and underpinnings of growth-oriented adjustment programs. Mr. Dallara's suggestion to hold a special discussion on policy interactions across countries has some merit and should be explored further. Special attention should also be paid to ways in which to enhance the *attractiveness of the SDR. As to the issue of an allocation*, I am interested in the preparation of a paper dealing with a specific aspect of the issue for discussion in the Executive Board. This approach will leave the Chairman with the task of consulting Executive Directors to verify whether there is broad support in favor of an allocation.

I favor enhancing the Executive Board's periodic discussions on exchange rate developments. In this connection, the staff should complement its tables with a brief statement on issues for discussion.

I endorse the proposals to conduct an extensive examination of access limits and to ensure timely work on the Ninth General Review of Quotas.

I hope that an effort will be made to avoid a heavy concentration of Executive Board meetings in the few weeks before the 1987 Annual Meetings. In order to maintain a high standard for our discussions, it is important to carefully avoid crowding the discussions on important subjects.

Mr. Lundstrom made the following statement:

The Chairman's statement on the work program is challenging and ambitious. I am confident that the staff will be able to produce the proposed papers, although the effort will place a heavy burden on the staff. I am less confident about the Executive Board's ability to digest all the papers, to form considered views on them, and to make its own constructive contributions. Most of the policy matters included in the proposed program are sufficiently important to warrant comprehensive consideration and discussion. Furthermore, while previous work programs provided for the handling of many issues on a preliminary basis, we are approaching the stage at which important decisions need to be taken on some issues. Therefore, we have to establish stricter priorities and be prepared to delay the consideration of a number of items on the proposed agenda. This is but one way of dealing with the problems that were mentioned by Mr. Posthumus and which certainly deserve a full discussion at an early date.

Particular importance has to be attached to the issues on which the Interim Committee has requested the Executive Board to report to it at its next meeting. Accordingly, the two papers on indicators and surveillance, which are scheduled for discussion on July 22, should be given the highest priority. This discussion, together with the discussion on the world economic outlook in September, should provide a good basis for the Interim Committee's consideration of the most important matters that are mentioned in the first part of the proposed work program. As to the scope and orientation of the two papers, I share the views that were expressed by Mr. Dallara and supported by Mr. Sengupta. I agree with Mr. Dallara that one day of the Executive Board's world economic outlook discussion might appropriately be devoted to the interaction of policies and performance among the major industrial countries. The aim should be to establish the foundation for an Interim Committee meeting that will mark an important step toward more effective economic policy coordination. The need for substantial progress in this field is rapidly becoming increasingly evident.

I welcome the informal discussions on recent exchange rate developments that the Chairman has initiated and for which three dates have been set in the proposed program. Such discussions should be a natural element of the Fund's work and should provide a good background for surveillance.

I look forward to the paper on the modalities of the new bi-cyclic procedure for Article IV consultations. The streamlining of the consultation procedures, if applied to a good number of countries, should yield considerable savings in staff man-years and reduce the Executive Board's work load. These effects could be enhanced by trimming the documentation for Article IV consultations more generally. The latest staff report for the Article IV consultation with Belgium is a good example. Such trimming is another way in which to address the problems that Mr. Posthumus has just mentioned.

I endorse the proposal to continue the practice of holding preliminary Executive Board discussions on enlarged access policies prior to the Annual Meetings. These discussions have been useful, as they have clarified positions and established the groundwork for the Interim Committee's deliberations.

The "thorough review of adjustment programs and their supporting Fund arrangements" initiated by the Interim Committee is an important and far-reaching project. In view of the ongoing work in this field--for example, on the compensatory financing facility, the structural adjustment facility, and conditionality--we should not rush this matter. Instead, the staff should be given sufficient time for a thorough preparation of the review, including the basic studies on the conceptual and empirical underpinnings of growth-oriented adjustment programs.

The two planned papers on adjustment in high-inflation countries will undoubtedly be of great interest to the Executive Board and should be suitable for seminar discussions. However, keeping in mind the heavy program, the discussion of these papers could perhaps be postponed until the end of the year. A similar conclusion could be drawn with respect to the paper entitled "Innovations and Institutional Changes in Capital Markets" and to the work on Islamic banking to which Mr. Salehkhou referred. In addition, I am attracted by Mr. Nimatallah's suggestion that preparation of a paper setting out some optional ways in which to improve the Fund's image might be worthwhile. However, none of those projects seems to be very urgent.

The paper on the problems of low-income countries facing exceptional difficulties should not be delayed. The problem here, as with a few other papers, particularly the one entitled "Debt, Capital Markets, and Concessional Assistance," is that matters discussed in different contexts are intimately interrelated, and the division of labor and the drawing of demarcation lines may therefore be quite intricate. As Mr. Dallara suggested, the paper entitled "Further Strengthening of the Debt Strategy" should take into consideration the question of an adaptation of the Fund's conditionality. Certainly there is such a connection. Similarly, the paper addressing the problems of countries facing exceptional difficulties should take into account the outcome of our discussion on the structural adjustment facility and will have a bearing on the debt strategy paper. Moreover, much of the discussion on the paper entitled "External Adjustment, Financing, and Growth: Issues on Conditionality" is relevant to both these papers. Mr. de Groote has previously stressed the relationship between adjustment and financing in the context of severely constrained borrowing conditions. As to the timing of the discussion of these and related subjects, I share the views that were expressed by Mr. Goos and supported by Mr. Ortiz and Mr. Foot.

I welcome the planned studies and Executive Board discussions on SDR matters, although I agree with Mr. Goos that they need not be given a high priority. I wish to underscore my wish to broaden the discussion of liquidity to cover global liquidity developments; in this context, the SDR question is only one element, although an important one.

The area departments' work program is, as usual, heavy. This implies that country items will take a considerable amount of Executive Board time even if a large number of countries are on the bi-cycle.

The proposed work program for administrative matters is also heavy, and setting priorities in that area may be necessary. I would prefer to discuss first the papers on the temporary outplacement assistance program, the comprehensive review of technical assistance, and the establishment of an administrative tribunal. The three remaining topics that were mentioned by the Chairman could then be taken up in due course.

Mr. Hubloue made the following statement:

I generally support the proposed work program. I welcome the continuing work on economic indicators, and I agree with Mr. Dallara that we should encourage the staff to interpret the mandate from the Interim Committee broadly and with a sense of urgency and to propose concrete policy recommendations for discussion at the Committee's next meeting on normative indicators. In this context, I fully agree with Mr. Sengupta's interpretation of the Interim Committee's mandate.

I support Mr. Goos's proposal to discuss the staff paper entitled "Further Strengthening of the Debt Strategy" before, rather than after, the 1987 Annual Meetings, and to incorporate this topic into our discussion on international capital markets, as Mr. Dallara suggested.

I support Mr. Sengupta's position on the question of an SDR allocation. I see no reason why we should abandon our past practice, which has been to examine this issue on a six-monthly basis in order to keep the Interim Committee informed of our views. Our study of the role of and improvements in the SDR has from the outset been separate from the question of an SDR allocation; therefore, we should maintain our commitment to our obligations to periodically examine the justification for an allocation in the light of current developments in international reserves. Even if it is true that an allocation is, in the final analysis, a matter of political will, it is the function of the Fund to entertain the conviction that political will can be influenced by economic evidence. However, in order to avoid overloading the agenda, the discussion of other SDR topics should be limited to a single meeting, perhaps in late July, to consider the staff papers that are ready by that time.

Mr. Donoso said that the proposed work program was comprehensive; it covered all the subjects to which the Interim Committee attached priority. Therefore, the program was acceptable.

He wished to associate himself with Mr. Sengupta's comments on the problem of an allocation of SDRs, Mr. Donoso continued. In addition, the discussion on further strengthening of the debt strategy should be held before the 1987 Annual Meetings rather than after. He attached considerable importance to Mr. Ortiz's suggestion to study the secondary market for developing countries' debt instruments. A further examination of enhancing the Fund's catalytic role would be an important part of the review of the debt strategy; that topic could be covered in the staff paper on approval of arrangements in principle. It was important to consider ways in which to increase the Fund's ability to catalyze financing for members' adjustment programs.

Mr. Yamazaki made the following statement:

I generally endorse the proposed work program. The experience of the previous several years suggests that it is useful to hold a preliminary discussion on matters related to the policy on enlarged access and the access limits for the special facilities. I favor continuing this approach.

I support the proposed timetable for the first discussions by the Committee of the Whole on quota calculations and the size of the Fund. I will take the occasion of those discussions to comment on the plan for further work by the Committee of the Whole for the coming period.

I accept the proposal under which the Managing Director will undertake consultations to ascertain whether or not there is the broad support that is required for him to propose new SDR allocations. It is my understanding that, if the Chairman finds that the support does not exist, there need not be an Executive Board discussion on this matter. However, if the majority of Executive Directors wish to have a discussion, I can go along with them. In this connection, it is useful to note that my authorities continue to believe that the question of a long-term global need for reserve supplementation remains the single most important criterion in the consideration of a possible resumption of SDR allocations. Therefore, a staff paper that concentrates on a specific topic other than the question of a long-term global need would not facilitate the discussions on this matter.

I support the preparation of a staff paper on the analytical issues related to the use of indicators and a discussion by the Executive Board of the paper. However, I share Mr. Goos's concern that the development of so-called normative indicators would introduce inappropriate rigidities and would therefore not be advisable. Like Mr. Goos, I doubt whether it would be useful to hold a separate world economic outlook discussion on the major economies.

I welcome the initiative that management has taken to undertake comprehensive reviews of the Fund's travel policies. I was among the Executive Directors who requested such a review during the previous discussion on the administrative budget.

Mr. Bethel made the following statement:

The Interim Committee gave explicit guidelines on several matters for consideration by the staff and the Executive Board. The proposed work program adequately follows these guidelines.

I recognize the ever-increasing importance of economic coordination among the major industrial countries, its impact on developing countries, and the vital role of the Fund in the surveillance of this coordination. Therefore, the planned discussions on these topics, particularly within the framework of the G-7 meetings and world economic outlook exercise, are welcome.

The continuing review of the various facilities, including the compensatory financing facility, the structural adjustment facility, and the buffer stock financing facility, will give us an opportunity to review the terms and conditions underlying the allocation of the resources of these facilities and to assess the extent to which they achieve the desired objectives. In addition, I look forward to the discussion on papers on the design of growth-oriented adjustment programs. However, discussions on these matters would prove more productive if the staff, in preparing the papers, provided Executive Directors with possible reasons for the success or failure of the implementation of programs under the various facilities.

In the light of the urgent need to find practical solutions to the international debt crisis, and especially alternative ways in which to achieve the objective of regaining adequate access for debtor countries to capital markets, the proposed paper entitled "Innovations and Institutional Changes in Capital Markets" is especially welcome. However, given the importance of the debt crisis to not only the Executive Board, but also to the Interim Committee, I am puzzled by the suggestion to discuss the staff paper on the debt strategy after the 1987 Annual Meetings rather than before.

In the interest of making the most efficient use of the Executive Board's time, I support the Chairman's proposal to have him ascertain through informal consultations the position of member countries on SDR allocations.

> The proposed preparation of three legal papers on different facets of the problem of overdue financial obligations is appropriate and timely. I have noted, with increasing concern, the extent of overdue financial obligations and the apparent limited scope for dealing effectively with delinquent members.

Mr. Jiang said that he agreed with previous speakers who wished to hold the discussion on the debt strategy before the 1987 Annual Meetings. In addition, he supported Mr. Sengupta's position on the question of an allocation of SDRs.

Mr. Alhaimus considered that the Executive Board should continue to handle the SDR allocation question in the traditional way. Accordingly, the staff should prepare a paper that should be discussed by the Executive Board. Furthermore, as his chair had stated on a number of previous occasions, management and staff should continue the useful work that had been started on Islamic banking.

The Chairman remarked that there appeared to be broad support for the proposed work program, which was clearly an ambitious one. Few suggestions had been made to postpone or delete items in the proposed work program, and priorities would have to be set in the light of the recommendations of the Interim and Development Committees. It seemed difficult to avoid a crowded schedule of meetings in the several weeks prior to the 1987 Annual Meetings.

The Secretary said that the staff fully agreed with the comments by Mr. Ortiz and Mr. Sengupta on the way in which the examination of the issues raised in the G-24 report on the role of the Fund should be pursued. In addition, there seemed to be support for having, as in recent years, a preliminary discussion on access limits prior to the Annual Meetings. As to the review of the compensatory financing facility, several Executive Directors had inquired whether the date of the next Executive Board discussion could be advanced. The staff would wish to consider whether an earlier date would be feasible. At present, the staff intended to bring the paper on approval of arrangements in principle to the agenda for the period after the 1987 Annual Meetings.

A number of Executive Directors had requested that the further staff paper on the debt strategy be discussed before the 1987 Annual Meetings, the Secretary recalled. In addition, several Executive Directors had suggested that the discussion on the paper on the debt strategy should be combined with the discussion on developments in and prospects for international capital markets. Another suggestion was made to include a paper on quota formulas in the work on the Ninth General Review of Quotas. It was noted that work on the Quota Review and on issues related to the role of the Fund were closely linked.

Some Executive Directors had suggested that the practice of holding a full-scale discussion on the question of an SDR allocation should be continued, the Secretary noted. However, a number of Executive Directors considered that the Managing Director should engage in consultations to determine whether there was sufficient support for him to propose a further allocation; that position appeared to be supported by the weight of opinion, although it had not been addressed by all speakers. A suggestion had been made to delay the discussion of some of the papers on SDR matters, given the heavy work program in general.

The staff would examine the feasibility of advancing the date of the discussion on provisioning to May 1987, as Mr. Salehkhou had suggested, the Secretary commented. To the extent possible, management and staff would try to schedule all the papers on matters concerning overdue financial obligations in a series of discussions, as Mr. Nimatallah had requested.

Further work on Islamic Banking is certainly contemplated by the staff, the Secretary explained. That subject was subsumed under, but not explicitly mentioned in, the reference in the fourth paragraph on page 4 of the Chairman's opening statement to a longer-term program of studies.

Mr. Salehkhou's proposal to review the tax allowance system before July 1987 appeared to present no problems to the Fund's management and staff, the Secretary said. However, management and staff would have to coordinate their work on the subject with the relevant ongoing work in the World Bank.

Mrs. Ploix remarked that, if the discussion on the debt strategy were to be held before the 1987 Annual Meetings, it would be helpful to discuss the paper on approval in principle of stand-by arrangements at the same time. The two subjects were closely linked.

The Chairman commented that scheduling was made difficult by the close interrelationship of a number of significant items. He had not suggested discussing the paper on the issue of approval in principle before the 1987 Annual Meetings, for practical reasons: the Fund was unlikely to face the kinds of problems raised by the issue in the period before the 1987 Annual Meetings. Accordingly, management and staff had felt that postponing the discussion on that issue would help to lighten what was obviously a very heavy work load in the period up to the 1987 Annual Meetings.

Mr. Al-Assaf said that he hoped that the paper on the impact of the industrial policies of the developed countries mentioned in the first paragraph of section 11 of the Chairman's opening statement could be discussed by the Executive Board in time for that matter to be taken up by the Development Committee at its fall 1987 meeting.

The Secretary replied that in preparing that paper the staff had had in mind the time frame that had been mentioned by the Development Committee at its previous meeting.

Mr. Dallara recalled that a number of Executive Directors had suggested that the discussion on the paper on the debt strategy should be held prior to the 1987 Annual Meetings rather than after. As the Chairman had stressed, the Executive Board must determine its priorities. He himself doubted whether the Interim Committee wished the Executive Board to review the debt strategy in the coming period, although he recognized the widespread interest in holding such a review.

The Executive Directors concluded their discussion on the work program.

2. CONDITIONALITY - REVIEW; AND ISSUES RELATING TO EXTERNAL ADJUSTMENT, FINANCING, GROWTH, AND PROGRAM MONITORING

The Executive Directors continued from a previous meeting (EBM/87/70, 5/6/87) their consideration of a staff paper reviewing the Fund's experience with adjustment programs supported by stand-by and extended arrangements, as well as guidelines on conditionality (EBS/87/40, 2/25/87). They also had before them background papers on recent experience with external adjustment and growth in Fund-supported programs (EBS/87/47, 3/2/87; and Cor. 1, 5/4/87) and recent experience with program monitoring (EBS/87/48, 3/2/87; and Cor. 1, 5/4/87).

Mr. de Groote made the following statement:

> This year's review of conditionality is of special interest because it is the first such review covering those countries that adopted Fund-supported adjustment programs designed in the light of the widespread payments difficulties that emerged in 1982. I will deal with three issues which I find particularly relevant to the programs under review: the relarionship between adjustment and financing imposed by severely constrained borrowing conditions; the promotion and monitoring of growth-oriented adjustment; and the situation of those countries whose limited adjustment capacity calls for prolonged concessional assistance.
>
> The severity and uncertainty of external borrowing conditions has several operational implications for the implementation and time horizon of adjustment programs. The staff has enumerated these implications on pages 12-14 of the paper, but I will not deal with them now because several of them will be reviewed in the coming months. Of more immediate and fundamental interest today is the impact of prevailing financial conditions on the nature and objectives of adjustment programs. The staff's approach to this issue focuses narrowly on the need to protect the revolving character of Fund resources, and concludes that

Fund conditionality should be designed to bring members back to a situation where the availability of external financing from other sources will guarantee the reimbursement of Fund credit. I believe that the adoption of such a narrow view of conditionality would require us to disregard a number of important implications for the design of adjustment policies, with the eventual risk that the adjustment process would become distorted in order to conform to external financing conditions, which themselves are anything but satisfactory.

Since 1983, many of the countries under review have been forced to adopt cramped adjustment paths in order to remain within the limits of the reduced current account financing external creditors were willing to provide. Not only have these constraints considerably increased the cost of adjustment itself, they also risk locking the member into an adjustment path that is not consistent with the attainment of a sound balance of payments viability in the medium term. The concept of balance of payments viability, frequently mentioned throughout the staff paper as the ultimate objective of Fund-supported adjustment, was very accurately defined by the staff in 1981 as "a current account deficit that can be financed, on a sustainable basis, by net capital inflows on terms that are compatible with the development and growth prospects of the country and therefore, with its debt-carrying capacity." In other words, in the context of Fund conditionality, external viability is a multidimensional concept requiring assessments not only of the member's prospective financing ability, but also--and even more important--of the member country's ability to carry a certain level of external debt at each stage of its prospective growth and development. There is no need to say that today we are far from being able to apply this ideal approach to adjustment and conditionality; it was necessary to design many of the programs under review almost entirely in terms of the current account target levels that it seemed possible to finance from one year to the next, instead of mapping adjustment and current account paths consistent with the member country's medium-term prospects for growth and development. Not only does such a bias tend to undermine the stability of adjustment programs, it also casts serious doubt on the sustainability and validity of the balance of payments outcomes to be expected from the entire adjustment process. In EBS/87/47, the staff admits that because of the limited availability of external financing, the current account deficits which can be considered viable over the medium term now tend to be substantially smaller than would formerly have been considered appropriate, and even suggests that for a number of countries, some of them low-income countries, external viability is possible only if they can somehow attain a balance of payments surplus. Mr. Salehkhou's reference to the case of Morocco is most illustrative in this connection.

The implications of this enforced departure from the original concept of balance of payments viability have not yet been fully addressed in the design of Fund programs. In order to clarify the distorting impact of external financing constraints, the staff should be encouraged to make more extensive and systematic use of alternative scenarios indicating the different adjustment paths that various financing assumptions would support. These scenarios should be designed in a dynamic perspective, which would go beyond the direct link between increased financing and increased current account obligations to show how the availability of additional financial resources would permit the mapping of different adjustment paths promising more stable growth and higher debt carrying capacity in the medium term. Such scenarios are already being prepared in connection with an increasing number of adjustment programs. Their generalization to all cases and their inclusion in the discussions between the Fund, the member, and the member's external creditors would make a significant contribution to the achievement of common understandings on desirable balances between adjustment and financing, very much along the lines of the proposals of the recent report of the Group of Twenty-Four. Further elaboration of these alternative financing scenarios could also help clarify our insight into situations where the level of outstanding indebtedness is an obstacle to the attainment of external viability no matter what mix of adjustment and financing is applied. In such situations, Fund programs should promote an orderly approach to the alleviation of the member's debt burden and propose solutions that would permit the creation of a sustainable debt profile at minimum economic and financial cost.

In sum, experience with the adjustment programs adopted since 1983 and the staff's reflections on the experience with conditionality seem to show that, given the prevailing external borrowing conditions, retrograde adjustment and financing patterns have had to be accepted that on the whole have not fulfilled expectations of a rapid return to external viability. Because this return to external viability has not materialized, the risk exists that Fund-supported adjustment will remain trapped in regressive patterns and can hope to restore viability only at growth and financing levels much lower than are desirable. As more and more voices now urge a more diversified approach to the debt problem, it thus seems essential for possible diversification of the financial solutions to the debt problem to be guided by a more diversified approach to conditionality which would maximize for each member the trade-offs between adjustment, growth, and indebtedness. Such an approach would in no way involve the relaxation of the present principles of conditionality, but would rather require those principles to be enforced in order to encourage members to make more balanced and lasting progress in all the areas in which adjustment is needed.

The need for enforcing the principles of conditionality is particularly relevant to the inclusion of growth considerations in the design of adjustment programs. An important lesson of recent experience with conditionality is that the promotion of growth in the context of Fund programs is not to be sought through the relaxation of external adjustment, but instead critically depends on increasing the quality of adjustment. The experience of Turkey, for instance, shows how that country's adjustment process yielded rapid results in terms of growth and restored access to external financing only because it was supported from the outset by far-reaching interventions to correct long-standing misalignments in the systems of production and resource allocation. The need to pursue growth through quality adjustment is also very convincingly demonstrated in a recent staff working paper entitled "Fiscal Policy, Growth, and the Design of Stabilization Programs." The paper concludes that including growth considerations in fiscal programs would require much more binding and comprehensive understandings on the nature and quality of public expenditures and revenue policies than can be obtained using the present approach to program negotiation; the present approach singles out the size of the fiscal deficit reduction as the most important of the parameters that must be observed in order to comply with a given current account position. The paper's suggestion that a given current account target could be pursued as well or even better through fiscal policies that initially allow for even higher deficits, but which from the outset give greater weight to the quality of fiscal adjustment measures, is most appealing and deserves further study. This is underlined by the fact that it is precisely in the area of fiscal adjustment that the majority of program slippages of the last few years have occurred, indicating that there is probably much scope in this area for improving understandings on policies promoting both adjustment and growth.

The explicit incorporation of growth and qualitative adjustment measures in Fund programs will require us to address, in time, the justification for maintaining our present guideline under which performance criteria are normally confined to macroeconomic variables. Now that it is generally accepted that success is likely to elude any adjustment that does not create conditions for sustained growth, and that the durable attainment of both adjustment and growth requires policy understandings which go far beyond the monitoring of a few macroeconomic aggregates, it is time to examine the question of the best way to embody these ideas in the performance criteria of programs. On previous occasions, I have suggested studying the possibility of establishing Fund programs that would focus on the achievement of progress in a number of major structural areas of a member's economy which are the most essential to achievement of external viability in the medium term. Such programs could give access to Fund resources according to the achievement of specified interim steps in the reform process provided broad-ranging criteria on demand-management policies are complied with. Although I made this suggestion specifically to meet the concerns of countries which are engaged in an adjustment process involving systemic reform, similar principles could equally well be incorporated into other programs that give high priority to the achievement of qualitative adjustment. If this line of reasoning is followed, we shall in due course have to modify the language of Section 9 of the Guidelines to explicitly recognize the possibility of basing a program mainly on structural and systemic criteria, otherwise we shall have to give a broader interpretation to the notion of "policies adopted under the Articles of Agreement" mentioned in that section. In any event, the Fund's intervention can only be justified if the structural or systemic aspects of the program have an effect on the balance of payments. In order to meet your request for explicit suggestions, I propose amending the last sentence of Section 9 of the Guidelines as follows:

> Performance criteria will normally be confined to (i) macroeconomic variables, (ii) those necessary to implement specific provisions of the Articles or policies adopted under them, and (iii) to such structural or systemic variables as are essential for the effectiveness of the member's program because of their impact on the viability of the balance of payments position in the medium term.

I believe that such an amendment would go some way toward meeting the concerns expressed by Mr. Dallara.

Let me now briefly turn to the situation of members with limited adjustment capacity, which are also typically low-income countries and frequently suffer from protracted payments difficulties inherited from past external debt policies. Severe poverty, export reliance on a few commodities, and low domestic absorption capacity are all among the factors that impede the ability of these countries to achieve rapid adjustment progress, and the present review confirms that most of them are still far behind in achieving external payments viability. For these countries, the results to be expected from classical demand-management policies are generally poor, and recent years have seen a welcome shift placing greater emphasis on areas of structural adjustment. This trend has been formalized with the creation of the structural adjustment facility.

The present review of conditionality raises the difficult question of whether these countries should be permitted continuous access to Fund resources under credit tranche policies. A valid argument cautioning against the continuous expansion of Fund credit to low-income countries with protracted payments problems has to do with the largely nonconcessional nature of Fund resources. At the most recent Interim Committee meeting, there was broad agreement on the desirability of replacing part of the low-income countries' market-related debt with assistance on highly concessional terms more consistent with their limited growth and adjustment capacity. At the Fund level, this shift could be achieved through the progressive replacement of credit tranche resources with structural adjustment credits, which would of course require that the resources available under this facility should be considerably enlarged in order to make it a full-fledged mechanism for pursuing comprehensive adjustment. Mr. Dai, Mr. Lundstrom, and other speakers have already made stimulating suggestions in this connection. As a number of us requested at the time that the structural adjustment facility was created, access to its resources has already been linked to the adoption of annual financial programs aimed at the balance of payments position. The facility contains all the ingredients necessary for its transformation into the Fund's natural facility for balance of payments assistance to low-income countries. It is urgent for the Fund to begin examining how to strengthen this facility with resources of appropriate size, now that the World Bank has considerably stepped up its financing efforts in favor of low-income countries, and other donor communities are considering similar steps. To this end, consideration should be given to a substantial increase of the resources of the facility funded by additional sales of a part of the Fund's gold holdings and by contributions from creditor countries. Therefore, I propose that we discuss at an appropriate moment the possibility of adding the following sentence at the end of paragraph 2 of the decision, after the words "in the present circumstances":

> However, in the case of low-income countries with protracted payments problems, the Fund is of the view that the principles of conditionality cannot be successfully implemented unless the countries' adjustment efforts are supported by financial assistance on highly concessional terms. The Fund will therefore study the possibility of enlarging the resources of the structrual adjustment facility.

Finally, I support the proposals made by Mr. Kafka, especially his suggestion for focusing on country studies rather than on statistical series for various economic aggregates. In my view, such an approach would considerably improve our understandings of the dynamics of adjustment and would promote the formulation of policy suggestions on which future program discussions can be based.

Mr. Posthumus made the following statement:

If the Fund is to remain an effective multilateral monetary institution, the revolving character of its resources should be safeguarded. Thus, external viability over the medium term is needed, and an adjustment process can therefore be supported only if external viability can be expected. A current account deficit can be viable if there is an expectation or certainty that financial flows to finance it will be available; if this includes a debt rescheduling arrangement or an expectation that there will be one, then I think this would also be a viable situation. In his statement, Mr. Ortiz commented that the definition of external viability in the staff report is not sufficient, because it includes only voluntary flows, and that the Fund should itself have a catalyzing role in arranging involuntary flows. I think that this would impose responsibilities on the Fund that it cannot carry out and should not assume on a permanent basis.

If external viability is not to be expected, then the role of the Fund in such a specific situation must be carefully reconsidered. The most important reason for this is that, as the staff rightly remarks, the provision of nonconcessional resources might in this situation increase the magnitude of the adjustment problem. In the case of low-income and heavily indebted countries Mrs. Ploix proposed that in a situation with a cost of resources problem, the structural adjustment facility or interest rate subsidized compensatory financing would provide a solution. However, the structural adjustment arrangement is not a stand-by arrangement on soft financial terms. Even more important, the structural adjustment facility is a limited facility, and I think that we should be realistic and not expect too much willingness by donors and multilateral agencies to provide additional means for this purpose.

The Fund's role in coordinating financing is a subject that is discussed in the staff paper mainly as an issue of critical mass or approval in principle. Perhaps this should be discussed later, but we should face the fact that we have problems, and not only in coordinated financing involving the commercial banks. It is not at all certain that donor agencies will change their priorities, whether they are commercial or development-oriented, and channel funds to specific countries in a coordinated effort by the Fund.

The staff rightly observes that "helping members to achieve and maintain a high rate of economic growth has always been a major objective of the Fund's conditionality." The experience with growth under Fund-supported adjustment programs has been considerably more positive than it is sometimes perceived to be, and this is indeed noteworthy. I agree with Mr. Dallara's observation that one would in fact have to compare growth with a Fund-supported program with growth in the absence of such a program.

The question, of course, is what constitutes a growth-oriented adjustment program. Some think mainly in terms of structural, supply-side measures; while others place heavy emphasis on additional resources. There are others who assume that a growth-oriented adjustment program simply means less adjustment. I look forward to the results of the staff studies on the conceptual and empirical underpinnings of growth-oriented adjustment programs, as announced in the work program.

Prior action--any policy steps taken before an arrangement goes into effect--decreases the need for persistence in implementation, the stronger the prior action is. A weak prior action increases the need for persistence in implementation, but in fact weak prior action weakens persistence itself. Political considerations often dictate the softening and postponing of adjustment measures. But weak adjustment measures usually give little results, while the sacrifices asked are perceived as being very great. Thus, a weak adjustment policy undermines itself. All this is very logical. It is good to realize that prior action and frontloading of adjustment measures are really very useful. Perhaps we should highlight the cases in which adjustment was rather rapid in the beginning. Of course, examples need not be taken from Fund-supported programs only. After all, adjustment is required by the internal and external economic situation of a country whether it needs Fund assistance or not. I agree with Mr. Zecchini that adjustment without Fund financing would be more painful and detrimental to the economy. I consider that both Mr. Ortiz and Mr. Dallara put too much emphasis on conditionality, Mr. Ortiz by warning that tight conditionality may be counterproductive, and Mr. Dallara by suggesting that conditionality be expanded to more policy areas.

Mr. Donoso made the following statement:

After extensive analysis and review of figures the main paper among the documents for today's discussion concludes by indicating--as explicitly stated in the draft decision--that present guidelines on conditionality remain appropriate. To arrive at this conclusion, the staff goes through many analyses, each of them worth some discussion. But we will touch on only a few of the points considered by the staff.

First, the notion of a relatively successful adjustment experience in the countries which entered into arrangements in 1983 is developed in the paper: 7 countries, of the total 1983 arrangement countries, would be close to reaching viability; 21 other countries would be on track to achieving viability within five years; only the 6 remaining countries of the group would be in a more difficult situation and would need a longer period to reach viability.

It is not clear that the best interpretation of the data presented on page 13 of EBS/87/47 is the one provided by the staff. In fact, looking at the mean or at the median of the figures measuring current account deficit as a percentage of GDP for the group of countries with expected viability within five years, we find that the reduction in the external imbalances of those countries occurred between 1982 and 1984. After 1984, the figures indicate renewed deterioration in their external situation. Thus, from the figures presented in the table one does not get the notion of a clear tendency toward adjustment. However, what we are aware of is the strong dependence of the external situation of these countries from the general external conditions. If we take into account the analysis presented in the most recent world economic outlook we do not have reasons to be very optimistic because of these considerations. Hence, we wonder about the basis for the optimism of the staff with respect to the situation of these countries. The diagnosis here is different from the ones which served as the basis for discussion when we reviewed the world economic outlook or the debt strategy. We believe the others were more realistic.

We consider that a good diagnosis of the situation of the countries that have undertaken adjustment is crucial to develop a correct view on the appropriateness of the design of the Fund's programs or of its guidelines on conditionality. An objective and practical measure of the quality of the design of a program is the degree of success of that program in taking a country to a situation from where it can grow at reasonable rates. From a more realistic diagnosis, perhaps the staff would have arrived at a more critical view of the present guidelines, which is my second point. Together with an optimistic diagnosis, the paper presents the view that, on most occasions, the difficulties that might arise under a program may be due to external developments or to inappropriate implementation. A logical conclusion embodied in these two considerations is a proposal to (a) keep guidelines on conditionality as they are; and (b) protect the revolving character of Fund resources by simply not entering into arrangements with countries that do not show the will to adjust as required to cope with whatever difficulties they must be facing.

Of course, if the problem was concentrated in very few and small countries, the approach proposed in the paper could be appropriate. If the problem is more extensive, as I think it is, then the approach proposed by the paper would amount to a decision to step out of the problem and wait until countries and creditors could solve their problems by themselves. The whole purpose of this institution is to contribute to solutions that minimize the damage of financial problems on the international financial system. So I do not think that the staff's proposal makes sense if the problem is more extensive than indicated in the staff's diagnosis.

As already indicated, we believe the problem is more serious. We consider, therefore, that there is the need to be open to explore new approaches, if they appear promising in terms of allowing the Fund to play a meaningful role in facilitating the restoration of creditworthiness and growth possibilities to countries and stability to the international financial system.

We have stated on other occasions that the root of the problem is that not enough consideration is given in the design of programs to the existing limits to internal adjustment. External developments and the availability of financing are taken as exogenous variables. The degree of adjustment is considered as endogenous and adjustment itself as a matter of will of the authorities. This way to look at adjustment is reflected, for example, in programs that, when facing adverse external developments, call for additional adjustment and do not consider additional financing. This bias becomes an important reason for difficulties in the implementation of programs and for interruption of programs which are costly for the adjusting countries and for the financial system.

We have recently seen that adjustment is being recognized in some cases as being more difficult to obtain than additional financing, which is the idea that debt forgiveness is necessary for low-income countries. The same recognition in relation to medium-income countries does not have to imply debt forgiveness, but it does imply more financing and some reorientation in the way programs are defined.

To try to define programs that recognize that, after a certain stage, marginal adjustment is more difficult to obtain than marginal financing would also imply consideration under the programs the idea of additional financing rather than additional adjustment to cope with unexpected adverse circumstances. If we move in this direction we might perhaps be able to avoid in part the results of what today is perceived as the effect of lack of political will. I do not think it is practical to elaborate more on this approach at this opportunity. It is clear that it is not easy to get financing to implement it; maybe there are even better alternatives. What I would stress at this time is that if reality is less favorable than what the staff depicted, we should not be content with the staff proposal to maintain guidelines for conditionality and step away from the most difficult cases. On the contrary, we should redefine our policies to cope with the situation as it is.

Third, we find that the staff paper does not indicate clear movement toward giving more priority to growth. As the staff indicates, there are two problems in this respect; making good use of available resources, and increasing the amount and quality of productive resources. We agree with the staff that in any country the reforms aimed at making more efficient use of resources can play a very important role. In most countries, consumption cannot be reduced indefinitely and, therefore, after some time lower current account deficits are associated with lower investment. This occurs not because of lack of good projects, but because there is no external financing and resources have to be transferred abroad. Most countries are servicing their debts with resources that otherwise would go into investment.

Priority to growth should imply more efficiency and more financing. In the staff's view, once efficiency has been introduced, investment can be financed from domestic sources. As the staff paper notes, external resources "must be on a scale and terms consistent with the capacity of the country to absorb and service them." I understand this as indicating that for heavily indebted countries growth will have to come from efficiency and domestic savings. This would not represent any change from the situation experienced since 1983. In acknowledging the difficulties in this respect, the Board is interested in a deeper analysis of the possibilities of achieving more growth in adjustment programs.

We note that the Fund is in a difficult position. The countries with imbalances face difficulties in adjusting, especially reacting to unfavorable external circumstances without additional financing. There are even problems in assuring the basic financing for adjustment programs. However, the staff notes that official creditors who have influence in Fund policies do not fully support the Fund's emphasis on external viability, both for the sake of adjusting countries and to preserve the revolving character of Fund resources that is at risk.

At this juncture, it is not a solution for the Fund to decide that there are no problems of design in the programs of adjustment and that to avoid risking its resources, it might suffice to give countries in need of adjustment enough time for them to produce an appropriate adjustment strategy as suggested by the staff. It seems to me more promising to review the situation with a totally open mind--to consider difficulties to adjust as part of reality and to be open to consider new elements in programs to take into account this reality. The appropriateness of our guidelines with respect to conditionality has to be judged in terms of their ability to bring countries from external difficulties to sustained growth. In our view, the staff has presented an excessively optimistic view that does not facilitate the task of finding out where the problems are and which changes need to be introduced. Like other Directors, I accept the present guidelines as appropriate in transition, and I look forward to more analysis of this topic.

I believe that the staff papers should be important for our work, but like Mr. Kafka, I think it is fundamental to ensure the quality of the paper that it be done by some special entity, free from operational responsibilities and in conditions conducive to developing a totally independent view. I also share Mr. Kafka's view that we could achieve a more precise understanding of the situation if the staff's analysis were based on country cases rather than cross-country statistics.

Mr. Sengupta made the following statement:

From time to time, we have reviewed the Fund-supported programs as required by guideline 12 of the 1979 guidelines on conditionality. These reviews, it appears to me, have tended to be somewhat routinized. In my intervention at the Board's discussion of program design and performance criteria (EBM/86/190 and EBM/86/191, 12/3/86), I had pointed out that there is an urgent need to formulate program designs that are growth oriented before we discuss Fund conditionality. I had also mentioned that the lengthy discussion on the theoretical aspects of the design of Fund programs (Seminar 86/10 and 86/11, 10/20/86) had been somewhat inconclusive and there was a need for further examination of several aspects of program design. Since we have to address this question again, we can only reach tentative conclusions in our present discussion of conditionality.

Conditionality and issues relating to adjustment and financing are usually discussed with reference to countries that approach the Fund for financing their external payment gaps. However, we all know that adjustment at the international level cannot be realized only by one set of countries--the deficit countries--if the other set of countries--the surplus countries--do not cooperate and adjust at the same time. Conditionality should not be associated with only stand-by and other Fund arrangements for deficit countries that approach the Fund for support; it should be related to the reverse adjustment programs of the surplus countries, too.

For some time, there have been suggestions from Mr. Kafka and from this chair that Fund programs should be evaluated regularly by independent units, if necessary with some help from professional expertise outside the Fund. The establishment of such a unit or a process for evaluating the experience, which can also be extended to the evaluation of the design of the programs and policies, would help to project an international image of objectivity for Fund programs.

The staff and background papers are based on the experience of 34 developing countries for which Fund arrangements went into effect in 1983. The assessment is on a cross-country basis that, as we are all aware, is not the best methodology to adopt for all circumstances and purposes.

As I review the papers, I get an uneasy feeling that the basic premise has not changed from the traditional approach to adjustment, dominated as it is by demand management, in spite of the demonstrated need for growth-oriented adjustment. The staff papers suggest that the need for adjustment is mainly to reduce external current account deficits and achieve balance of payments viability over the medium term in a manner that will establish "adequate safeguards for the temporary use of the general resources of the Fund." They maintain that preservation of the revolving character of Fund resources is the most critical issue for the Fund and, ipso facto, of conditionality.

No one disputes the need for the Fund to make resources available to members in need under "adequate safeguards." However, the major purposes of the Fund should not be subordinated to the notion of "adequate safeguards." The primary objectives underlying these purposes, as Article I(ii) so aptly puts it, are "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members as primary objectives of economic policy." The excessive emphasis on the temporary use of Fund resources has in practice led to reduced access to resources, which on an annual basis has declined from 103 percent of quota in 1983 arrangements to 43 percent of quota in 1986 arrangements. This has happened at a time when growth-oriented adjustment would have required much larger access to Fund resources. In fact, the revolving nature of Fund resources can be best maintained only in an environment conducive to growth, which would ensure the ability of the program countries to service their debt. Balance of payments viability cannot be achieved and sustained without the country in question achieving an adequate rate of growth. I agree with Mr. Ortiz that the staff definition of balance of payments viability should be amended to focus on growth. I suggest the following amendment: a viable balance of payments would mean a current account deficit, consistent with a reasonable rate of growth which would make full use of the development potential of the country, and would permit that deficit to be financed on a sustainable basis by expected net capital inflows compatible with its debt carrying capacity.

If the borrowing country has other objectives such as improvement of income distribution or poverty alleviation, those should also be taken into account in the design of the programs. The Fund should adopt a practical approach to the feasibility of programs by paying, as guideline 4 puts it, "due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems." Even when a program's main objective is to achieve an appropriate balance of payments outturn, it is necessary to adopt a flexible approach regarding the speed of adjustment. Such an approach would not be inconsistent with the preservation of the revolving character of Fund resources, but would only affect the speed at which resources rotate and on the resources required by the Fund at any point of time. It is also not necessarily true that stronger adjustment measures would be required in cases in which the time needed for adjustment is expected to be longer or when there are uncertainties in securing the needed external finance to close the financing gap. It is here that program design plays an important role--it should be tailored to circumstances of the countries involved.

The staff points out that in many cases in 1983 large current account deficits had to be met by strong adjustment efforts, owing to the abrupt decline in commercial bank lending and other official flows, and that Fund arrangements had to be put in place without any assurance about closing the ex ante financing gaps. The Fund's assumption of an important role in coordinating external financing defused the tensions and uncertainties associated with the debt crisis at that point of time. The staff describes three techniques--prior actions, approval in principle and gathering of "critical mass"--for dealing with financing uncertainties without fully analyzing their usefulness in adjustment that is oriented to growth. The technique of prior actions tends to front load adjustment, thereby increasing the burden on the borrowing country and decreasing the amount of financial support that the Fund would need to provide. Furthermore, the guidelines on conditionality envisage that some prior actions can be taken, only if necessary, for carrying out a Fund program. This, prior actions should be suggested, not as a matter of routine, but only when necessary, and their number should be kept to the minimum. Even then, the Fund should not insist on the achievement of specific targets, but regard it as appropriate if the variable involved moves in the desirable direction.

We have recently had an example of the technique of the approval in principle when a country which could not avail of compensatory financing in the upper tranche because the Fund did not consider that the member has shown evidence of requisite cooperation with the Fund, even when the member's request for a stand-by arrangement was approved in principle. This raises issues not only concerning the notion of cooperation with the Fund under the decision on compensatory financing, but also about the usefulness of the very technique of approval in principle. As to the gathering of the critical mass, the delays in attaining it in some recent cases raise many questions as to what the Fund should do in such circumstances. These experiences and questions have not been so far subjected to in-depth examination.

As to the reviews, they should be used for flexibility in unavoidable cases or when developments could not be foreseen. They should not be employed for changing the very basic process of policy planning and implementation of a program, except in cases where it is unavoidable owing to lack of information or understanding about the nature of difficulty at the beginning of the program. When they are used, reviews should be restricted to evaluation of the current macroeconomic policies of the member and to reach new understandings, if necessary, and not extend to sectoral or microeconomic issues.

I agree with the staff that for coordinated financing to be effective, all parties--borrowers, creditor countries, commercial banks as well as multilateral financial institutions--should "live up to their respective responsibilities, with regard to both adjustment and financing." However, this should not mean that the Fund's financing role should be progressively reduced if other parties do not play the role expected of them.

I wonder whether the maintenance of a high rate of growth has at all been given its due place in Fund-supported programs. It should be mentioned that for 31 of the sample countries in 1982-85, the current account adjustment was associated with a cutback in investment. Import volumes were also reduced for the sample countries during the period 1983-85. It is not clear how far the programs have contributed to actual growth rates in the sample countries. It is also not clear whether the achieved growth rates were equal to the potential rates and whether they could have been higher had there been larger external financing. The experience does not help us to judge the positive effect of Fund programs on growth.

In the current circumstances of limited official and private capital and financial flows, and commodity price declines, there is clearly a need for urgently shifting the focus of program design from demand-management oriented policies to growth orientation and to the need for incorporating growth contingency mechanism. Growth contingency should be treated as a part of exercises pertaining to program design, and should be made use of when the actual rate of growth deviates significantly from that targeted for the program period. If the actual rate is less than the target rate for a period of time, even when the performance criteria are met, it could be presumed that growth-oriented adjustment would need to be supported by additional external financing.

In addition to this, contingency mechanisms to protect the member's programs from the threats posed by exogenous developments would need to be provided for under the programs. The exogenous developments that may be considered could include the prices of primary commodity exports and of oil exports, the rate of market growth for nontraditional exports, receipts from nonfactor services such as workers' remittances, the prices of key imports, and the interest rates on external debt. This is not an exhaustive list. The exogenous variable that should be considered for inclusion in contingency mechanism would have to be chosen with reference to the circumstances and characteristics of the country seeking Fund support. The report of the Group of Twenty-Four on the role of the Fund has made elaborate suggestions about such contingency mechanisms.

As to performance criteria, program targets should be confined only to external variables with which the Fund is basically concerned, and which should be consistent with the objectives of growth. Only if these targets are not met should the Fund assess the possible need for policy changes. The Fund could assess whether the policies are generally consistent in terms of direction and broad orders of magnitude. These should be set not in precise numbers, but as ranges. Even if the balance of payments targets are not fulfilled, the program should not be disrupted, and disbursements stopped, so long as the performance criteria are met, or the broad objectives are met. In my view, if the staff recommends the stoppage of disbursements, that should not be made effective till the Executive Board approves it--taking an overall view of the progress of the program--not by a simple majority, but by a 70 percent majority of the voting power.

Waivers and modifications reflect not only the proliferation but also overly rigid specification of performance criteria. Due regard should be taken of the feasibility of implementation of policies, the quality of the data base and the assumptions relating to exogenous developments or international environment.

It is very unfortunate that the extended Fund facility has been greatly de-emphasized in the Fund's operations. In 1984 and 1986, there was not a single extended arrangement, and in 1985, there was only one. This does not mean that deficit countries do not have structural problems. The extended Fund facility has a potentially significant role to play, especially since it is now being increasingly recognized that growth-oriented adjustment, coupled with larger international cooperation, is essential for more orderly international adjustment than the world has witnessed in this decade.

Finally, it may be necessary to amend the proposed draft decision to reflect the concerns expressed above and the spirit of the Interim Committee's communiqué of April 1987. The Interim Committee "requested that deliberations in the coming months cover any additional suggestions on the role of the Fund included in the forthcoming report of the Group of Twenty-Four, as well as any outstanding issues from those raised in earlier reports of both the Group of Ten and Group of Twenty-Four." It encouraged this Board "in its forthcoming discussions, to conduct a thorough review of adjustment programs and their supporting Fund arrangements in order to ensure that they are appropriate to conditions now facing member countries."

Such a "thorough review" would necessarily have to go beyond the periodic reviews of staff studies of the programs as the one we have performed today and as envisaged under guideline 12. The report of the G-24 Working Group, which is expected to be adopted, with amendments, if any, by the Group of Twenty-Four, on the role of the Fund has also made a number of far-reaching proposals on Fund conditionality and program design. When they are discussed together with the concerns about the Fund programs and their implementation, as have been reflected in the interventions of the Board members today, it would be clear that we require a comprehensive review of conditionality in all its aspects including the guidelines. The time now has come to take a decision about the need for such a comprehensive review.

Guideline 12 also refers to the Executive Board determining "when it may be appropriate to have the next comprehensive review of conditionality." It may take some time to prepare for such a comprehensive review. But let us take a decision today that, in the light of the forthcoming discussions on the role of the Fund in the Executive Board and in the next Interim Committee as envisaged in the April communiqué, we shall have a comprehensive review of conditionality as early as possible, but not later than March 1988--well before the spring Interim Committee meeting next year. Pending such a comprehensive review, we could take a decision today that the guidelines on conditionality and the provisions of the extended Fund facility would remain in force in the present circumstances.

Mr. Al-Assaf made the following statement:

It is encouraging to note that, despite a difficult external environment, a number of countries among those that had initiated arrangements with the Fund in 1983 have made substantial progress toward achieving balance of payments viability. However, there have been cases in which, for one reason or another, progress toward balance of payments viability has either been slow or negligible. These cases raise a number of fundamental issues, including the appropriate design of Fund programs, the capacity of developing countries to sustain adjustment, and the role of the Fund in securing the required financing. The design of Fund programs is a "learning by doing" process, and the Fund has made some welcome modifications since 1983. However, there remain some features that need additional attention.

I believe that the twin objectives of growth and adjustment are not mutually inconsistent. As the Managing Director pointed out at the recent symposium on adjustment with growth, held at the Fund, the real issue is to ensure that the type of adjustment which is associated with Fund programs is conducive to growth. The key to ensuring that adjustment is of the quality that permits growth lies in designing Fund programs with sufficient attention paid to structural matters and the efficient use of scarce resources. Futhermore, not only can growth and ajustment be mutually consistent, there are circumstances in which growth is a prerequisite for the achievement of balance of payments viability. In this context, I should emphasize that failure to implement the needed adjustment policies in some cases may permit rapid growth in the short run. Such growth, as the experience of a number of countries has shown, has proved to be unsustainable over an extended period of time.

The issue of attaining growth with adjustment also bears on the issue of the appropriate pace of policy implementation. While the strategy of rapid adjustment provides a margin for the economy to be in a better position to deal with adverse developments, it is important to recognize that not all policy objectives can be achieved at the same rapid rate. It is clear, for example, that the rapid removal of severe exchange rate misalignments can yield significant immediate benefits to an economy. However, when it comes to meeting the objective of eliminating a large fiscal deficit, an overly ambitious pace might not only undermine the country's commitment to implement needed measures, it might also disrupt the growth-oriented adjustment process itself. Furthermore, we should recognize that the pace and direction of policy implementation should depend on the external circumstances experienced by the adjusting country. As the Saudi Arabian Minister of Finance pointed out at the most recent Interim Committee meeting, it is simply not realistic to expect developing countries to proceed with trade liberalization when faced with high levels of protectionism in certain industrial countries. In that connection, the conventional advice that there is a need for developing countries to diversify their exports will not meet with great success if those countries find their access to industrial country markets constrained. Therefore, it is important when designing adjustment programs to ensure that program expectations are realistic and globally consistent.

An analysis of recent Fund programs in a variety of countries clearly suggests that an important challenge for the Fund is to find ways to ensure that countries sustain their adjustment efforts. The question that needs to be answered is why some member countries have been unable to do so. In my view, there are four interrelated reasons: the external environment many countries face has continued to deteriorate; there has been insufficient financing in support of the adjustment efforts of these countries; adjustment fatigue has arisen due to the fact that adjustment is often painful, without producing an obvious improvement in a country's circumstances in the short run; and slow progress has been made on the supply side.

What should be done to alleviate these concerns? Although the external environment has to be taken as given, the Fund could, through the design of Fund programs, ensure sufficient flexibility so as to enable the adjusting country to adapt its policies to exogenous shocks. The Fund should also continue to play its role in securing needed financing for members.

In this connection, I note that the experience of the countries with stand-by arrangements in 1983 is varied in the sense that the countries that made the least progress toward viability tended to be countries with low income levels. This evidence is consistent with an ongoing awareness by everyone that the poorest countries, with their limited product ranges, face particular problems. I believe that the Fund should respond to their needs by developing arrangements similar to structural adjustment arrangements. Such arrangements have the advantage of not only attacking the structural problems of those countries, but also of offering financing at longer maturity.

As to adjustment fatigue, the Fund could also try to minimize the adverse effects of adjustment programs on the poorer sections of the population, for example, through targeted subsidies. As I have already implied, adjustment measures should be of the type that encourage a strong supply response and therefore stimulate overall growth. In addition to encouraging the removal of major price distortions, these measures might include emphasizing quick-yielding investments and ensuring that structural and institutional impediments to the expansion of productive capacity are dealt with early on in the program.

Although the use of "critical mass" and "approval in principle" techniques have served the Fund reasonably well so far, they raise a number of complex issues, especially in light of more recent experience. I have no strong opinions on how to proceed in this area. My one thought is that we might want to consider setting up programs in which, for example, the first drawing might not take place until three months have elapsed, thereby allowing the financing situation to become clear. Also, I look forward to a full treatment of the matter of approvals in principle in a forthcoming staff paper.

Although I welcome the increased use of reviews as a means for improving the flexibility of programs, I am concerned that too many reviews could shorten the horizon for policy planning, especially at a time when the orientation of Fund programs is increasingly taking on a medium-term focus. Another danger of increasing the frequency of reviews is that they may conceal differences between the Fund and the member country regarding the policy path to be followed for the later segment of the program. In this connection, it is a matter of concern that, in many cases, decisions regarding a number of important policy matters have been postponed until the time of the review, rather than being dealt with at the outset. This clearly is a deviation from the intent of these reviews, and it has turned them in some cases into a full-fledged renegotiation of the program. The statistics in this regard are quite telling. As indicated in the staff paper on program monitoring, only about one third of the envisaged reviews were completed on schedule or with minimum delay, and one fourth were never completed. The Fund needs to reconsider the rationale for its review procedures with the view to minimizing the differences regarding future policy paths. One possible approach is to specify, at the outset, the path of major policies for the whole program period, while also specifying potential adaptations which might be made to those policies to accommodate unforeseen developments. Reviews will then be used to resolve technical matters rather than to determine the basic policy stance.

In conclusion, we continue to face a number of complex issues concerning program design. However, there is a common theme underlying these issues: we must ensure that adjustment is of such a quality that it is conducive to economic growth. By so doing, we can also ensure the sustainability of adjustment efforts and progress toward balance of payments viability.

Mr. Engert made the following statement:

My authorities endorse the proposed decision and support a large number of the views in the staff and background papers. Like others in this series, these papers make clear the close, positive association between the record of policy implementation and the achievement of adjustment objectives. There are a number of reasons for lack of policy continuity and sustained adjustment effort including, for example, genuine disagreement over the efficacy of various policies, weakness in program design, the desirability of different policy goals, a difficult external environment, and a shortfall of growth below expectations. Other important influences are lack of administrative or technical ability, and insufficient political will, including the influence of vested interests. More generally, policies that in a broad economic sense seem to be misguided or inappropriate may be perfectly rational in a political context, at least in the short run, inasmuch as such policies may serve the parochial interests of policymakers and decision makers.

All these factors contribute to the formation of a particular structure of constraints and incentives from which policy decisions emerge. And each of these explanations for a lack of sustained policy implemenation or expected inability to adopt a sustained adjustment effort may suggest different remedies and responses from the Fund. Notwithstanding the difficulties involved, it seems that there would be important benefits to examining more closely and understanding better, both in specific country contexts and in general theoretical terms, the reasons for the lack of sustained policy implemention in our conditionality reviews.

Turning to the issue of conditionality and growth, a shortfall of growth can undermine adjustment efforts, and it seems clear that stabilization and growth are complementary. Without sustainable internal and external balances, growth may not be technically possible over the medium term. At the same time, stabilization without growth may not be feasible politically, except in the short run. As the staff puts it, it is questionable whether medium-term viability can be attained without a growth-oriented approach. In this connection, it is important to stress that targeting a particular growth rate is inappropriate; instead, Fund programs ought to incorporate stabilization policies that, to the extent possible, also contribute to an improvement in potential output.

I would like to focus briefly on fiscal policies, because fiscal adjustment is at the heart of most Fund programs. A recent paper by the Director of the Fiscal Affairs Department notes that in the context of a program concerned only with demand restraint, the particular fiscal measures used to achieve a reduced fiscal balance may be irrelevant. However, a concern for growth imparts a special significance to the choice of particular measures, which I think that Fund programs increasingly recognize. Following the line of the paper: first, a stabilization program should incorporate fiscal measures that are both durable and efficient; second, unless attention is paid to the durability and quality of the specific measures, stabilization programs may be short-lived successes; and third, if the fiscal adjustment is carried out with well-chosen specific measures, the supply response may be sufficient to reduce the size of the needed fiscal retrenchment. The upshot of this argument is that there is likely to be some trade-off between the size and quality of fiscal adjustment. We must pay attention to the type and structure of the fiscal measures advocated by the Fund. But it is my view also that such considerations essentially complement, rather than substitute for, traditional demand-management aspects.

Putting the preceding issues more squarely, there is an attraction to tailoring assistance more closely to a member's ability or willingness to implement policies. In some circumstances, we may need to be more readily prepared to insist on more determined implementation of policies as well as on stronger and more specific measures to improve growth and balance of payments performance. To do otherwise may be to invite failure. However, as the staff notes, moving in this direction could lead to some conflict with the present guidelines on conditionality.

More fundamentally, I think the Fund is moving toward a crossroads which the Board must soon address explicitly and give the staff guidance. On the one hand, it seems evident in a number of cases, that a closer focus on microeconomic issues and on growth, for example, would be indispensable to the achievement of viability. At the same time, this could introduce problems regarding the appropriate role of the Fund, given its mandate, financial resources, and skills. Similarly, there is the equally fundamental aspect of respecting the member's domestic policy choices, whether or not some believe that these choices are rational or legitimate. To begin down this road could even undermine the Fund's effectiveness. Therefore, it is important--even essential--that we implement changes in our procedures and policies, while remaining fully aware of the implications and that we do not unknowingly evolve into a different institution.

My authorities feel there is no need to revise our conditionality guidelines at present. However, it will be important to consider, in the coming months, the implications of the considerations I have noted more fully and more precisely than we have done thus far. This must be done in relation to the broader macro context of the difficult external environment facing many countries, especially the lack of external financing, which is perhaps the ultimate constraint. There are links between conditionality and growth, the debt strategy and debt overhang issue, and multilateral surveillance more generally, that we need to examine more rigorously.

The unexpected exogenous factors that have affected members undertaking Fund programs in recent years have on balance been negative. This is suggested by the sharp decline in terms of trade, which has resulted in a transfer of some $100 billion from less developed to developed countries in 1986. In addition, Table 26 of EBS/87/46 lists a number of major negative exogenous factors affecting economic performance of members undertaking Fund programs. These considerations suggest the need for a flexible response by the Fund, members, and creditors in order to effectively manage these shocks. They also suggest the importance of the Fund in playing a central, and perhaps innovative, role in the debt strategy, as noted by some Directors on the occasion of the most recent Board discussion of the debt strategy.

I would like to refer very briefly to the way that Fund programs and conditionality are frequently perceived. There seems to be a view that conditionality is the price that a member must pay in order to have access to the Fund's resources. This seems to be a false representation. With external and internal imbalances, a member, acting without the Fund's assistance and advice, faces the prospect of probably less efficient adjustment. Not only does the Fund offer perhaps the best technical advice available, it also provides financing to cushion the impact of adjustment. The real trade-off is between inefficient and efficient adjustment or, similarly, between achieving a lower or higher probability of viability. We should try to persuade the various decision makers involved--through all the methods available to us, including conferences, seminars, symposia, and discussions at our institutions--that without the Fund members facing adjustment problems and external shocks would almost certainly be worse off.

Mr. Reddy made the following statement:

In welcoming today's decision, I will limit myself to highlighting six points. First, we would like to emphasize the importance of a favorable external environment for deficit developing countries to undertake adjustment. The continued weakening of commodity prices, the increase in protectionism in industrial countries, and relatively high real interest rates have not been conducive to external adjustment in developing countries. Hence, macroeconomic adjustment in industrial countries, together with trade liberalization, will be crucial to the process of external adjustment in the developing countries.

Second, there is ample evidence that considerable progress has been made in achieving adjustment in many developing countries, but much more remains to be done. In some countries there is a need for greater political will and the capacity to develop and implement coherent adjustment programs.

Third, given the current adverse external environment and the uncertainties regarding financial flows, the Fund should be careful in its specification of balance of payments targets. We believe that it is important for these targets to be realistic and not too ambitious.

Fourth, the availability of external financing will remain crucial for ensuring an orderly adjustment process. We have noted with some disappointment that access to the Fund's own resources has been cut back at a time when commercial banks are also withdrawing from developing countries. We believe that a somewhat more liberal implementation of the guidelines on access would be justified. Increasing access to Fund resources at this time would be particularly important in establishing the confidence of the commercial banks, which have become unduly cautious in their lending to developing countries.

Fifth, we believe that Fund adjustment programs should not focus too much on external adjustment. In designing Fund programs, due weight should also be given to other important economic objectives such as growth, employment, and income distribution.

Sixth, we believe that proliferation of performance criteria should be avoided, and that caution should be exercised in prescribing prior actions so that they do not impose excessive financial and political costs on member countries. Members experiencing financial difficulties should be encouraged to come to the Fund at an early stage of their problem, and they should not be intimidated by excessive conditionality.

Finally, this chair shares the reservations expressed by Mr. Ortiz and Mr. Sengupta about paragraph 2 of the proposed decision, and would support inclusion of language that would make it clear that the decision is interim, pending the consideration of the report of the Group of Twenty-Four and other papers.

Mr. Mawakani made the following statement:

At this juncture of the world economy and the work of the Fund, this year's review of the experience with Fund-supported adjustment programs provides a welcome opportunity for me to say that the time has come for the Board to consider scheduling the next comprehensive review of conditionality, as called for under guideline 12 of the 1979 guidelines on conditionality.

I am invoking the provisions of guideline 12 because it is now widely known that in recent years the use of Fund resources in support of adjustment programs has become the subject of intense debate and controversy. This debate has focused on the conditionality underlying the Fund's financial assistance, and on whether it has been effective in helping members' adjustment programs, not only for achieving their external payments objectives, but also for generating sustainable economic growth. The controversy has led to the perception that the present guidelines on conditionality have not been flexible enough and do not provide a satisfactory basis for use of Fund resources and for the achievement of members' objectives. After nearly eight years since the guidelines were adopted, the time has certainly come for them to be reviewed and amended if necessary to sufficiently reflect the concerns of most developing countries on the issue of conditionality and to take into account the recent attention paid by the Fund to growth-oriented adjustment.

This view is reinforced by the staff's acknowledgment on page 16 of the paper that "in recent years...some countries' efforts at balance of payments adjustment have been associated with prolonged periods of economic stagnation or decline, and this has led to increasing attention to the growth objective in discussions of the Fund's conditionality." Furthermore, Part B of the background paper (EBS/87/47) elaborates the concerns that have recently been expressed about the growth aspects of Fund-supported programs. In the Managing Director's statement on the work program, attention has been drawn to part of the Interim Committee's recent communiqué which encourages the Board "to conduct a thorough review of adjustment programs and their supporting Fund arrangements in order to ensure that they are appropriate to conditions now facing member countries." The statements that I have quoted support my request for a review of the guidelines to reflect a number of developments over the last few years that have become of major concern to the international financial community.

The growth experience of the sample countries in the staff paper has been disappointing, a majority of them registering low or negative growth rates. Of the 34 countries whose experience has been reviewed, it is indeed significant that 27 have not made satisfactory progress toward achieving balance of payments viability and only 7 have come relatively close to achieving that viability. Indeed, the programs were designed with the focus on the restoration of internal and external balances, with little or no attention paid to growth, while the international economic environment was characterized by an inadequate flow of foreign financing. Unfortunately, the situation has not improved; several countries cannot finance their current account deficits on a sustainable basis because the capital flows that should be available have either ceased, as in the case of African countries, or have significantly declined; and those that were made available were on terms not compatible with the countries' ability to service their debt. The result has been a debt overhang that has become a major challenge for the international financial community. It is now generally accepted that a satisfactory solution to this debt problem lies in durable growth, and, therefore, the design of Fund-supported programs should reflect this objective. It should be noted that the political will to put in place appropriate macroeconomic and structural policies and to persevere in their implementation has always been evident in most countries. What has not been evident is an appropriate design of adjustment programs that fully takes into account the specific needs and circumstances of each country, including the sociopolitical consequences of the measures being undertaken.

In the past, the call has been made for more analytical work to ensure that program design is flexible enough to accommodate the specific needs and circumstances of each country and, in particular, to take account of exogenous developments that have hindered progress toward external viability and sustainable growth. Program design should also take into account the need for a gradual implementation of policy measures. Therefore, time is needed to allow policies to have their intended effects if supply-side and growth-oriented aspects are to be emphasized in future adjustment programs. It has been said that programs that are oriented toward supply-side policies tend to be more demanding and entail more Bank-Fund collaboration. While collaboration between the Fund and the Bank is important for supporting the structural adjustment policies of countries, and for coordinating the required financing in support of such policies, the need for each institution to concentrate on areas of expertise and responsibilities has raised the issue of cross-conditionality, especially regarding approval of arrangements under the structural adjustment facility.

I have not changed my view on program monitoring and performance criteria. Proliferation of performance criteria does not ensure the success of a program, as some Directors have observed. Indeed, the evidence seems to suggest that proliferation of performance criteria hinders rather than promotes progress toward smooth adjustment. In this connection, I would like to suggest that the staff consider the use of a small number of performance criteria instead of as many as the 8-14 that were applied in the arrangements studied. Furthermore, I would favor quantitative performance criteria that are based on ranges instead of precise figures, so that the appraisal of programs and policies being implemented can be determined on the basis of broad objectives.

I believe that the staff papers should be substantially revised and their scope broadened to make them more suitable for the next comprehensive review of conditionality, which should take place after the report of the Group of Twenty-Four on the role of the Fund in adjustment with growth has been issued.

I support paragraph 1 of the proposed decision. Paragraph 2 should be amended to reflect the fact that the guidelines on conditionality are not suitable in the present circumstances, and paragraph 3 should be reformulated in line with the proposed new version of paragraph 2.

Mr. El Kogali made the following statement:

I will limit my comments to the experience of the small, low-income countries, many of which are represented by this chair. The experience of these countries is of particular importance because they comprise a majority of the 34 countries whose experience is reviewed in the staff paper. Indeed, low-income African countries represent almost 50 percent of the case study, and all but one of the countries singled out by the staff as in the most difficult situations are low-income African countries. The reason for the disappointing outcome of the experience of many small low-income countries with Fund programs is not simply lack of commitment to adjustment or faltering adjustment efforts, as stated by the staff; it is perhaps more due to the failure of Fund programs to give adequate attention in both program design and conditionality to the circumstances of this group of countries.

The small, low-income countries have certain features which severely limit their capacity to adjust and which make adjustment through continued compression of domestic demand most inappropriate. The recognition of these characteristics has important implications for the design of Fund programs and the nature of their conditionality, and the financing role of the Fund. As has been ably put by Mr. de Groote, these countries are characterized by severe poverty, reliance on a single or only a few export commodities, and low domestic absorption. These characteristics, together with a narrow production base, fragmented and highly imperfect markets, and large nonmonetized sectors that dominate their economies make adjustment that relies heavily on austerity measures most unlikely to succeed. Continued compression of domestic demand when the level of absorption is already extremely low results in excessive hardship that goes beyond limits of tolerance, thereby prejudicing the political sustainability of programs and seriously weakening the capacity for real adjustment. The experience of many African countries since 1982 best exemplifies the difficulty of adjustment under such circumstances, and we should learn from the results in a number of countries, including my own country, Sudan, and the unfortunate recent case of Zambia.

The design of adjustment programs must reflect these realities for countries in which it is nearly impossible to make a distinction between short-term stabilization problems and problems which reflect the level of development. In the case of small, low-income countries, Fund programs should put emphasis on gradual, medium-term adjustment that will facilitate the attainment of long-term goals of economic growth. This means that Fund programs must not only ensure expansion of output but must also take account of the distributional implications of adjustment measures.

Program design should be reviewed to make supply expansion its essential feature rather than a curtailment of absorption, and it should be tailored to the structural characteristics of the country in question and should deal with the specific economic problems being faced at any particular time. For instance, while the need for export promotion in those sub-Saharan African countries that have experienced catastrophic food shortages in recent years remains important, initial emphasis ought to be given to increased food security. Indeed, there should be a concerted effort, perhaps in collaboration with the World Bank, to ensure that the agricultural sector becomes efficient. Such a strategy, besides helping to meet basic needs and improving the distributional impact of adjustment, will reduce the import bill, alleviate inflationary pressures, and eliminate the need for subsidies. More important, this strategy would be consistent with national plans and, therefore, would have the strong political support of the authorities and the people, thus giving the program the needed element of sustainability. As agriculture becomes more efficient and food supplies recover, resources could be released to promote exports and other industrial activities.

In most small, low-income countries, since output is constrained by a shortage of critical basic imports--a situation referred to by John Williamson as "import strangulation"--the provision of adequate financing simultaneously or ahead of implementing adjustment measures will help to achieve adjustment in the context of expanding output, and will avoid the danger of overkill in terms of loss of output and imposing excessive hardship. Adequate financing preceding or accompanying adjustment will help to release that single most important constraint to output and export growth in small, low-income countries by expanding imports, making basic inputs available, and utilizing excess production capacity.

The reorientation of the Fund's program design and conditionality to suit the realities of the small, low-income countries would also require a reconsideration of the present performance criteria. The relevance of the Fund's performance criteria has been questioned. In fact, the relationship of performance criteria to program design and the realities of the economies implementing adjustment policies, their concentration on quantified short-term demand-oriented variables, and their application in a mechanistic fashion have made the present performance criteria inappropriate. The question is not whether quantified variables have a role as instruments for monitoring performance; the issue, rather, is the type of variables chosen and the way they are applied. The instruments chosen for monitoring adjustment programs should vary from one country to another in accordance with the prevailing conditions in each country. For the small, low-income developing countries, where output expansion is a fundamental requirement for adjustment, the variables chosen for monitoring performance criteria should focus on the need to stimulate growth. Accordingly, performance criteria should concentrate on supply-side variables and should be applied in a flexible manner, taking into consideration the structural nature of these economies and uncertainties surrounding their prospects.

On the matter of financing, I found it most disturbing to note the staff's conclusion that the way to preserve the revolving character of the Fund's resources is to deprive the small, low-income countries of their right to continued access to Fund resources under credit tranche policies. On several previous occasions, this chair and others have cautioned that the excessive emphasis being put on the revolving character of the Fund's resources and on the so-called prolonged users of Fund resources would lead the Fund to abandon those of its members that are most in need of Fund resources; and today we see that this is clearly the intention. However, we are concerned about overemphasizing this aspect to the extent of preventing the Fund from providing the needed assistance to its members.

In this connection, I share the views expressed by Mr. Sengupta. The real safeguard for the revolving character of Fund resources is to ensure growth in these low-income countries and not to abandon them. Indeed, Fund policies regarding use of its resources appear to have become rather irrelevant in the effort to solve the contemporary problems of poor countries, and it seems that the time has come for the Fund to undertake far-reaching reforms in its policies so as to cope with the present nature of problems of poor countries. These reforms could include lengthening the repurchase period and establishing a special facility to reduce the cost of borrowing for the small, low-income countries.

I have read and listened carefully to the interesting views expressed by a number of my colleagues regarding the structural adjustment facility. Although we will be reviewing the facility in the coming months, let me say at this stage that if the structural adjustment facility is to play a useful role, its resources should be substantially enlarged and the nature and intent of conditionality attached to its use should be changed to suit the situation of low-income countries.

In view of what I have said, I cannot agree that the guidelines on conditionality and the way in which they have been applied are appropriate. Therefore, I would request that paragraph 2 of the proposed decision be amended to reflect the need for changes.

The Director of the Exchange and Trade Relations Department observed that Directors had already mentioned a number of constraints on the Fund in designing and monitoring programs tailored to individual countries. He would note three more, specifically related to the drafting of relevant staff papers. First, uniformity of treatment was fundamental to the work of the Fund, and the staff papers on different countries perhaps appeared overly similar in their presentation because of that principle. Using the monetary approach to the balance of payments as a consistency check on programs formulated with and for members also led staff papers to appear similar for all countries. Finally, there were constraints on staff time which affected the preparation of papers. In that connection, the amount of work involved in meeting Mr. Kafka's suggestion that the staff undertake detailed country studies and analyses was considerable. Nonetheless, the staff shared the view that such studies could be useful and would try on the next occasion to present Directors with some that were particularly illustrative.

The staff representative from the Exchange and Trade Relations Department noted that a number of Directors had referred to the concept of balance of payments viability. It was generally agreed that growth was at the heart of that definition. The Fund, in applying the concept of viability while helping members to develop their adjustment programs and in providing financial support, needed to take account of the realities of each member's situation. In that connection, one Director had asked how Morocco--a low-income country--had been judged to need a current account surplus to be considered viable. As he understood it, the argument rested on the assessment that the current level of debt, which exceeded 100 percent of GDP, was raising doubts about the sustainability of Morocco's position and was acting as a brake on its development. Part of the problem was that the difficulties Morocco had faced in resolving its external difficulties in recent years had meant that direct investment and other spontaneous capital flows had not materialized; indeed, there had been a withdrawal of short-term trade financing. Morocco was currently engaged in a vigorous program that, if carried through to fruition, should improve the medium-term outlook. Once spontaneous capital inflows resumed, a higher level of imports would be possible; and in a context of higher growth, a lower current account surplus or a deficit could be envisaged.

Another example of how the Fund was dealing with the realities of financial situation of members was provided by Bolivia's current program, the staff representative continued. Bolivia had undertaken a very strong adjustment effort, but the valuation that the market had placed on Bolivia's external debt was very low and it was apparent that a special arrangement would need to be worked out between Bolivia and its commercial creditors. The scenario underlying the balance of payments projections for Bolivia, therefore, assumed that highly concessional rescheduling of commercial debt would take place. As that had not yet occurred, the Fund had approved the arrears pending a resolution of the problem between Bolivia and the commercial banks.

Of course, realities were not just something to be taken as given, the staff representative said. In fact, the Fund, through its own efforts to help countries with their adjustment and financing requirements, was working to improve these realities.

On specific aspects of the staff paper, the staff representative recalled that some had raised questions about the possible conflict between growth and income distribution. Although with growth over time rising incomes could be obtained for all, in the short term there could be a trade-off between growth and income distribution. For example, rationalization of agricultural prices promoted growth and development in the economy and benefited the rural poor, but in the short run could have the effect of lowering real wages in the cities.

In response to a question on how well staff projections took account of what was in the world economic outlook paper, the staff representative noted that the medium-term scenarios were experimental and the staff needed to first gain experience. In general, however, the scenarios were consistent with the paper. The main problem had been that the export growth of developing countries had not been expected by most forecasters (including the authors of the world economic outlook paper) to be so weak as a result of weaker growth in the industrial countries and the low prices of commodities.

Finally, on the methodology of conducting annual reviews, the staff representative observed that the procedure involved identifying issues that were particularly important; at present, the major issue was growth and structural adjustment. The Stand-By Policies Division intensively examined individual cases and undertook extensive discussions with staff who had been involved in the various situations to be analyzed in an effort to draw out the important features of the experience of individual countries. In that process, the staff discovered areas for improvement and made an effort to incorporate those improvements into the papers or the process itself wherever possible.

Mr. Sengupta asked that the Chairman, in his summing up, make a reference to the desire expressed by some Directors for an independent unit to undertake the reviews of conditionality.

The Chairman made the following summing up:

> Directors' comments have covered a wide range of issues, and by its very nature the subject matter has produced a wide variety of views. It is not surprising that those views are held very strongly, given the difficult period we have been going through and the fact that even under the best of circumstances, adjustment is difficult. Nonetheless, I believe that the differences among us are not as sharp as might appear on first hearing the remarks that have been made. In this summing up, I shall try to draw out of the discussion not only views that I see as common to all or most speakers, but also the important differences that have been put forth. The most essential common view that we share is that conditionality remains a question of both financing and adjustment. I will deal with these issues in turn, and then move to the related issue of adjustment and growth. Thereafter, I will have some comments on program monitoring and the review of conditionality.
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> Financing
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> Directors noted that this review of the experience with Fund-supported adjustment programs was particularly important since it dealt with the complex problems posed by several years of external debt difficulties and major cutbacks in the availability of external finance. In the difficult period since the emergence

of the debt crisis, the Fund has been called upon to provide financial support and policy advice to a record number of member countries on an unprecedented scale. Directors noted with concern that although a number of countries had achieved external viability, many others would need several more years to attain a satisfactory external position, in spite of the substantial progress made to date. Moreover, in a number of countries the limited degree of progress and the very high level of external indebtedness meant that viability would be difficult to achieve without large infusions of concessional aid.

In considering Fund support for the adjustment efforts of its members, all Directors underscored the need for adequate financing to ease the path of adjustment and to provide for a more orderly adjustment process that would benefit both the adjusting country and the global economic community. In this respect, Directors drew attention to how deteriorating prospects for the availability of external financing have in many cases led to a need in successive programs to scale back the current account deficit targeted over the medium term, which has made achievement of growth more difficult. Directors considered that in a number of those cases, efficiency in resource use and the high marginal productivity of capital would justify greater reliance on foreign savings, but that in fact most countries with adjustment programs have faced severe financing and debt servicing constraints.

In light of this experience, Directors noted, the Fund should emphasize even more strongly the need for adequate external resources on appropriate terms in support of adjustment efforts. Various ideas were put forward on how best the Fund could help on the financing side. The resources that the Fund can supply are of course of paramount importance, and I noted that a number of Directors have urged that the forthcoming quota review be undertaken as expeditiously as possible, and that quotas be substantially enlarged. Directors also saw an important role for the Fund in coordinated financing, even though such an approach has on occasion led to time pressures in completing negotiations, a shortening of policy time horizons, and delays in approvals or reviews of Fund arrangements.

Resources provided by official donors and creditors are of critical importance to growth-oriented adjustment in program countries, particularly the poorer ones. However, it is clear that there will also be a continuing need for larger private financial flows to adjusting countries, such as bank lending and direct investment. The role of the Fund in such flows is necessarily more limited, and I have noted the concerns expressed in that regard. In general, it is clear that the Fund can only be effective and maintain its role if official and commercial creditors respond with financing, including concessional aid, on terms that provide appropriate and realistic support for countries' adjustment efforts. Countries need more resources to facilitate adjustment, but they also need better adjustment to attract more resources.

Adjustment

Directors appear to be in broad agreement on the fundamental requirements of adjustment. Certainly, they are all agreed that the traditional Fund concerns of macroeconomic balance and issues such as pricing and competitiveness should remain at the heart of adjustment programs. Beyond that, there is a clear need for greater emphasis on a broad range of other structural measures. There are, of course, differences in the relative importance that Directors attach to the various elements of such comprehensive strategies and to the role that the Fund should play in that regard. I shall take note of such differences as I touch on the various aspects of adjustment that were discussed.

All Directors agreed that a strong political commitment by adjusting countries to a coherent and comprehensive strategy was vital. It was also clear that greater attention to certain elements of program design could raise the prospects for success. Directors stressed the need for program design to be consistent with achievement of the external objectives in terms of the strength, the mix, and the pace of implementation of policies. They also stressed that, given the magnitude of the structural problems to be overcome, longer periods of adjustment must be envisaged. Several Directors noted that given the structural nature of the imbalances facing many members, and in light of the specific situation of individual members, a more active role could be played by the extended Fund facility. This would be feasible when the nature and the time frame of corrective policies over the medium term could be clearly specified in advance and could be expected to remain broadly appropriate for the life of the arrangement. It seems to me that the central issue is not so much the period of the arrangement as the expectation of continuing financial assistance from the Fund--if necessary through a series of arrangements--while adjustment is being effected.

Different views were expressed regarding a strategy of gradual adjustment. Clearly, if more resources are available, a more gradual adjustment is feasible and often desirable. However, I have noted the point made by a number of Directors that a gradual strategy, because it is slower to yield fundamental improvements, can be more vulnerable to exogenous developments and more difficult to sustain. Certainly, gradual adjustment should not imply delays in the adoption of measures to raise the level of domestic savings--and to attract the foreign savings--necessary to finance the higher levels of investment that are indispensable to growth.

Directors considered that determination in policy implementation and the ability to adapt to changing circumstances were the keys to success in adjustment. Some Directors also pointed out that the problems with implementation were associated not only with the uncertainties and constraints in the availability of external resources, but also with the adverse global economic environment. They urged the Fund to attach more importance to the responsibilities of its larger members in providing a more favorable and stable global environment. They also advocated the use of contingency mechanisms to protect a member's program from exogenous developments.

Despite the relatively small number of cases in which the maintenance of the revolving character of Fund resources was in question, Directors emphasized that those cases raised serious issues for the Fund. There was need to avoid commitment and disbursement of credit tranche resources when their use was not compatible with prospects for external adjustment, or when there were uncertainties about the ability of the member to carry out adjustment consistent with the use of nonconcessional resources. In such circumstances, most Directors indicated that both the Fund and the member might more usefully work toward realistic understandings on a feasible adjustment process based on concessional assistance from donors. The Fund's role in some cases might take the form of assistance in the process of policy formulation and monitoring and, where appropriate, provision of its own concessional resources through the structural adjustment facility. Directors will of course return to this matter in the forthcoming discussion of the structural adjustment facility, but it is worth stressing today that this facility can play the valuable and indispensable role envisaged for it only if it can be supplemented by significant amount of concessional resources from elsewhere.

Adjustment and growth

A variety of views were expressed on the balance of adjustment and growth, with many Directors arguing that Fund-supported adjustment programs may not have had a sufficiently strong growth orientation. Those speakers considered that external viability over the medium term might remain elusive unless greater emphasis was placed on growth in the adjustment strategy. Other Directors took the view that the experience with growth under Fund arrangements has been more positive than often perceived and more positive than what would have occurred in the absence of arrangements with the Fund. Although a favorable external environment was clearly important to the growth strategy, experience suggested that a critical factor in growth performance was the quality of adjustment policies.

In addition to the general emphasis on the need for adequate financing, there was also general agreement on the need to better direct adjustment policies toward growth. All Directors supported a sharper focus in Fund programs on enhancing economic efficiency and competitiveness. It was also generally considered that a growth-oriented strategy called for greater emphasis on stronger and more specific structural measures and on higher levels of domestic savings. Although there was consensus on the growth-oriented approach in broad terms, it is fair to say that there were differences of view on how the Fund should more specifically promote growth-oriented policies in the exercise of conditionality. It is clear that there is room for further work in this area of program design. In this context, the staff is engaged in a program of studies to examine further the conceptual and empirical underpinnings of the design and monitoring of structural adjustment and the role that the Fund can play in this regard. Directors' comments have been helpful, and in preparing forthcoming papers, the staff will be reflecting on the issues that have been raised during our discussion.

Program monitoring

Directors were agreed that program monitoring helped provide the member with assurance of the circumstances under which purchases could be made and helped provide the Fund with assurance of safeguards for the revolving character of its resources.

That being said, I note that some Directors felt that it was important not to build an overly rigid and overly precise structure of monitoring on a basic program design that they felt was in need of strengthening. Moreover, they considered that the current monitoring practices, such as prior actions, the numerical precision of performance criteria, and the perhaps growing multiplicity of performance criteria, constrained members' policy choices excessively, and in some cases created severe problems for economic management. Other Directors, however, stressed the important role of prior actions in ensuring a strong beginning for the adjustment program and enhancing its credibility, which was indeed crucial for gaining the support of commercial creditors. They also emphasized the desirability of confining performance criteria to the most essential aspects of the adjustment program and of setting performance criteria in advance for the member's entire basic policy period.

Directors considered that waivers and modifications had generally proved useful in promoting flexible adaptation to unexpected events but noted that they must be based on a consistent and comprehensive examination of the overall policy package.

Directors regarded midyear reviews as an essential aspect of the Fund's response to financing and other uncertainties, but observed that those difficulties must not be permitted to lead to a shorter focus of policy planning. There was broad support for the Board to be able to conclude some program reviews on a lapse of time basis, provided that such reviews were limited in scope.

Review of conditionality

The Executive Board agreed that, for the present, the guidelines on conditionality that had been applied on a case-by-case basis continued to provide an adequate and sufficiently flexible basis for Fund policies on the use of its resources. However, during the discussion a number of Directors called for a comprehensive review of conditionality. I take it that that is indeed the sense of the meeting; thus, we will undertake such a review following the discussions currently being planned on a number of related topics--including the consideration of the Group of Twenty-Four report in August--and in the light of further studies on the design of Fund programs. A review of conditionality is a complex and time-consuming matter, and I propose that in our work program for the period after the Annual Meetings, we agree on a program of studies on the application of conditionality and on the design of Fund programs that could be brought forward for Board consideration at the end of 1987 and in the beginning of 1988. The implications for the guidelines on conditionality and its application will be considered on the basis of the Board's views of those studies.

It is also the Board's wish that we continue with periodic reviews on the effectiveness of conditionality. However, I note that Directors want further analysis to include case studies, as well as studies on specific issues of the application of conditionality, in addition to cross-country analyses. Finally, while some Directors advocate the establishment of a separate unit for the evaluation of the effectiveness of conditionality, I have also noted the majority of the Board does not wish to introduce changes in procedural arrangements and organizational responsibilities for that purpose. But I understand the concerns that are behind this proposal.

Personal concluding remarks

I would like to conclude with a few personal remarks on our discussion, remarks which your views on issues concerning conditionality have helped me to crystalize. First, I do not believe--and I understand that you share my opinion--that there is any case for relaxing conditionality. Second, I certainly share the widespread view that there is a need for larger external resources to be made available to countries that are undertaking the ever politically difficult task of implementing a serious adjustment program. Third, I concur with the view expressed by the majority of Directors that most adjustment programs need to incorporate appropriate growth-oriented measures in a more visible way to reduce the structural rigidities and imbalances that hamper growth. Fourth, I have great sympathy with the view that over time a balance of payments position will prove sustainable only if it is attained against a background of growth, and not only temporary demand restraint. Growth goes hand in hand with sustained adjustment.

It is important that these views--which, I believe, are shared by the great majority of Directors--become more widely known so that a member country's approach to the Fund ceases to be regarded as something that should be avoided so long as possible. This avoidance is not in the spirit of the relationship between a member and the Fund that pervades the Articles, nor is it consistent with the spirit that lies behind the guidelines on conditionality. Ideally, the way in which some difficulties can most easily be overcome is by fostering the Article IV consultation process so that both the Fund and the member agree clearly in advance on the steps that need to be taken to obtain a secure, viable balance of payments position. This is the genuine sense of the first guideline on conditionality, and we should strive to implement it fully. We should do what we can, through the various methods that you have discussed to avoid the tensions that are too often associated with discussions on Fund lending.

The Executive Board then turned to the proposed decision.

Mr. Sengupta proposed that paragraph three be changed to state that the "Executive Board will decide when it may be appropriate to have the next comprehensive review of conditionality."

Mr. Salehkhou wondered whether, in view of the forthcoming discussions of the G-24 Report, it would not be preferable to state clearly that the Board would undertake a comprehensive review at the earliest possible opportunity.

Mr. Foot, supported by Mr. Goos and Mr. Posthumus, considered that Mr. Sengupta's formulation offered greater flexibility.

Mr. Sengupta suggested an amendment to paragraph one to state that the provisions of the extended Fund facility and the guidelines on conditionality "will remain in force in the present circumstances."

The Executive Board then took the following decision:

1. Pursuant to Decision No. 8192-(86/13), adopted January 27, 1986, the Fund has reviewed the experience with recent programs supported by stand-by and extended arrangements, and decides that the provisions of the extended Fund facility and the guidelines on conditionality will remain in force in the present circumstances.

2. The Fund will again review the experience relating to programs supported by stand-by and extended arrangements at an appropriate time pursuant to paragraph 12 of the guidelines on conditionality. At that time, the Fund will also review the provisions of the extended Fund facility.

3. In the light of forthcoming discussions by the Executive Board on issues relating to conditionality, the Executive Board will decide when it may be appropriate to have the next comprehensive review of conditionality.

Decision No. 8583-(87/72), adopted
May 8, 1987

3. REPORT BY MANAGING DIRECTOR

The Chairman made the following report on his recent meeting with the Korean authorities:

Executive Directors will recall that during the latest world economic outlook discussions, concern was expressed about exchange rate developments and trade imbalances, not only between large industrial countries, but also between those countries and some of the newly industrialized countries. In this connection, the recent strengthening of Korea's current account position has raised questions about the appropriateness of Korea's exchange rate and other external policies. I discussed that issue informally with the Vice Prime Minister of Korea and the Finance Minister on the occasion of the most recent Interim Committee meeting, and I am in a position today to inform you that I have decided to initiate and conduct, with the authorities' full concurrence, a supplemental consultation with Korea pursuant to the principles and procedures of surveillance. I am convinced that such a consultation can play a constructive role within the cooperative framework of the Fund's multilateral surveillance activities.

As you know, the next Article IV consultation with Korea has been scheduled to be held in the near future. Accordingly, it seems reasonable to combine the discussions between the staff and the authorities for the supplemental and Article IV consultations, and these discussions will commence on May 18. Although I initially proposed that the discussion begin on May 20, the Finance Minister indicated that he was ready to start as soon as the staff was available. The discussion will allow an analysis of current account developments in the context of the full range of domestic and external policies that I believe are essential for a full appreciation and balanced assessment of the situation.

A report on the supplemental consultation will be issued soon after the discussions with the objective of placing it before the Executive Board as soon as possible--I hope before the end of June. The principal content of the report will be an examination of Korea's exchange rate policy in a broad context, including, inter alia, trade policy--especially import liberalization--demand-management policies, and capital market policies. Developments and policies in those areas will be further reviewed in the report for the regular Article IV consultation that will be brought to the Board at a later time.

I wish to stress again that these modalities were worked out in full agreement with the Korean authorities, who have taken a very positive attitude. I am confident that this exercise will benefit both Korea and the international community.

The Executive Board took note of the Chairman's report.

APPROVED: November 18, 1987

LEO VAN HOUTVEN
Secretary