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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/96

3:45 p.m., July 19, 1991

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

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	L. E. N. Fernando
	C. M. Towe, Temporary
Dai Q.	
	M. E. Hansen, Temporary
J. de Groote	
E. A. Evans	
	N. Kyriazidis
M. Finaish	A. F. Mohammed
	I. Fridriksson
B. Goos	
J. E. Ismael	
	J. C. Jaramillo
	J.-L. Menda, Temporary
	O. Kabbaj
L. B. Monyake	
D. Peretz	P. Wright
	C. J. Jarvis, Temporary
G. A. Posthumus	
C. V. Santos	
A. Torres	R. Marino
	L. E. Breuer, Temporary
	M. Nakagawa, Temporary

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present

African Department: E. L. Bornemann, Deputy Director; A. Lennblad, A. Tazi Mokha. Asian Department: M. R. Figuerola. Central Banking Department: R. K. Abrams. Exchange and Trade Relations Department: J. T. Boorman, Director; A. Basu, S. Eken, R. A. Feldman, J. R. Pujol, S. M. Schadler, B. C. Stuart, P. J. P. Szymczak. External Relations Department: V. Khanna. Fiscal Affairs Department: V. Tanzi, Director; A. Premchand. Legal Department: P. Francotte. Treasurer's Department: B. B. Zavoico. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, M. B. Chatah, B. R. Fuleihan, A. Gronn, J. M. Jones, E. Martínez-Alas, B. A. Sarr, B. Szombati. Assistants to Executive Directors: B. Abdullah, T. S. Allouba, C. Björklund, Chen M., J. A. Costa, Deng H., N. A. Espenilla, S. K. Fayyad, J. Jonas, V. Kural, S. Shimizu, Tin Win, S. von Stenglin, J. C. Westerweel.

1. STRUCTURAL ADJUSTMENT FACILITY, ENHANCED STRUCTURAL ADJUSTMENT FACILITY, AND ESAF TRUST - EXTENSION OF DEADLINE FOR REVIEW

The Executive Directors agreed, without discussion, to extend the period for the review of the operations of the structural adjustment facility, enhanced structural adjustment facility, and ESAF Trust until September 30, 1991, and adopted the following decisions, accordingly:

Structural Adjustment Facility, Enhanced Structural Adjustment Facility, and ESAF Trust - Extension of Deadline for Review

Decision No. 9487-(90/106) SAF/ESAF, adopted July 2, 1990 is amended by substituting "September 30, 1991" for "July 31, 1991."

Decision No. 9776-(91/96) SAF/ESAF, adopted July 19, 1991

ESAF Trust - Extension of Deadline for Review of Access Limits

Decision No. 9489-(90/106), ESAF, adopted July 2, 1990 is amended by substituting "September 30, 1991" for "July 31, 1991."

Decision No. 9777-(91/96) ESAF, adopted July 19, 1991

2. CONDITIONALITY IN FUND-SUPPORTED ADJUSTMENT PROGRAMS - ISSUES AND REVIEW OF EXPERIENCE

The Executive Directors resumed from the previous meeting (EBM/91/95, 7/19/91) their consideration of a staff paper on selected aspects of conditionality under stand-by and extended arrangements (EBS/91/101, 6/20/91; and Sup. 1, 7/2/91), together with a paper on selected operational issues related to the use of Fund resources (EBS/91/108, 7/3/91; and Cor. 1, 7/3/91). They also had before them a staff paper on public expenditure management processes and fiscal conditionality (SM/91/136, 7/5/91).

Mr. Fridriksson made the following statement:

Like others, I commend the staff for the wealth of information provided in the papers before us. I would tend to agree with Mr. Landau and Mr. Goos that we are perhaps trying to cover too much ground today.

The observations in the main paper confirm earlier findings on cause-and-effect relationships. The improvement in program results during the 1985-88 period, as opposed to the early part of the 1980s, is encouraging, although this might be partly attributable to a general improvement in the global economic environment. Be that as it may, as mentioned by others, the staff analysis finds that only two out of every five annual programs could be seen as generally successful.

The approach used for the review obviously has its limitations, as the staff also notes. For instance, the period under consideration is short, and it is not fully clear what weight is given to world economic trends and their effects on program results.

In order to label a program a success, it is necessary to go beyond looking at the mere observance of specified macroeconomic criteria. Perhaps the analysis would have benefitted from a greater focus on the fundamental macroeconomic goals which a Fund-supported program is supposed to help a country to achieve. Above all, like Mr. Goos, my authorities wish to emphasize the importance of assessing the extent to which Fund-supported programs contribute to the attainment of medium-term external viability. We agree with the staff that external viability is the ultimate goal of a Fund-supported program. I note in this connection that, according to the staff, those countries that achieved or made substantial progress toward external viability during the period under review performed strongly with respect to annual targets and objectives. Moreover, the four countries included in the review which have attained external viability undertook major structural reforms prior to, or during, the period of the Fund arrangements.

At the same time, it can be quite difficult to assess the relative contributions of different factors to the failure of a program. Slippages can be attributed to inappropriately defined conditionality, weak policy implementation, the Fund's review method itself, or to external factors. The Fund must strive to enhance program design and a more effective program implementation. In our view, this can be achieved within the present guidelines.

On the issues proposed for discussion in EBS/91/101, I have the following comments. The Fund needs to continuously review and--as just mentioned--seek to improve its programs. Moreover, a key contribution of the Fund to the adjustment process in program countries is the catalytic effect of strong and relatively short programs. A growing number of successful programs improves the Fund's credibility in the program countries and in the eyes of international investors and creditors.

The staff paper confirms the strong relationship between the implementation of firm fiscal and monetary policies, on the one hand, and the attainment of inflation and external targets, on the other. Furthermore, my authorities are encouraged by the apparent strong association between the implementation of firm fiscal and credit policies and economic growth. This underscores the importance for the authorities in program countries to fully implement the agreed policies. Waivers with regard to the nonobservance of performance criteria should generally only be granted when exogenous factors derail programs, and then, selectively. If program targets are not achieved because of deficient policy implementation, waivers should only be granted in exceptional circumstances.

My authorities are aware of the problems associated with comparing programmed objectives of structural reforms with actual outcomes, but they nevertheless think that this is an important area, particularly in light of the growing role of structural policies in Fund-supported programs.

Terms of trade developments can obviously affect the implementation of fiscal and monetary policies, and we agree with the staff on the appropriateness of contingency planning in Fund-supported programs, but the medium-term objectives of each program must be kept in sight.

Exceptionally high inflation generally reflects large imbalances in an economy, so it does not come as a surprise that problems surface in Fund-supported programs entailing a high rate of inflation. This underlines the fact that emphasis must be placed on a sharp and early reduction in the inflation rate. Thus, we support the use of prior actions and/or front-loading of measures aimed at swiftly curbing inflation.

My authorities agree with the staff view that fiscal policy plays a central role in supporting a tight monetary policy, in containing the external current account deficit, and in freeing resources for private investment. However, they are disturbed that budgetary income targets seem to have been difficult to meet, even in cases in which overall fiscal criteria have been observed. As it is disappointing that technical assistance does not seem to have been as effective as had been hoped and expected, we believe that enhanced technical assistance in the fiscal area in connection with Fund-supported arrangements should be given high priority.

We agree with the staff that real interest rates must be positive in order to mobilize private savings, to provide efficient investment incentives, and to promote a deepening of financial markets. Moreover, positive real rates should be established at an early stage of a Fund-supported program, and prompt reduction of inflation can facilitate this process. However, there may often be limitations to a central bank's ability to raise nominal interest rates to a degree sufficient to unequivocally achieve positive real rates. This further reinforces the need for rapid declines in the rate of inflation.

For financial reform to be fully effective, interest rate and credit policies need to be accompanied by careful supervision of the functioning and profitability of the banking sector.

We concur with the staff's views and suggestions regarding private capital inflows. We also endorse the proposals in the paper for a more explicit treatment in staff documents of regulations and restrictions on capital flows and policies for attracting capital flows.

On the selected operational issues related to the use of Fund resources, this chair basically shares the staff's views and supports the suggested further action in the three areas covered. We are satisfied with the relatively restrictive approach suggested in the paper, while accepting that some flexibility may have to be exercised in selected cases. Generally, on the extended Fund facility, new arrangements should take priority over the lengthening of an extended Fund arrangement.

On the use of Fund resources in the first credit tranche, we find the currently applied conditionality appropriate, but we also share the view that the Fund should emphasize the temporary nature of the use of these resources. We support the quarterly monitoring of targets as a standard procedure. Quarterly performance criteria could for that matter also be standard in extended arrangements. Furthermore, like many others, we support the suggestion that the provision for the "floating" of the CCFF and the extended Fund facility be considered in the context of the general review of access policy.

We agree that access for prolonged users should continue to be guided by the need to reduce their outstanding use of Fund resources over time. We also welcome the suggestion that staff reports supporting future requests for Fund arrangements by countries identified as prolonged users include a review of past programs, as well as an assessment of the factors underlying the member's prolonged use. We are willing to consider programs for prolonged user countries on a case-by-case basis. Continued Fund support of a prolonged user would call for front-loading of adjustment measures, and should be provided on a limited scale. It is important for these countries to improve their creditworthiness so that they can use alternative sources of balance of payments financing. As stated by the staff, continued Fund financing would require strong policy justification, and the extent of such financing would take definitive account of the prospects for external viability.

On the topic of public expenditure management, it is obvious that administrative improvements in a particular country cannot compensate for lack of political commitment in the implementation of programs, or for policy lags. However, this does not diminish their importance. On the contrary, when appropriate, certain structural improvements could be made preconditions for Fund support.

More generally, there is a clear need for the Fund continuously to study program performance. Thus, we support the studies suggested in the main paper, and we would also like the Fund to focus on the effectiveness of programs in establishing external viability.

In closing, what once again clearly emerges from the review papers is the importance of tight conditionality in Fund programs. A weakening of conditionality would serve neither the interests of the Fund nor of the program countries. I support the proposed decision.

Mr. Finaish made the following statement:

The papers prepared for the current review are based on a cross-country analysis of programs approved from 1985 through mid-1988 in the upper credit tranches. By excluding programs for members eligible to use SAF or ESAF resources, the analysis is restricted to middle-income developing countries. This should permit some degree of homogeneity in the sample, but the group remains sufficiently diverse to raise a question as to whether an averaging of their experience can provide a basis for drawing firm conclusions.

This misgiving is intensified by the methodological limitations inherent in the cross-country approach and the choice of "program versus actual" comparisons for measuring success or failure, especially when judged against targets set at the start of annual programs. The staff is quite candid in pointing to these limitations, and it has sought to correct for them by providing country-specific data for each of the 44 annual programs in the Appendix tables and in footnotes identifying countries to which particular policy matters relate, especially when describing structural measures. The staff clearly warns against drawing strong conclusions about cause and effect relationships based on the approach adopted; it also notes data problems, even for basic financial and economic variables, in some cases. The inclusion of structural measures in programs to a greater extent than in past years creates an additional problem, given the difficulty of quantifying objectives for many of these policy areas, as well as determining the extent to which the policies were implemented as planned. Finally, the staff notes that comparisons with stated program objectives may be influenced by "other than strictly technical considerations in the interest of garnering domestic support for the program or influencing expectations".

The staff finds, however, that because it takes into account the degree of implementation of programs and the extent to which implementation was affected by nonprogram factors, such as unexpected changes in external circumstances, the approach adopted "is useful in evaluating the internal consistency of programs and drawing some inferences about the effects of particular policies on different economic variables." One would like to agree with this carefully qualified judgment, if only to proceed with examining the results of the vast amount of staff effort that has undoubtedly gone into these papers.

Looking first at the measures of the success of programs, one finds that in about 40 percent of the annual programs, three or four of the main macroeconomic objectives were met. This is said to compare favorably with the earlier 1980s, particularly with regard to growth and to some extent inflation. The record is said to be even better if a margin of 1 percentage point for the growth target and of 1 percent of GDP for the current account were allowed. However, against an average growth target of 2.3 percent (see Table 3), a margin of 1 percent allows for a deviation of more than 40 percent; if countries could claim such large margins in meeting performance criteria, many more programs could be pronounced successful, at least statistically.

A second interesting result is that when programs meet both fiscal and credit targets, on average, they also meet their inflation and external objectives. This leads the staff to suggest that the approach to financial programming is "broadly appropriate." Here again, one may need to be rather modest. Looking at Table 4, one finds that out of 23 programs in which the inflation target was met, in 12 of them, it was met despite the fact that either the fiscal or the credit target (or both) were not met; similarly, out of 25 cases in which the external current account objective was met, in only 13 cases were the fiscal and credit targets also met. Even more to the point are the results for the overall balance of payments, which is what the financial programming approach targets: of 23 cases in which the objective was met, this was despite the fact that in 13 cases, either the fiscal or the credit (or both) targets were missed. The staff paper concedes that the association between implementation of fiscal and credit policies and program outturns is "far from perfect" and attributes this to "the complexity of the relationships between these policies and program outturns and transmission mechanisms that are not fully understood." We support the staff view that this calls for further improvements in the understanding of the relationship between fiscal and credit policies and macroeconomic objectives, and we would expect that until such understanding is improved, excessive concern with adhering to point targets at specific test dates should be avoided. Additionally, it would add to the analysis if in future studies the staff could look in greater depth at individual cases in which fiscal and/or credit targets were not met, and also cases in which fiscal and/or credit targets were met, but objectives were not achieved. Such a detailed analysis could perhaps shed light on policy design, or nonprogram factors that have a bearing on the success of programs.

In this connection, the staff advances two ideas for improving the chances of success. As regards inflation, it suggests prior actions that would give greater confidence that inflation would be reduced, or actual progress made in reducing inflation, before a Fund arrangement is approved. Since inflationary expectations may be more difficult to subdue in the absence of a program approved by the Fund, it is perhaps best to keep to the existing practice of approval on the basis of measures taken, rather than asking for results which may not be forthcoming for some time. Another risk in insisting upon outturns is that a government may be tempted to adopt ad hoc measures of an inappropriate character from a longer-term point of view only to obtain short-term effects in order to seek Fund approval for a program that might be needed for debt relief, or for other urgent balance of payments considerations.

A similar issue arises in connection with the staff suggestion that positive real rates should be established at an early stage if a response is to be expected within a program year. Since real rates are as likely to be achieved by a reduction of inflation in the course of a program year, an insistence on an early outturn would place the burden almost exclusively upon a raising of nominal interest rates to levels which might abort the prospects of recovery; in this connection, the empirical experience with the Eastern European countries--Poland in particular--may well be worth recalling.

Before concluding on the financial elements of program performance, it is important to underline a significant statement at the top of page 12, to the effect that a careful assessment of the economy's growth prospects should be an important element in program formulation. The financial programming approach gives primacy to obtaining an overall balance of payments result. The domestic credit expansion that is consistent with that external constraint comes out of a demand for money equation in which the growth rate tends to be little more than an inspired guess. By explicitly recognizing the importance of making a careful assessment of the economy's growth prospects, we may be able to improve program design in quite a significant way, and enhance thereby the chances of achieving more successful programs.

Another aspect that is brought out in the same staff conclusion is the emphasis on the interconnection between structural and macroeconomic policies. It is usual to assume that these are mutually reinforcing, and this should surely be true after structural reforms have had the time to produce results. But the period of maturation may be longer than the time horizon typical of Fund-supported programs. In the short run, there may well be trade-offs, in the sense that progress on structural measures might prove to be at the expense of immediate macroeconomic performance. It would enhance the success rate of programs if such trade-offs were more fully recognized and taken into account in setting macroeconomic targets.

With respect to specific instruments, the papers emphasize the importance of fiscal adjustment in the overall success of programs, in contributing to the effectiveness of credit and monetary--as well as incomes and wage--policies, and in helping with the choice of exchange rate policies. The quality and sustainability of fiscal adjustment is seen as an important element of the growth orientation of programs. Given this significance, it is discouraging to find from Table 8 that fiscal outturns failed to meet program targets, both with respect to levels of fiscal balance and with respect to changes in fiscal balance, in slightly under one half of all cases. Part of the explanation, especially in respect of levels of fiscal balance, lay in incorrect estimations made at the start of programs of the fiscal deficit in the pre-program year; thus, the target for the change in the fiscal balance may be met even when the target for the level of the fiscal balance is missed, because the baseline is revised. Moreover, the targets from which shortfalls are measured in this staff document relate to overall fiscal balance or the public sector borrowing requirement, rather than to the operational balance, which might be the more appropriate target in high inflation cases. Making allowances for these factors still leaves too many cases in which expenditure overruns or revenue shortfalls, or both, led to failure to meet fiscal adjustment targets, with particularly deleterious consequences for private investment. The staff has no particular recommendations on how the situation can be improved, beyond stressing "the need for careful design of fiscal policies and close monitoring of fiscal developments, including in some cases through the use of prior actions."

In the accompanying paper on public expenditure processes and fiscal conditionality (SM/91/136), the staff suggests that improving monitoring procedures can reduce risks of slippage in expenditure targets; initial steps in improving these could be treated as preconditions, and accompanied by structural benchmarks to follow up on the progress made. However, fundamental changes in expenditure control systems, undertaken in ways that are compatible with the particular political and constitutional structures of the member country, may be difficult to insist upon as prior actions at a time when the country is in urgent need of Fund support. It would be much better to offer technical assistance in developing appropriate control mechanisms and, as noted by the staff, to place greater reliance on review and consultation procedures.

Concerning the exchange rate instrument, an issue of considerable interest is the relationship of the exchange rate regime to inflation performance. While fixed rate and adjustable peg cases performed relatively well even when fiscal targets were not met, the performance was clearly inferior in cases in which nominal exchange rates were flexible, whether under a real exchange rate rule or floating regimes. The inflation target was met in only 3 out of 9 programs under a real exchange rate rule regime, even though the fiscal target was met in all these programs. In half of the cases of free or managed floating, the inflation target was missed by fairly substantial margins on the average, even though in 7 out of 20 cases, the fiscal target was met. It would be useful to look at individual cases to see whether program design improvements can achieve greater consistency between flexible nominal exchange rate regimes and inflation performance.

With respect to the paper on operational issues related to the use of Fund resources, we welcome the review of first credit tranche conditionality. We have felt for some time that such a review was needed to clarify Fund policy in this area. Fund conditionality has evolved significantly over the past two decades in so many areas that we found it odd not to have revisited the first credit tranche in the past 23 years. As I stated in the past, this had led some of our authorities to question whether the Fund's attitude toward first credit tranche requests has indeed remained a "liberal" one, as described in the 1959 Annual Report.

We have always viewed the first credit tranche as one of the instruments that the Fund can use to engage gears with a member country that has not had much prior experience of Fund arrangements. There can be a natural reluctance to accept the full paraphernalia of conditionality, complete with its performance criteria, review clauses, phasing, and test dates. It is useful to bring the member into a relationship without the negotiating complexities involved in these procedures, even where the Fund staff feels that major structural reform may be needed. The heady experience of the past year or two should not lead us to expect all countries to plunge into comprehensive programs in one go. In some cases, a more feasible route may involve incremental steps. But if the balance of payments position and outlook provide a margin for gradual movement, the Fund should not shy away from supporting the member. Safeguarding the fund's revolving character is of course fundamental. The requirement of "reasonable effort" to correct a balance of payments imbalance cannot be challenged, although what constitutes reasonableness is a matter of judgment.

The staff is correct in pointing to situations in which the first credit tranche request may come on top of large Fund exposure from previous regular arrangements or CCFF drawings. But this issue has to do with the floating feature, which can be dealt with separately, as proposed by the staff.

We agree with the staff that no changes in the guidelines for the extended Fund facility seem to be necessary at present. Although some of the adaptations agreed upon in 1988 have not been utilized extensively, they continue to be of potential usefulness.

One technical aspect of the extended Fund facility which, in our view, adds undue complexity to Fund operations, is the particular mix between ordinary and borrowed resources. In the past, the decision to increase the ratio of ordinary to borrowed resources was motivated by the desire to reduce the effective rate of charge under the extended Fund facility. I am not sure there is a particular reason why one would want to differentiate between stand-by arrangements and extended arrangements in terms of cost of resources. Also, with burden sharing, one is now less certain whether ordinary or borrowed resources will be more expensive. I suppose that with the coming into effect of the quota increase these issues can be resolved, and, therefore, there is no need to pursue the question at this time.

Turning to contingency provisions outside of the CCFF and under Fund arrangements, I cannot but agree with the staff that the relative simplicity and flexibility of such ad hoc provisions are the main reason why they are more widely used than CCFF provisions. We have always felt that the objective of safeguarding Fund-supported programs against unforeseen developments could be served by a variety of instruments, of which the CCFF is only one, particularly given its complexities. Even when no contingency provisions are included--CCFF or otherwise--it is still crucial that unforeseen shocks to programs be responded to quickly and effectively; and to the extent that the thrust of the program can be maintained, the Fund and the authorities should move quickly to agree on the adjustments and waivers needed to keep it on track. Additional Fund financing may sometimes be warranted. The possibility of such augmentation should not be excluded, even if there are no specific prior provisions to that effect. Of course, this would have to be considered on a case-by-case basis. But I mention this because the staff seems to draw too sharp a line between CCFF contingencies and other ad hoc contingencies in terms of Fund disbursements.

I do not have major problems with the rest of this section, but I would again stress the need for simplicity, particularly in light of the staff's suggestions regarding deviations for capital account variables.

Regarding prolonged use of Fund resources, I agree with the staff that rigid rules would not be desirable. The steps agreed upon in 1986 to enhance the Board's ability to monitor and make judgments on access by protracted users remain appropriate. By the same token, it is important that the absence of explicit rules not be at the expense of uniform treatment.

The question of creditor attitudes and its implications for access of protracted users is admittedly a difficult one. Clearly, the integrity of Fund policies should be preserved. At the same time, one should not be under any illusion that the catalytic effectiveness of Fund arrangements could be preserved if the Fund is seen to be reluctant to extend its own resources in support of a program for which it seeks the resources of other creditors.

Mr. de Groote commented that he wondered whether those who had spoken in favor of a more liberal approach to the first credit tranche also advocated a substantial reduction in the rate of charge on the use of resources in that tranche in comparison with the other tranches.

Mr. Al-Jasser stated that the question raised by Mr. de Groote needed to be addressed, but it did not have to be dealt with at present. Perhaps the staff could look into the matter.

Mr. Finaish remarked that he had raised the question because of the practical experience of some members of his constituency. Some countries would like to approach the Fund by way of the first credit tranche, the policy for access to which they had been led to believe was liberal, but had found the door shut in their faces, so to speak. For example, there had been the case of a socialist country with a relatively small balance of payments problem and with no debt problem that had considered requesting access to the first credit tranche, but the authorities had been told by the staff that the economy had many distortions and problems with growth, and had thus recommended another facility instead. The Fund might lose the opportunity in such cases to begin a relationship, even if only essentially symbolic in nature at the start, with a country that had not been involved with the Fund before. The meaning that the Fund attached to the word "liberal" should thus be clarified. It would certainly be useful to reflect on Mr. de Groote's suggestion in that connection as well.

Mr. Monyake made the following statement:

The orientation of Fund-supported programs has changed over the years, and for the better. The concept of adjustment with growth is now generally accepted. Also, there are not many dissenting voices over the desirability of adjustment with a human face--that is, the inclusion, to the extent possible, of safety nets as an integral part of adjustment programs to alleviate the pains of adjustment for the most vulnerable groups in society. The question now is how to ensure that growth does take place with adjustment, and that safety nets become in fact a transparent part of the adjustment matrix.

There appears to be no need at this time for major changes to the existing guidelines. In this context, it is necessary to reaffirm the importance of flexibility in the application of performance criteria, as well as the need to maintain the case-by-case approach.

One of the lessons from this review, and from previous ones, is that there is no universally perfect recipe for economic adjustment. However, there are some guideposts that could be used to develop a general framework for the application of conditionality. I would draw attention to four of them. These are, first, the importance of financial discipline as a basis for establishing a stable macroeconomic framework; second, the fact that adjustment programs stand a better chance of success when the external environment is favorable, and when the terms of trade, in particular, are favorable; third, the importance of underpinning the change in policy orientation with institutional reform; and fourth, that success in meeting performance criteria does not guarantee success in meeting program objectives, and, therefore, that increasing the number of performance criteria is not necessarily the way to get a better program.

The paper makes the point that programs performed better in the latter part of the 1980s than in the earlier period. A major reason has to do with the slight improvement in some areas of the external environment. There was a strong association between terms of trade developments and a country's ability to implement reforms as planned. Having said this, one could hardly describe the overall performance record as satisfactory, with only 40 percent of the programs meeting their stated objectives. For example, the objective for economic growth was met in only about half the programs; even then, the record is skewed by high performers such as Chile and Korea.

Nonetheless, this is not a sign of failure as much as it is a reminder that there is much to be learned about the process of economic adjustment. The analysis of the programs shows that a priori relationships between policy instruments and targets can be ambiguous in reality. We see, for example, that private saving declined in cases in which real interest rates increased, but rose in cases in which real interest rates declined. Another case of ambiguity is where actual credit is less than the target and the outcome on the fiscal side is better than expected, but inflation is substantially higher than planned and growth is better than expected. Examples such as these suggest that theory can only be used as a starting point for guiding policy decisions. The interaction of economic variables is complex, and there are many imponderables in the real world that make the job of economic management very difficult--sometimes more difficult than we would like to admit.

The staff raises the question how the track record might be improved. It is not intended to be facetious to say that programs should avoid being too ambitious. Fiscal projections is one area where there appears to be a continual problem. As far back as 1980, a study on stand-by arrangements between 1969-78 showed that there was frequent overshooting of credit targets for the government, because revenues generated from tax measures were frequently overstated, while there was a marked tendency for program projections to understate expenditure (Staff Papers, June 1980). The programs now under consideration experienced similar problems, where slippages with respect to both expenditure and revenue were responsible for the breach in the overall fiscal target. Even when fiscal targets were met, the revenue performance was weaker than programmed. This situation points to the need for caution in making fiscal projections.

Given the difficult external environment for developing countries, including the impact of negative terms of trade, access to adequate resources could help to improve the chances of success for adjustment programs. During the period under review, there was a significant decline in international bank lending to debtor countries, while there was only a small increase in official financing flows. Meanwhile, real interest rates remained high.

A meaningful reduction in the debt burden of countries pursuing adjustment would also help such countries to sustain the implementation of adjustment policies, which are by and large in the right direction. It cannot be overemphasized that increased attention must be given to making debt reduction a more transparent aspect of adjustment programs.

The capacity of developing countries to implement adjustment also needs to be strengthened. This falls under the rubric of institution building. Technical assistance needs to be more focused, with particular attention being given to developing local expertise. That should be the yardstick to judge the technical assistance that is provided. I should raise a note of caution here, however, regarding the reference that the staff makes to the monitoring of the implementation of recommendations arising from technical assistance. The Fund should not give the impression that members must accept all recommendations that are given under its technical assistance program. In fact, it would be presumptuous to suggest that all such recommendations are correct, or even feasible.

The large majority of the programs provided for some degree of exchange rate flexibility. The outcome of these programs suggests the need to avoid a standard policy package for the use of this instrument, and a clearer indication of the task assigned to the exchange rate. Usually, the exchange rate is given the task of achieving balance of payments objectives, by changing relative prices of tradable versus nontradable goods. However, although the survey shows that programs with some degree of exchange rate flexibility did better in meeting their external objectives, the strongest association was between the exchange rate regime and inflation, with programs with fixed rates experiencing the lowest inflation rates. Also, it should be noted that although the econometric analysis indicates that the real effective exchange rate is significant in explaining nonoil exports, GNP in industrial countries and the previous year's exports were even more significant. The point to be made is that there are limitations to the use of the exchange rate; there are trade-offs that need to be carefully considered.

With regard to interest rates, one cannot argue against the need for some degree of flexibility. However, it is worth noting from the programs that positive rates were achieved not by attempting to catch up with inflation, but by bringing down the rate of inflation. Another key point is that maintaining positive real interest rates was not sufficient to encourage the holding of domestic financial assets when there were expectations for a significant real depreciation of the currency.

With respect to the extended Fund facility, if, as the staff correctly states, the problems of many of the countries have to be addressed in a medium-term context, then one must express some disappointment that only six arrangements have been approved since June 1988.

The inclusion of contingency mechanisms outside the CCFF should be used more often, and I agree with the staff that the variables should be as simple as possible and easy to monitor.

Extending the scope of fiscal conditionality to include formal performance criteria for institutional changes could lead to more problems instead of providing solutions. The Fund might be getting too involved in the day-to-day affairs of member countries. We should rely on reviews and consultations to address such questions.

On the issue of prolonged use of Fund resources, there is a legitimate concern about safeguarding the revolving character of Fund resources, but adopting rigid rules is not the answer. The basic policy of controlling access seems to be a fair compromise. However, this also places a responsibility on the Fund to intensify its catalytic role to help countries secure the necessary financing for their adjustment effort. Many of the prolonged users are low-income countries that do not have access to the capital market. Under the circumstances, it is difficult to see how these countries could continue their program of economic reform without meaningful support from the Fund.

Mr. Jaramillo made the following statement:

The staff has produced an interesting and comprehensive, although somewhat detailed, set of papers, based on the experiences of more than 20 countries during 1985-88. Despite the caveats and warnings regarding causality, one is tempted to draw some conclusions which, in general, are not beyond what might be expected a priori. From the experiences referred to in the paper, a few patterns seem to emerge, upon which we wish to comment, with the hope of contributing to improvements in program design. Surely there is room for this, since we suspect that, at least in some cases, slippages in implementation may have been due to failures in program design.

Overall, the paper tends to lead to the conclusion that fiscal adjustments, more than other actions, pay the highest dividends in terms of program success. Not only was the achievement of the fiscal targets associated with better than average overall performance, but also strong fiscal discipline, not surprisingly, helped to achieve other objectives, on the domestic credit front, in particular. Programs may on occasion be too ambitious in terms of fiscal targets, but in the sense that they might not be practically or politically feasible, not in the sense that they may disrupt a program--except perhaps for the long-term considerations of excessively reduced public investment outlays.

The same is not true of credit policies. These seem to produce the desired results when accompanied by fiscal restraint, but in general not otherwise. Put somewhat differently, tight credit policies, thoroughly implemented, do not seem to be always adequate substitutes for not-so-tight fiscal positions. In this respect, the appropriate choice of a policy mix is associated with the exchange rate regime adopted and with the degree of confidence in that regime. With a fixed or quasi-fixed exchange rate, a tight credit policy can to some extent substitute for lack of fiscal restraint, if confidence in the exchange rate is not strong. But if confidence in exchange rate stability is strong, monetary tightening without fiscal restraint may be neutralized by capital inflows.

The review of public expenditure management and fiscal conditionality sheds light on the many problems encountered in the fiscal area, and indicates that further improvements in program design may be achieved, as modern public expenditure management techniques become more widely adopted in the program countries. In trying to answer some of the questions posed in that paper, we conclude that the medium-term benefits of stressing these techniques are great and should thus continue to be emphasized, since we are convinced that slippages in implementation go far beyond the lack of desire by governments to pursue adequate policies. But, more than creating a probably cumbersome public expenditure management conditionality, and since improvements must be made by the executing agencies, technical assistance will not only enhance the speed of the necessary transformations, but will also help the Fund staff negotiating programs to recognize the particular problems of individual cases.

The staff paper finds an association between inflation performance and the exchange rate regime. The causality caveats in this case are obvious. But even disregarding them, one must recognize, as Mr. Kafka pointed out this morning during the session on Ecuador (EBM/91/95/R-1, 7/19/91), that when there is a shortage of policy instruments, the choice must be made between objectives. The question, then, is what objective may be a more pressing necessity. In most--if not all--cases, countries seek Fund support when they have balance of payments difficulties. When this is the case, the priority is most probably foreign sector performance. True enough, inflation not only produces all the well-known distortions, but may in fact also be a contributing factor in the payments problem. However, it is also true that if enough policy instruments are not available, a choice must be made between objectives. Under circumstances such as these, an economy confronted with balance of payments problems and inflation can ill afford to seek price stability at the expense of exchange rate appreciation. Such situations, which are not uncommon, will probably require some trade-off regarding the speed of accomplishments in the area of price stability. The staff paper seems to point correctly in this direction.

We found the lack of correlation between fiscal performance and aggregate savings rather surprising given the close association apparently present between fiscal success and private savings. As the paper mentions, the lack of empirical association might be due to data shortcomings, or perhaps, to central bank quasi-fiscal losses. In any case, we believe that this issue deserves closer examination.

With regard to financial sector reform, there appears to be no statistical relationship between aggregate savings and positive real interest rates. This is not a surprising result, and is in accordance with the results of empirical research on this matter. Advice on real interest rates should hinge more on the benefits of the improvement in resource allocation to which they give rise, than on their positive effects on aggregate savings, which repeatedly fail to appear in empirical research.

Regarding financial deregulation, the staff paper rightly points out that margins between borrowing and lending rates are excessively large in highly regulated financial systems, and it is true that many of these regulations contribute to the observed large spreads. That notwithstanding, in many cases, restraints on financial operations have come about as governments' responses to a lack of competition in highly concentrated financial sectors. Deregulation in these cases should be accompanied by a wider degree of competition, at which appropriate policies can also aim. And, since a more competitive system will arise only gradually and only if the correct incentives are in place, it seems sensible to proceed gradually in financial deregulation, for this reason as well as for other reasons frequently noted in this connection.

Concerning the quasi-fiscal losses of central banks, it is not uncommon that a more market-oriented approach to monetary policy gives rise to losses in the central bank's treasury-related operations. On occasion, these tend to be overlooked in program design, but they can give rise to severe imbalances, especially when strong reliance is placed on credit rather than fiscal policies. Care should be taken to include these effects in program design.

The staff paper concludes that private capital inflows have not been a destabilizing factor. We believe that this matter should be looked at more closely. The experience of several countries, including my own, is that success in attracting these flows can create severe domestic imbalances when they cannot be used to substitute for other sources of foreign credit, particularly that directed to the public sector. After long years of heavy, if not exclusive, reliance on the public sector by many heavily indebted developing countries, so as to be able to sustain the availability of foreign credit, institutional frameworks have been geared to making this achievement possible. A sudden inflow of private capital is thus difficult to accommodate in the short run without serious domestic monetary pressures.

Mr. de Groote made the following statement:

First, let me address the implications of changes in the world economy for Fund policies, especially in terms of the adequacy of available financial resources. I will indicate possible responses by the Fund to these changes, and then discuss some of the paper's findings concerning the results of the programs reviewed.

Great attention has been paid to recent events in Eastern Europe, but they represent only the well-known tip of an iceberg the actual dimensions of which are still not fully seen. As the Bank's annual World Development Report indicates, the principles which have long guided the economies of a majority of developing countries--continual and active intervention by the state in the operation of the economy, and the stressing of redistributive goals over economic efficiency--are precisely those that were rejected in the command economies of Eastern Europe. Like the economies of Eastern Europe, many developing economies labor under the handicaps of widespread market distortions, and the success of their transformation efforts will therefore likewise depend greatly on a combination of correct policies and access to external financial assistance. Both the World Development Report's analysis of the global economic environment, and the conclusions of the paper on policy issues in the evolving international monetary system--to be discussed next week (EBM/91/99 and EBM/91/100, 7/24/91)--provide little or no assurance that the international banking system will be able to cover these prospective needs fully. This prospect poses a real challenge for Fund-supported programs. The strong impetus provided by the emerging political commitment to economic reform in many developing countries should not be lost due to the present shortage of commercial financing. It would be particularly regrettable if the success in observing program targets could not elicit a positive response from other sources of financing.

In response to the emergence of more market-oriented programs which are worthy of support, the demand for financial resources is bound to increase. We must plan to ensure an adequate response. Two options exist. The first is to ensure a better use of existing resources. As the staff report shows, only about 40 percent of the programs reviewed were generally successful. This raises the question of implementation, and the issue of complementarity between macroeconomic and structural reforms. Although the Fund's primary responsibility is surveillance over macroeconomic developments, the staff paper amply shows that progress in the area of structural reforms is often correlated with improved macroeconomic performance. It is open to discussion as to whether, and how, indicators of structural reform might be incorporated into Fund decisions on releasing resources. This topic has already been discussed at length in the Board, and the staff has commented on it at some length as well. In substance, the staff has answered that structural elements can be a target in Fund-supported programs, but not a performance clause. It is true that all components of structural change cannot easily be quantified. The prospective impact of such decisions as the liberalization of trade or the elimination of subsidies can nonetheless be assessed at least approximately. Is it unreasonable to submit that the phasing of these measures over time could become an explicit performance target in its own right? We might even consider that in the case of countries that do not suffer from pronounced macroeconomic imbalances, the program could be based mainly on criteria of this nature. I readily admit that this issue is complex, and Mr. Posthumus has adopted a different view from the one I have just recommended for further study. My suggestion does not, of course, imply that we should try to substitute another approach for the monetary approach to the balance of payments, but simply that in today's world, with increasing recognition of the importance of structural elements, the traditional approach could be complemented by additional criteria when the effects of the different phases in the implementation of a structural program can be reasonably assessed.

On the use of Fund resources, another and perhaps more fundamental issue now comes to the fore: a small number of countries which are performing satisfactorily under Fund-supported programs and at the same time maintaining the full service of their debt will not be able, despite their good performance, to achieve the needed modernization of their capacity: the only way they could do so would be to obtain an extension of the maturities falling due during the next three to four years, when they face a large hump in their reimbursement obligations. Hungary, Algeria, India, and soon, Indonesia, all belong to this category. Can we say that Fund resources are being used efficiently in cases in which they produce nothing more than correct implementation of a Fund-supported program with its positive implications for the balance of payments, the budget, and so forth, while the country is forced to abandon the further objectives of growth and structural change because reimbursements absorb an excessive share of its export proceeds during this crucial stage? This question is most relevant if we wish to see all sources of financing recognize countries' respect of conditionality. Has the time not come to define a special category for countries which correctly implement their Fund-supported programs and correctly service their debt, but which need longer reimbursement maturities? A new terminology has to be devised to distinguish the case of these countries from that of countries that need to restructure their debt, since the term "restructuring" always connotes cases in which some reduction of principal or interest has to accompany the extension of maturities. Would the term "debt reprofiling" not effectively convey the idea that the point at issue is only to assist countries that are already doing well to do even better? And should we not find specific ways of impressing on the creditors the view that, by considering an extension of maturities for these very countries, they would be recognizing the success of Fund conditionality, thereby ensuring the validity of the programs in terms of growth, and laying the foundation for the restoration of a normal relationship between the banking community and these top-grade debtors that are on the point of emerging from the debt crisis? Let us also not forget that there could be an element of reverse moral hazard in the present situation, if the banks gave to debtors performing well under Fund-supported programs the impression that their achievements are not understood and do not elicit as positive a response as the behavior of some other countries that continue to threaten the value of the banks' claims by performing less favorably. By suggesting that special consideration should be given to the cases of well performing countries to allow them to realize the full benefit of their successful performance, I fully recognize that I am entering territory where misunderstandings are likely to occur: the signals the purpose of which is to induce the markets to extend maturities for countries which might thereby be enabled to grow rapidly out of debt should not be interpreted as a sign of weakness. Is there a way for us to avoid such confusions?

A second way of ensuring an adequate response to these needs would be increasing the resources made available under Fund-supported programs. The Fund's recognition of the general need for increased resources is clear from the outcome of the Ninth

General Review of Quotas. Although this increase was not insignificant, it is nonetheless debatable how much of that increase will go to satisfy financing needs identified in the past, and how much will remain for responding to the impending systemic changes the importance of which can already be foreseen easily. A final point, which is highly relevant to the problem of financing, is the discovery of a strong correlation between fiscal performance and private investment: the paper shows that private investment is more sensitive than expected to a country's success in meeting its fiscal objectives. Not surprisingly, it was found that weak fiscal performance is followed by crowding out from the markets; more unexpectedly, it was also discovered that fiscal discipline is rewarded by strong crowding in. Fiscal discipline thus represents an indirect but helpful way for a country to increase the volume of private financial inflows.

Closely related to the financing question is the issue of the appropriate duration of Fund involvement. Given the need to protect the revolving character of the Fund's resources and the possibility of longer-term involvement under SAF and ESAF arrangements, the issue of eventually modifying the duration of Fund support is still open. Under certain circumstances, preserving the revolving nature of Fund resources could prove unduly costly in terms of preventing otherwise well-designed programs which have received strong political commitment from achieving their goals. Nonetheless, the discussion in the staff paper on selected operational issues strongly invites caution. We fully agree with the staff's conclusions on page 62 of this paper, favoring the case-by-case approach, strong political justification, and prospects of external viability as the main factors justifying a decision to approve a country's prolonged use of Fund resources.

Having made those general remarks concerning the Fund's strategy, I would like to comment on some of the results of the staff review, which occasionally contain the kinds of surprises and apparent logical contradictions to which economics is no stranger. First, let me touch briefly on the problem of evaluating program success. The staff used the most straightforward method, namely, comparing "what is" with "what should be." However, as indicated, in terms of obtaining a realistic assessment of a program's success, this method can provide an unbiased result only if all the main assumptions embodied in the program concerning the behavior of exogenous variables have been fulfilled. If this is not the case, the comparison of the actual and programmed results cannot provide an adequate measurement of the program's success.

Second, some very important conclusions and hypotheses are contained in the section on the main findings of the review. It is especially noteworthy that, in the paper's somewhat oblique language, a "fairly strong association [was found] between the implementation of programmed fiscal and credit policies and the attainment of the program objectives." The medicine, in other words, generally cures the illness. It is very encouraging for the Fund's future work in this area for us to have an indication that such failures of Fund-supported programs as do occur are not in general caused by erroneous design or internal inconsistencies, but rather by slippages in implementation. The implication for the Fund's work is straightforward: if better program results are to be achieved, better implementation is a more promising avenue than redesign of policies. Of course, I hasten to add that this in no way implies that there is no room for improvement in terms of the design of the programs themselves. However, even an ideally designed program is bound to fail in the absence of a sufficient commitment to implement it correctly. This conclusion is further underscored by the finding that even some countries that received technical assistance in the fiscal area did not succeed in implementing their fiscal policies as planned. Of course, we can dismiss the possibility that the Fund's provision of technical assistance contributed to these fiscal failures.

Third, I would like to draw attention to the issue of time lags, which, in view of its potentially significant effect on program evaluations, is very important precisely because of the Fund's commitment to support the attainment of a viable macroeconomic position in the medium term. The existence of lags complicates assessment of the success of various kinds of economic measures. The importance of lags in the evaluation of economic policies is further witnessed by the frequency of differences between an economy's short-term and long-term responses, before and after the necessary adaptation to the changes in economic policy have occurred; and the more complex and profound the policy change, the less prompt and straightforward will be the economy's response. Complex and profound changes are a characteristic feature of many Fund-supported adjustment programs. An analysis of time sensitivity of the program results would be useful for evaluating the true extent of the problem of lagged effects: programs are usually evaluated on the basis of the results achieved during the period of Fund involvement, which cannot always provide the true picture.

One example of such a lagged effect is provided by my own country, which did not follow a Fund-supported program, but rather a kind of shadow program in 1962. The effects we expected in fact came out five to six years after the program was adopted, in particular with respect to the behavior of savings in response to a change in interest rates. As indicated in the staff paper, under some programs, financial deepening continued even after the real interest rates turned negative. The existence of lags is recognized in some econometric findings, on the basis of which the staff argues that "there is no significant relationship between contemporaneous changes in ex post real interest rates and financial deepening."

Another interesting topic for further analysis is the experience with macroeconomic performance under various exchange rate regimes. This question has already been discussed on several occasions in the Board, and the present staff paper supports the general conclusion of those discussions: if a country fails to maintain fiscal and monetary discipline, or pursues loose incomes policies, there is little that any given exchange rate regime can do to ease inflationary pressures or to prevent inflation. Nevertheless, some evidence is adduced that inflation performance is generally better under fixed exchange rate regimes. Here, one could easily fall into the fallacy of "post hoc, ergo propter hoc": there is no reason to suppose that causality runs only from the exchange rate regime to the inflation performance. On the contrary, one could also regard inflation performance as a controlling factor in deciding what exchange rate regime will be best for the economy; inasmuch as the economy will benefit most from a fixed exchange rate regime, provided a fixed rate is sustainable, it follows that the best way of avoiding a possible devaluation is to prevent inflation from reaching higher levels. The expectation that inflation will be controlled can thus be an important factor in determining the choice of a fixed exchange rate regime, and if the expectations are fulfilled, the impression that a better inflation performance has been achieved under the chosen regime is easily formed. Of course, this is not to say that stable prices cannot be further supported by a stable exchange rate system. It should also be noted that the same argument applies to a certain degree to the case of flexible exchange rates.

Allow me to comment briefly on the classical topic of all macroeconomic discussions, namely, the relationship between monetary and fiscal policies. Like the balance between macroeconomic and microeconomic measures, or the balance between demand management and supply stimulation, the balance between the fiscal and monetary sides of our programs is shown to possess great importance, as today's review indicates. First, a slippage in one part of the program endangers all of its objectives; and even if they can still be attained, it will be at much higher costs than necessary, in terms of lost output and increased unemployment. Furthermore, the best that can be done under these circumstances will be to meet inflation targets: the targets of output performance will lag far behind if the fiscal performance is not there. Second, as hinted at by some figures from the staff paper, a balanced approach can bring substantial advantages in terms of synergy when the fiscal and monetary measures are both implemented as targeted, because in that case the individual policies reinforce one another. This point is illustrated in the report: according to Table 5 on page 21, in countries in which fiscal targets were met and credit targets were not met, the average rate of growth was 2.9 percent, and in countries in which credit targets were met and fiscal target were not met, average growth was 0.5 percent; but in countries in which both targets were met, the growth rate was 4.4 percent. That is a very strong conclusion of the papers. This synergy also operates negatively when neither fiscal nor credit targets are met. The impressive strong positive growth effects of compliance with demand restriction targets clearly show that fears of the destructive impact of over-restrictive policy are often not well founded.

In order to avoid any misunderstanding about the intentions behind my question about a more liberal access to the first credit tranche, let me say that I share the preoccupations expressed by Mr. Al-Jasser and Mr. Finaish. For this reason, I support imaginative reflections on ways of making such use more cost attractive. Another--perhaps even more important--reason for reflecting on this issue is that we might, in the framework of our own work on the world payments system, find ways of facilitating access to Fund resources for the money centers. This approach, analogous to the one suggested for the first credit tranche, might have to be envisaged.

The Chairman commented that Mr. de Groote had suggested that perhaps it was time to draw attention to the problems of another category of debtor countries--those with significant existing stocks of external debt which were nevertheless making every effort to keep current in their debt payments, even at the risk of becoming incapable of financing an appropriate level of investment. To some extent, the efforts of that group of countries were not being recognized by the international banking community.

Mr. de Groote said that he believed that a number of countries, including Algeria and India--and, to a certain extent, Indonesia--belonged to that group. There might well be others. His chief concern was that there was not a clear recognition that countries that performed well under Fund conditionality seemed to receive little reward for their good performance in the market, and in fact, it seemed that the market played against them.

In his experience, Mr. de Groote continued, the moment the question of extending debt maturities was broached with commercial bankers--and even some central bankers--the fear of rescheduling and the ultimate reduction of payments of interest and principle inevitably arose. The fact that the issue of extending the debt maturities had been raised only because the country had been successful, and because there were good prospects, in the medium term, for the country to grow out of its debt, was completely lost sight of. Certain countries were experiencing short-term liquidity problems, not a solvency problem. If the liquidity problem could be solved in such cases by way of an extension of debt maturities, or a "debt reprofiling," to overcome the hump in scheduled debt repayments, the country could then proceed with rehabilitating its productive capacity, providing the means for paying back the debt in the long run. Perhaps what he had suggested was akin to rescheduling; but a different term should be found to cover the situation he had described, which was different from a clear-cut case of rescheduling, in his view.

Mr. Ismael commented that the cases that Mr. de Groote had identified were similar to what he had described as the "forgotten countries" of the debt crisis. He would take exception to including Indonesia in that category, however, as the major part of Indonesia's debt was to public or government creditors, not commercial banks.

Mr. de Groote said that it might be useful not to limit the category to those countries with debt only to commercial creditors. It was important that governments be made aware of their responsibilities in respect of the global debt situation as well.

Mr. Jarvis said that the World Bank, by making available expanded cofinancing operations only to those countries that had avoided reschedulings over the previous five years, offered some benefit to the countries that Mr. de Groote had referred to.

Mr. Nakagawa made the following statement:

> I would like to thank the staff for the detailed and thorough analysis it has conducted for this discussion. The large volume of papers before us are very interesting and helpful, and deal with a number of important topics. However, it is my impression that, despite the variety of issues covered in the papers, the fundamental message they are trying to convey is a familiar one. The papers once again confirm the importance of the strong commitment by member countries to the policy measures in the programs, and the prompt implementation of these measures in order for the programs to be successful. Even though the staff formulates programs with strong conditionality after careful consideration, the final objectives of the programs will not be realized without strong and timely implementation of the measures by the members. Therefore, I believe that before entering into a discussion on the quality of conditionality, the Fund should make a careful judgment as to whether the member concerned has been embarking on a credible adjustment effort aimed at restoring a viable balance of payments position, and whether the member has demonstrated its

strong commitment to the program. In some cases, this judgment can be reinforced by the member's prior actions and front-loaded measures in the program period. I believe that this judgment is particularly important when we face a new request from a prolonged user of Fund resources.

Unlike the previous review, the staff has adopted a cross-country analysis of limited aspects of conditionality--namely, fiscal adjustment, exchange rate policies, interest rate policies, financial sector reforms, and private international capital flows. Certainly, this approach has led to some interesting findings.

I welcome the fact that programs in the review period tended to be more successful than those in the early to mid-1980s in meeting their objectives for economic growth, inflation, and the balance of payments. The staff reports that about 40 percent of the programs were generally successful in meeting these goals.

At the same time, the main findings of the review have interesting implications for future programs. In particular, I note the empirical finding that there has been a fairly strong association between the implementation of fiscal and credit policies in the programs and the attainment of program objectives for growth, inflation, and the balance of payments. Also, it is interesting to know that experience shows that countries with a fixed peg generally attain more stable prices, but record lower growth and a weaker external position during the program period, than countries with a more flexible exchange rate system. Although these points have already been discussed in the Board on other occasions, it is interesting that the empirical studies confirm them. However, we must be very careful in interpreting these findings and applying them to specific program formulations in the future.

It goes without saying that the reason for and purpose of setting conditionality on the use of Fund resources are to secure the monetary character of the Fund. By setting conditionalities, the Fund requires members to adopt and implement adjustment policies that can be expected to lead to external viability, which, in turn, safeguards the monetary character of Fund resources.

However, another study in the review paper shows that the number of prolonged users of all Fund resources, including SAF and ESAF resources, has changed very little in the latter half of the 1980s. Although the average outstanding use of Fund resources by the prolonged users was reduced substantially during the same period, the fact that most of the prolonged users have shifted to SAF/ESAF arrangements suggests that these countries are expected to rely on Fund resources for an even longer time than before.

The number of arrears countries has also increased in the same period. This situation of prolonged users and users in arrears raises serious concerns about Fund conditionality, since the purpose of conditionality is to safeguard the monetary character of the Fund.

Although the staff reports that overall performance under programs was better in the latter half of the 1980s, does it necessarily follow that the purposes of conditionality have also been achieved? Although the findings of the main paper are interesting in themselves, I wonder whether these findings have significant implications for the achievement of the purposes of conditionality. I believe that the more relevant questions that should be addressed in the conditionality review are why programs were not more successful in achieving their objectives, and why certain countries are still dependent on Fund resources.

These questions need to be considered against the historical and institutional background of individual cases. I believe that an evaluation of Fund-supported programs and of performance under those programs would be more productive if it were carried out in the context of a systemic and historical background. Therefore, the periodic review of conditionality should focus on a more limited number of questions and try to get answers based on the actual experience of individual cases.

With regard to some specific findings of the review, the importance of achieving the fiscal and credit targets of a program is obvious. In this connection, I appreciate the staff's analysis of public expenditure management and the feasibility study on developing performance criteria on institutional development in this regard. This chair basically shares the staff's view. In light of the long-term nature of the institutional development of fiscal administration, this issue should be addressed mainly through technical assistance from the Fund and the Bank, and it should not be linked rigidly to Fund-supported programs either through setting performance criteria or making it a precondition. As the staff notes, it is reasonable to place greater reliance on the program review and consultation procedures to monitor developments. This issue, as well as the issue of financial sector reform, should be regarding as requiring closer Fund/Bank collaboration.

The empirical findings in the staff paper concerning the exchange rate are interesting. However, as this chair stressed at the Board discussion on exchange rate policy last November (Seminars 90/7 and 90/8, 11/21/90), the role of exchange rate policy should be considered in conjunction with the policy objectives of the country concerned and the financial policies that are already in place. Therefore, the choice of exchange rate policy should be considered strictly in the context of individual cases, and the findings in the staff paper should not be regarded as having categorical implications for individual programs.

As the findings of the staff suggest, a stable and credible macroeconomic situation appears to be the main determinant of private capital inflows. In this sense, the capital inflows themselves are not regarded as the primary objectives of Fund-supported programs. However, in light of the important role attached to private capital inflows in restoring external viability, I hope the future conditionality reviews will study this aspect in depth, based on the actual experiences of both successful and unsuccessful cases.

With respect to the selected operational issues, this chair can go along with the staff's conclusions regarding the use of resources in the first credit tranche; the present conditionality guidelines should be maintained. In the interest of securing the effectiveness of the resources used, the staff is quite right in proposing to strengthen the monitoring process through the establishment of quarterly targets as a standard element of the first credit tranche programs. This chair, like others, also endorses the staff's intention to reconsider the provisions for the "floating" of the CCFF and the extended Fund facility in relation to first credit tranche arrangements. The principle of phasing should be applied more strictly to the use of Fund resources beyond the first credit tranche.

It is difficult to assess at this stage how effective programs under extended arrangements since 1988 have been in addressing medium-term objectives, including structural targets, since most of them are still going on. However, I believe that the extended Fund facility is an appropriate facility to support members that are conducting economic reforms over the medium- and long-term, such as countries in Central and Eastern Europe. In this sense, we welcome the adoption of extended arrangements by Hungary and Poland.

The incorporation into programs of contingency mechanisms outside the CCFF could help the timeliness of policy adaptation, and thus increase the probability of continuity in adjustment efforts. In this light, we welcome the increased incorporation of contingency provisions. While going along with the attachment of flexibility to provisions, we also share the staff's concern over the selection of variables, the adjustment of program objectives, and ensuring the symmetry provisions. These provisions outside the CCFF should be designed keeping in mind the need for parallelism with the contingency mechanism under the CCFF.

This chair basically endorses the staff's view concerning prolonged users. The general principle that access for prolonged users should continue to be guided by the need to reduce their outstanding obligations over time should be strictly maintained and applied. This chair considers this issue a potential threat to the conditionality guidelines. The monetary character of the Fund's resources should be safeguarded on a case-by-case basis, based on appropriate design and monitoring of the program, and by applying strictly the conditionality guidelines. In this connection, we endorse the staff's view expressed in the context of methods to address prolonged use. It is stressed that there is the need to assess more thoroughly the factors behind prolonged use on a country-by-country basis at the time prolonged users request new arrangements. It is also suggested that the staff paper could highlight the prospects for continued need for Fund resources in the future. I hope that in the future, staff papers on requests from prolonged users will be prepared along these lines. We also support the view that access for prolonged users should be decided on a case-by-case basis. In light of the importance of the issue of prolonged use, this chair hopes that the next review of conditionality will contain an in-depth study of factors contributing to prolonged use of Fund resources, based on actual case studies. I support the proposed decision.

Mr. Torres made the following statement:

We welcome this opportunity to review some selected aspects of conditionality. The papers allow us to reflect on the effectiveness of Fund-supported programs and the Fund's advice--undoubtedly highly controversial issues, especially as the objectives of Fund-supported programs have been broadened to include explicitly such aspects as growth, poverty reduction, the environment, in addition to the traditional objectives of external viability and price stability.

The staff has prepared a number of papers reflecting the areas which have generated controversy in Board discussions of different country programs, and also reflecting the general policy problems that the Fund confronts, including the ongoing debate of what should be the role of the Fund in the 1990s.

Therefore, the issues for discussion are numerous and touch at the heart of Fund operations. On many issues we are in general agreement with the staff's analysis and stance.

I will concentrate on a few issues on which we have a strong position, and concerning which we may not share the conclusions of the staff. I will also focus on those issues concerning Fund conditionality of which we have first-hand experience, based on the adjustment programs of the countries in our constituency.

The papers do a very good job in drawing conclusions from the average experience with Fund-supported programs. Many of the lessons are in strict harmony with the theoretical framework that supports the Fund's recommendations. It is of course completely satisfactory to see that policy advice and recommendations, when fully implemented in a supportive international environment, bring the expected results. However, we perceive one general fault in the papers--namely, very little self criticism. The underlying message and the general conclusion are that better policy implementation would have improved the overall performance record of countries--and we cannot disagree with that. However, there is no effort to determine whether different policy recommendations would have facilitated policy implementation and, therefore, might have led to a better performance overall. Thus, in general terms we see that one of the standards for measuring performance--that used to compare "what is with what might have been" in the presence of a different set of policies, or with more timely Fund assistance--is missing in this set of staff papers.

We also did not find any proposal that would help to simplify the operation of Fund facilities or the conditionality requirements of Fund-supported programs. This is a topic which deserves to be discussed in the Board in the near future. We see with great concern that in each conditionality review, what prevails are calls to add more and more complex performance criteria, and more and stricter monitoring. One gets the impression that mission chiefs are competing with each other in trying to impose the greatest number of performance criteria--effective only in constraining countries' discretion in taking policy decisions. We may be approaching a situation in which we cannot see the forest for the trees. Strong adjustment linked to efficient conditionality is needed, with as simple a monitoring mechanism as possible.

It is difficult to believe that all performance criteria have worked well and have served their intended purpose across the whole range of Fund-supported programs. However, the paper is silent as to whether some have turned out to have been redundant, or have represented only an administrative burden, both for country officials and Fund staff monitoring the program. It would also be useful to have an idea as to when reviews and consultations have been fruitful in terms of fostering the ultimate objectives, and when they could have been foregone. There is a feeling that the staff is overworked, that the institution is working at more than full capacity and therefore needs more resources, but I wonder how it could be otherwise, given that the staff and the Board make proposals that seek to involve the Fund in very detailed aspects of administering and implementing an adjustment program.

I make these comments in a constructive spirit, in an attempt to search for ways to improve the performance record of countries that adopt a Fund-supported program in the upper credit tranches. In this search, it is important to look critically at our programs; they are most under our direct control, and it is in our hands to improve our methods and our diagnostic capability so as to make better policy recommendations and to improve our understanding of all the constraints faced by the authorities in the countries seeking our assistance. All these factors point to the urgent need to have the proposed independent evaluation unit functioning as soon as possible, to which my authorities continue to attach the greatest importance. Only an independent analysis can point out objectively the strengths and weaknesses of Fund-supported programs, the effectiveness of the monitoring techniques, and the usefulness of the whole array of performance criteria that characterize Fund-supported programs.

With respect to selected aspects of conditionality, we are in broad agreement with many of the conclusions. The paper poses challenging questions for anyone involved in the design and implementation of adjustment programs. For instance, on the general questions of how to raise the proportion of successful programs and how to foster better policy implementation, it seems easier to identify what surely would not work: increasing the complexity of conditionality and the monitoring requirements.

We would like to stress that successful programs seem to be those to which the authorities are completely committed, those that the authorities perceive as their own, supported by technical and financial assistance from the Fund. We must be effective in persuading and involving the authorities in the adjustment process, in helping them understand the issues at stake; in this respect, the IMF Institute can play a useful role not only by providing technical assistance, but also by increasing the awareness of developing country officials of the different aspects of Fund-supported programs, including case study of successful programs.

We were pleased with the observation made by Mr. Breuer on the need to enhance the role of the IMF Institute as a liaison with other institutions in member countries and as a catalyst for other efforts. We consider that a thorough assessment of the Institute's performance and a discussion of its role in the Board are warranted. Perhaps this proposal might be considered in our next discussion of the work program.

Developments in terms of trade, as the empirical evidence shows, are closely related to performance under the adjustment programs. In this regard, contingency mechanisms can play a useful role in smoothing out the adjustment process. We agree with the staff that contingency provisions in Fund arrangements should be as simple in design as possible, should be easy to monitor, and should be tailored to the particular situation of a given member. It seems paradoxical that contingencies outside the CCFF have worked well and have proven their value in reducing the vulnerability of programs to external shocks, yet we cannot use this experience to develop a workable facility to address the problem. In this regard, I have found very interesting the proposal made by Mr. Goos, Mr. Posthumus, and Mr. Al-Jasser to replace the contingency element of the CCFF with built-in contingencies in the context of Fund arrangements, to be adapted as needed--including the possibility of additional Fund financing.

One of the issues for discussion that surprised us was that on dealing with high inflation countries. To ask a country that is facing an inflationary problem first to stabilize prices, and to enter into a Fund arrangement only afterwards, is to forget that high inflation is a symptom of the disease, not the disease itself. Of course, it is difficult to undertake financial programming in conditions of high and volatile inflation, and it is difficult to implement policies in an inflationary environment, but that is the main challenge of stabilization policy. Moreover, the staff should be well aware that experience shows that it is easier to bring inflation down from high--two-digit or three-digit--levels than from low two-digit levels. One of the lessons of the debt crisis was that a country needs resources up front to break the vicious circle of the inflation tax, capital flight, devaluation, and high real interest rates.

We find the empirical evidence on exchange rate policy to be at best inconclusive. However, we believe that countries, and the Fund's staff, should not emphasize the so-called short-run trade-offs. It took many years to dispel the notion that policymakers could move along a negatively sloped Phillips curve, that there was a short-run trade-off between inflation and unemployment. We would suggest not making the similar mistake of identifying short-run trade-offs that vanish when the monetary authorities try to exploit them. In this regard, we are in full agreement with the remarks made by Mr. Landau, Mr. Goos, and Mr. Posthumus, and we strongly encourage the staff to conduct the study on dynamic effects of exchange rate regimes in combination with trade reforms over time.

This chair has reiterated the view that fiscal policy is the centerpiece of adjustment programs. Therefore, any action that will help countries attain a solid fiscal position will go a long way toward assuring the success of an adjustment program. However, let us not fall into the trap that would suggest that the fulfillment of the fiscal targets will be ensured by monitoring more closely the fiscal administration of countries and by incorporating into programs all sorts of performance criteria. As the paper on public expenditure management processes and fiscal conditionality points out, "slippages in fiscal programs arise often for policy rather than technical or organizational reasons." Based on this analysis, we would encourage the staff to help countries in the organizational aspects of tax administration. While we would favor the provision of competent technical assistance, we would not like to see this transformed into a further proliferation of fiscal conditionality. The Fund has neither the human resources nor the mandate to look into the detailed operation of administrative processes in program countries. It is clear from the staff paper that "the inclusion of organizational improvements as a specific agenda in letters of intent may also require more specialist knowledge than is normal in financial programming exercises, and monitoring these aspects may entail additional expense."

Concerning the selected operational issues related to the use of Fund resources, we do not see a need to strengthen conditionality in the first credit tranche. It would appear that the staff's suggestion that monitoring arrangements be included as a standard element of first credit tranche purchases in the future is an unnecessary complication that would not change materially the final results in terms of program implementation. Moreover, such a practice would undermine the "low conditionality status" of the first credit tranche--a long-established practice. It seems particularly unwarranted given the fact that Fund quotas have lagged behind the growth of world trade, and that the method for dealing with this situation has been to enlarge the access limits, thus rendering the 25 percent of quota in access available under the first credit tranche insignificant. Furthermore, as the staff itself points out, first credit tranche transactions did not represent an undue risk for the Fund's resources.

We should continue to look at ways to encourage the use of the extended Fund facility. An important lesson from this conditionality review is that countries that have undertaken balanced adjustment with structural reforms in a medium-term financing framework have been the most successful. We are in general agreement with the staff on the principles that should guide the application of a fourth-year arrangement under the extended Fund facility--namely, mainly in cases in which there is a need of one more year in order to complete the Fund's financial involvement in support of the adjustment process, and in which the policy measures for the fourth year are broadly in line with the thrust of the overall program.

We were favorably surprised by the findings in the section on prolonged use of Fund resources, namely, that there has been a considerable reduction in the number of prolonged users since 1986--from 23 in 1986, to 6 in 1990--when the last comprehensive review of the subject was conducted. We concur with the staff that it would not be appropriate to adopt rigid access rules for prolonged users or other major changes in the policies on prolonged use. We do not see any need for a precise definition of prolonged users, but we can go along with the intention to include in staff reports on prolonged users a review of past programs and of the factors underlying the member's prolonged use.

The Executive Directors agreed to continue their discussion on July 22, 1991 (EBM/91/97).

APPROVED: January 14, 1992

LEO VAN HOUTVEN
Secretary