MASTER FILES
ROOM C-525

0404

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/98

3:00 p.m., July 22, 1991

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	B. R. Fuleihan, Temporary
	L. E. N. Fernando
	C. M. Towe, Temporary
Dai Q.	
	J. M. Abbott, Temporary
J. de Groote	
	N. A. Espenilla, Jr., Temporary
	N. Kyriazidis
M. Finaish	
	I. Fridriksson
B. Goos	
J. E. Ismael	T. Sirivedhin
	J. C. Jaramillo
	J.-L. Menda, Temporary
	O. Kabbaj
	Y. Patel, Temporary
D. Peretz	
G. A. Posthumus	G. P. J. Hogeweg
	B. A. Sarr, Temporary
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; R. C. Williams. Asian Department: M. R. Figuerola. Central Banking Department: R. K Abrams. Exchange and Trade Relations Department: J. T. Boorman, Director; T. Leddy, Deputy Director; B. Christensen, S. Eken, R. A. Feldman, J. P. Pujol, S. M. Schadler, B. C. Stuart, P. J. P. Szymczak, J.-Y. Wang. External Relations Department: V. R. Khanna. Fiscal Affairs Department: V. Tanzi, Director; A. Premchand, K. Nashashibi. Legal Department: P. L. Francotte, A. O. Liuksila. Secretary's Department: A. Tahari. Treasurer's Department: B. B. Zavoico. Advisors to Executive Directors: M. B. Chatah, B. Szombati. Assistants to Executive Directors: B. Abdullah, C. Björklund, J. A. Costa, Deng H., S. K. Fayyad, J. Jonas, D. Sparkes, Tin Win, S. von Stenglin, J. C. Westerweel.

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

The Executive Directors resumed from the previous meeting (EBM/91/97, 7/22/91) 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).

The Director of the Exchange and Trade Relations Department stated that the staff, as well as Executive Directors, had debated the extent to which growth was a purpose of the Fund in a formal sense. Whatever the outcome of that debate, the fact remained that growth was an objective of the Fund's member countries, and that, whenever the staff entered into discussions with the authorities on the policies they wished to follow in pursuit of balance of payments adjustment, growth was a consideration. In the process of finding common ground with the authorities, therefore, the staff had found that growth became an important part of the discussions in practice.

The heart of the matter was the extent to which the growth objective could be accommodated without impeding the external objective, the Director commented. It could not be denied that the purpose of the Fund was to create the conditions for growth, not to target growth in a narrow sense. At the same time, the Fund's programs were quantified, and in that respect it was necessary to provide a number for growth in Fund-supported programs--a consistent, quantified monetary demand number. That raised a question as to how the issue of growth should be approached in the context of programs. The staff needed to analyze the situation as carefully as it could to see the potential sources of growth, but not to target growth in an arbitrary way.

There were different ways of going about designing policy programs, the Director pointed out. Mr. de Groote had mentioned one--to focus in the context of programming for Fund arrangements on the structural elements which would elicit a supply response. In many of the cases in which the staff's growth forecasts were perceived as being too high, the programs had embedded in them structural measures on the supply side--such as price and exchange rate adjustments that would elicit a switching of resources from one sector to another--that would suggest that the external objectives of the program would be attained, and in which the growth and external objectives were complementary. In that regard, the growth and external objectives need not be substitutes; there could well be measures that would lead to a supply response which would provide growth and a solution of problems in the external sector simultaneously. The results of the staff's paper suggested that even in the short run, the policies for containing demand at a sustainable level were also the ones that generated growth and had a crowding-in effect. Good fiscal and monetary policies encouraged the private sector to respond in the right way, even in the short run, contributing to growth.

It needed to be borne in mind that the Fund collaborated closely with other institutions that had growth as part of their mandate, just as the Fund was dealing with individual member countries which had growth as a policy objective, the Director went on. In order for adjustment programs and policy programs to be sustainable in the medium term, they must provide results for the population. A socially and politically acceptable program could not be sustained for very long if the population was increasing by 2.5 percent a year, while growth was at zero. The preferred approach was therefore to search for policy measures that provided resource switching incentives and a supply response that made growth compatible with external sector adjustment.

Some speakers had commented that the staff had attempted to cover too much ground and too many topics for the current review of conditionality, the Director recalled, both from the perspective of the ability of the staff to analyze the material to the necessary degree of detail, and from the perspective of the limited ability of the Board to digest it at one meeting. The staff needed to be cautious in advancing too many topics for the conditionality review, but there was a tendency to fold a number of issues into it. Topics such as public expenditure and prolonged use of resources could have been taken up separately. However, some speakers had noted that the conditionality review had not been comprehensive enough--for example, that the staff should have gone into greater depth about structural adjustment and reform measures taking place simultaneously in individual countries. In any case, the staff was not completely satisfied with the approach it had chosen; and it was for that reason, as well as others, that the staff had warned against trying to draw hard conclusions from the results of the study.

The study had intended to present a broad picture, encompassing the experiences of countries with Fund-supported programs, and a profile of their success or failure over a particular period, the Director said. Even if the results were only empirically indicative, however, some tentative conclusions could begin to be drawn, which were nevertheless important. One conclusion was that if the policies as defined in the original program design were adhered to, there was a greater chance that the objectives of the program would be met than if the policies were modified. Another conclusion was that by adhering to the kinds of fiscal and monetary policies designed into Fund-supported programs, private sector activity appeared to get crowded-in, with better growth performance as a result. Those two conclusions about the linkage between policy performance and meeting objectives, and between fiscal and monetary policies and growth, even in the short run, were critical to the way the Fund approached the design of programs with the authorities.

That notwithstanding, the staff was uneasy about reading too much into the results, as it was well aware of the arbitrariness inherent in the set of countries chosen, as well as in the time period chosen, the Director remarked. The countries were heterogeneous, and the types of problems they confronted were very different. There was the need to delve into every case in order to make the analysis comparable across countries, but that would take an enormous amount of staff time. However, in the final analysis, while the staff believed the study was useful, it would admit that there might be a better way of going about it. Directors appeared to support the proposition that the staff should work continuously to define more specific analytic issues in the future. That would include analyzing the priorities and policymaking choices, the sequencing between various policies, the interaction between exchange rate policy and trade liberalization, the nexus between exchange rate policy, inflation, domestic savings and investment, and growth, as well as the different ways of achieving positive real interest rates. He detected the Board's support for the staff's intention periodically to present papers which analyzed the experience of countries under Fund-supported programs, so that, at the time of the next review of conditionality, some perspective could be taken, and that review could be focused a bit more precisely.

A number of speakers had commented on the desirability--or lack of it--of trying to agree on a definition of prolonged use of the Fund's resources, the Director recalled. The staff did not intend to create a convenient category into which certain members could be placed, or to come up with a hard or immutable definition that would serve to segregate certain countries from others. However, in attempting to make historical comparisons, some kind of criteria had to be agreed that would indicate which countries could be so categorized. The criteria which the staff had included in the paper could serve as a way of raising some caution signs with respect to prolonged use in the context of requests for arrangements from those countries. The staff would analyze such cases in a bit more depth than would have been done otherwise. By doing so, more light would be shed on those countries within the group of prolonged users that might have been prolonged users for good reasons, as a number of speakers had stressed. In that respect, the category of prolonged user would not indicate--before the fact--that something was necessarily wrong. There were cases of prolonged users that had made progress, however slow.

Questions had been raised about whether the staff hesitated in recommending financial liberalization, and about the establishment of performance criteria within a liberalized monetary and financial system, the Director went on. On both efficiency and monetary policymaking grounds, the staff generally recommended both the liberalization of financial markets and the move to indirect methods of monetary control; it preferred to base performance criteria on a reserve mechanism, and to move away from individual bank credit ceilings. Nevertheless, in some cases--such as that of Yugoslavia--the staff had been cautious in recommending such a course and, indeed, had recommended that both credit ceilings and a reserve mechanism be retained, because it did not have confidence that indirect mechanisms of monetary control would be powerful enough to work under the program. In that case, two kinds of performance criteria had been used for an interim period.

It had been suggested by Mr. Goos that the approach taken in the paper might not have been appropriate, because the targets or objectives set were too lenient to begin with, and that a comparison was being made between the outcomes and insufficiently aggressive targets, the Director of the Exchange and Trade Relations Department noted. The staff had taken the approach it had because it believed that the outcome of the program had to be compared with the targets of the program as approved by the Executive Board. The staff's task, in assessing conditionality, was to determine whether or not the programs the Board approved for individual program countries were operating successfully; that seemed to be the only standard the staff could go by.

Mr. Goos said that progress toward medium-term viability was the clear-cut standard for judging the effectiveness of Fund programs, and that should be the starting point for an analysis of Fund conditionality. Only after that question had been answered should the next question be raised, namely, whether there was a problem with the Fund's program design. Only then could the details and the assumptions of the program be assessed and the extent to which the targets had been achieved on the basis of those assumptions. In the next conditionality review, the first chapter of the staff paper should assess the progress made toward medium-term viability under Fund-supported programs.

The Director of the Exchange and Trade Relations Department responded that the external targets and objectives of programs were set in the context of medium-term scenarios that provided guidance as to what was expected with regard to medium-term viability. Some programs that had been brought to the Board for its approval had not foreseen the attainment of medium-term viability within the program period, and in most of those cases that fact had been made clear to the Board--the case of Mozambique, for example. By implication, therefore, an important factor in measuring the outcomes against program objectives was the external sector target.

Mr. Goos reiterated that the main objective of Fund-supported programs was progress toward medium-term viability. If medium-term viability was not achieved, then an examination should be undertaken of the mistakes or erroneous assumptions that had been made in the formulation of the medium-term program. Such an analysis would not necessarily conclude that the Fund-supported program was wrong; perhaps it would be found that an error had been made in the assumptions, in which case no more time should be spent in analyzing it. However, if it were discovered that medium-term viability had not been achieved and that the medium-term assumptions underlying the program were nevertheless correct, then the effectiveness of the program design should be assessed, and perhaps some conclusions drawn, so that in the future the program design could be corrected and the measures applied differently. The critical issue remained achieving the objective of medium-term viability.

The Director of the Exchange and Trade Relations Department replied that there were very few cases in which the staff could conclude with confidence that medium-term viability had, or had not, been achieved. It would therefore be difficult to follow the approach that Mr. Goos had recommended. In many cases, the most that could be said was that the country had moved closer to medium-term viability under the program than it was at the beginning. The staff therefore found itself in the position of having to assess the degree of progress that was under way. In that respect, the staff had put the various objectives of the program on an equal footing and had not put the progress toward attainment of medium-term viability per se ahead of the others in its analysis.

Mr. Goos remarked that the staff's analysis showed the facts very clearly in terms of the attainment of medium-term viability. Four out of the 21 sample countries no longer relied on Fund resources; it could therefore be said, without reservation, that four of the countries that had followed Fund-supported programs in the reference period had reached medium-term viability. That was admittedly a disappointing result. Could not some assessment be made in qualitative terms of the progress of other countries in that respect? When a program was presented to the Board, the staff paper outlined when the country was expected to reach medium-term viability; it should be possible to make an assessment of where the country stood at present in its progress toward medium-term viability, and how much longer it would take, including the reasons why the time horizon might have to be extended. He was confident that such an analysis would stimulate many qualitative and highly sensitive observations.

The Director of the Exchange and Trade Relations Department said that such a study could be undertaken, but it would be different from the one the staff had done in the past reviews of conditionality. The experiences of all the program countries would have to be gathered together and brought up to date, which might take more staff resources than the present study. Nevertheless, the points Mr. Goos had raised could be addressed in that way.

Mr. Goos commented that such an approach might take a lot of resources, but probably not more than the amount of resources that had gone into the current analysis. He would urge that in the next review of conditionality, the cases of a few selected countries be analyzed to determine how they had proceeded over time toward the attainment of external viability, and what the causes for any delays had been. From that analysis, conclusions could be drawn for the Fund's program design and technical assistance.

The Director of the Exchange and Trade Relations Department said that the next review of conditionality could be handled in a different way, following different analytical approaches. The staff would look into that suggestion very carefully.

There was indeed a reluctance on the part of members to use the contingency element of the CCFF, as had been shown in the last review of that facility, the Director continued. That reluctance originated in the symmetry provisions, as well as in the facility's complexity. Contingencies had been included more frequently in the context of Fund arrangements, but outside the CCFF, because it was simpler and more straightforward, especially in cases in which a certain variable was particularly critical to the country's external situation, and in which the effects of variations in that variable--such as public sector receipts from oil enterprises--could be traced back relatively easily to the entire program. No funding could be attached to contingencies in the context of arrangements outside the CCFF, however. If funding was needed in order to accommodate the shock that had occurred, it would have to come out of a reserve buildup that might be smaller than anticipated originally--in effect, funding that came out of the country's own resources over that particular period of time. The problem was that, in the context of contingencies and the Fund's involvement, it was rare that the environment was such that additional resources--other than the country's own resources--were not needed. Once the need for the contingency became apparent, the status of the rest of the current account or of the balance of payments would have to be assessed. The staff would look into those issues in the context of the subsequent review of the CCFF.

One speaker, Mr. de Groote, had drawn attention to the issue of the Fund's involvement in a country having a perverse effect on the behavior of commercial banks and the country's other creditors, thus compounding the adjustment problems of the affected country, the Director went on. In the most problematic of those cases--which were all too frequent--banks became more concerned about the situation facing the country, and began to withdraw from it, once a country embarked on an adjustment program. Another situation was best exemplified by the case of Hungary, in which a strong adjustment effort was maintained for a period of time, but the creditors remained outside or, indeed, continued to remove themselves by accepting repayment, or by not either refinancing or offering new credits. The problem manifested itself in quite different ways across the set of countries in question, which were different in terms of their level of development and the stage of their adjustment process, as well as in terms of their dependence on official versus commercial sources of financing and the type of commercial financing. They differed also in terms of their relationship with the Fund. Because of those differences, the question arose as to whether or not it would be worthwhile to try to find a general solution to the problem. The staff continued to approach the problem on a case-by-case basis, accordingly, although it had formulated a number of principles. One of those was that a solution should be found which maximized the inflow of appropriate financing over a number of years, and not simply in terms of immediate cash-flow relief. For example, countries that were not rescheduling or seeking some kind of debt relief might face short-term constraints, but the staff and the authorities might agree that future financing flows might be put in jeopardy unless the country stayed the course vis-à-vis its creditors. That required upsetting as little as possible the confidence of the other creditors, including the banks and private investors.

A number of positive developments could be seen arising out of sticking to that principle, the Director observed. Creditors were looking to different types of financing than they had in the past, such as trade-related financing, project financing, and non-debt-creating flows from private investors. That fact highlighted the lesson that certain countries had learned from past experience, namely, that when bank creditors were anxious to find markets for their loans, they tended to be too easy as to the conditions they attached to them. The countries had therefore contracted debts that should have set off alarm bells in the first instance, in consequence, and that presaged the withdrawal of short-term deposits by their bank creditors as soon as difficulties arose.

The staff would continue to deal with those problems on a case-by-case basis, the Director went on. The staff would examine whether or not there was scope for a better dissemination of the Fund's views, perhaps in the context of the forthcoming paper on debt, and whether or not the authorities were doing enough to publicize the positive results of their adjustment programs. Also, there was the question of whether the assessments of the Fund's Executive Board penetrated through the regulatory agencies to the banking communities of the major industrial creditor markets, and whether there was sufficient flexibility in certain regulatory provisions. For example, a provision in most countries stipulated a wait of five years before provisioning restrictions--following upon a country's rescheduling--could be removed.

In specific cases, the staff had recommended that the debtor country approach informally its major bank creditors, partly because the creditor group was large, varied, and dispersed, with different interests in engaging in ongoing operations in the country, the Director of the Exchange and Trade Relations Department concluded. It was also important, in the context of the global movement toward market-oriented mechanisms, that the Fund not send a signal that there were other than market-related ways of assuring a quick reflow of resources to those countries that were engaged in difficult adjustment programs.

The staff representative from the Exchange and Trade Relations Department noted that Mr. Ismael had raised the question of whether the empirical results reported in the main paper on the effect of exchange rate movements on exports had been biased by the inclusion of countries that were primarily exporters of manufactured products. The four countries that had done very well on the export side--Korea, Mauritius, Thailand, and Tunisia--were affecting the results, but there were also a number of other countries where there was a close relationship between movements in the exchange rate and export performance--namely, Chile, Mexico, Ecuador, Uruguay, and Jamaica. There were also a few other countries in which a loss of competitiveness was associated with stagnation in export volumes. It was true that, for a commodity producer that was a price taker in the international market, an adjustment in its exchange rate would not affect the world price of its exports; however, such an adjustment would raise the local price of its exports, which it was to be hoped would elicit a supply response. Such a response would be expected in particular in a situation in which the price prior to the exchange rate adjustment was such that the commodity could not be produced at a profit. The other aspect was that countries could not be classified as primary producers or manufactured exporters across time independently of the kind of exchange rate and other policies that they were following; and there were several examples covered in the paper of countries that had diversified their exports during the 1980s--Chile and Mexico were prime examples.

Nominal fiscal targets were indeed crucial for providing an anchor for programs, the staff representative concluded. The staff had focused in the paper on fiscal targets in terms of GNP, or relative to GDP, only to enable cross-country comparisons to be made and to summarize the results.

The staff representative from the Fiscal Affairs Department stated that the problem of the quasi-fiscal accounts held by central banks in a number of countries was an important consideration in the failure of expenditure control systems. Others were the problem of domestic arrears and "ghost" employees.

The technical assistance which the Fund could provide in the area of public expenditure management to ensure a minimum level of adequacy of such systems was of fundamental importance, the staff representative said. There were six components of an adequate public expenditure management system, of which the Fund's technical assistance had so far focused on four.

First, there was the adequacy of the analytical capacity of the Ministry of Finance and of other financial agencies in the government responsible for the formulation and monitoring of fiscal policies, the staff representative went on. That was the first and fundamental step, and most of the technical assistance had been geared toward that end. Second, there was the need for adequate transparency and accountability of government finances, in order to contribute to the economic and efficient use of resources. The Fund's technical assistance had made progress in that direction over the years, but transparency tended to be very country-specific, as well as situation-specific. Third, there was an adequate system of government payments, in which remarkable progress had been made during the previous few years. While payment accounts systems had been well established in a number of countries, they had fallen into disuse in some countries, and had been politicized in others. The Fund's technical assistance had focused on bringing as much of an empirical value as possible to payment accounts systems. Fourth, there was the timely preparation of government accounts. There were still a number of countries--including some program countries--for which the latest available accounts data were from the mid-1980s, but for which a host of informal, unaudited government data was used for decision-making purposes, including decisions on debt. Fifth, there was the management and structuring of budgets so as to ensure their timely submission to the legislature, which tended to be a controversial subject because of the differing political systems and the different ways in which budgets were processed across countries. In that connection, it might be noted that the Fund's technical assistance had been partly responsible for setting up a budget system in some countries in which there had been no budget at all even six years previously.

Finally, there was the regular auditing of government finances, the staff representative from the Fiscal Affairs Department concluded. Although the staff saw that as important, the staff tended to give it a lower priority than the other components. It also tended to be a sensitive issue; for example, the staff had received a complaint from a country in which it had been engaged in assisting the audit agency that it was attempting to build up an organ of government that was critical of the state.

Mr. Goos stated that he broadly concurred with what the Director of the Exchange and Trade Relations Department had said about the place of growth in Fund-supported programs. However, the Director had noted that the Fund needed to cooperate with institutions which had growth as their explicit mandate. He trusted that that did not mean that the Fund, in cooperation with those institutions, would be forced to compromise on its own mandate--to correct balance of payments disequilibria in as short a period of time as possible. That strengthened his concern that, given the medium-term orientation of the World Bank, with which the Fund was in close cooperation, the Fund had a tendency to neglect the need for forceful adjustment measures aimed at correcting financial imbalances, and that the growth objective was at the expense of significant progress in adjustment.

The Director of the Exchange and Trade Relations Department responded that it was not a question of the Fund yielding or compromising on the basic objectives of Fund-supported programs, nor of how to achieve external financial adjustment in as short a time as possible. Rather, the question was how to frame a sustainable program that would give the desired correction, while accommodating--at least to a certain extent--the other objectives. An appropriate mix of policies, including structural measures designed in close collaboration with the World Bank and with other institutions in the country, was needed, so as to secure a supply response that would contribute to growth. There would always be a question as to the pace at which the correction was to take place. Whether or not the policies that were formulated to attain that correction could be implemented and sustained was the crucial issue, in his view. The key was to find the elements of an adjustment process that would produce growth as well as external sector adjustment.

The Acting Chairman made the following summing up:

There was a consensus that the documentation provided by the staff provided a rich basis to examine the many issues that had emerged from time to time in Board meetings over the preceding year and a half, in the context of actual performance across a range of Fund-supported programs. Nevertheless, a number of topics had not been given their full due, because of the amount of ground that had to be covered. As would be expected, given the nature and range of the subjects at hand, views on some issues were wide ranging.

1. General Issues

On the overall adjustment record, Directors noted that performance under the programs covered in the current review represented an improvement when compared with those of the early 1980s, but there clearly was a need to continue improving on that record. There was a strong link between the successful implementation of programmed fiscal and credit policies and the achievement of the balance of payments, inflation, and growth objectives of the programs. Nevertheless, the relationship was far from perfect, and there was a need for further improvements in understanding the relationships between fiscal, monetary, and exchange rate policies and macroeconomic objectives, as well as the effects of other policies--particularly in the structural area--on the efficacy of macroeconomic policies. Policy packages should be balanced, and weakness of implementation in one area could not be compensated or offset by greater stringency in other areas.

Directors stressed the importance of a favorable external environment and terms of trade for the success of programs. Directors were also reminded of the importance of ensuring adequate financial support when the adjustment process was beginning, as well as of ongoing financial support, to enable countries to realize fully the potential gains from macroeconomic and structural reforms.

A number of Directors referred to the problems that had been encountered in high-inflation cases, both in financial programming and in policy implementation. They emphasized that in cases in which inflation was to be reduced to still comparatively high levels, and in which the prospects for success were especially uncertain, prior action that would give greater confidence that inflation would be reduced would need to be sought.

Directors emphasized the key role played by fiscal policy. There was a need for close monitoring of fiscal developments, to include as required prior actions, use of performance criteria, or detailed discussion of fiscal issues in reviews. In the fiscal area, the effectiveness of Fund technical assistance could be improved by--for example--relating it more closely to program needs, and by closer monitoring of implementation of technical assistance recommendations. Consideration should also be given to enhancing the role of the IMF Institute in improving the administrative capacity of countries, including through closer coordination with learning institutions in member countries.

While recognizing that fiscal slippages have generally occurred for policy rather than technical or organizational reasons, Directors stressed the importance of an adequate public expenditure management system as a precondition for lasting fiscal adjustment. Noting the practical difficulties of specifying and monitoring quantitative benchmarks in this area, they endorsed the present emphasis on prior actions and periodic reviews to assess progress made. At the same time, a few speakers stressed that the need for improvements in expenditure management should be addressed through technical assistance, and should not become a part of Fund conditionality.

Directors emphasized that exchange rate policies needed to be supported by sound fiscal and monetary policies. There was also general agreement that when the exchange rate was seriously out of line, a move in the rate to its appropriate level should be ensured early in the program. A number of Directors strongly underscored the advantages of fixing the exchange rate vis-à-vis a low-inflation currency and noted the difficulties in containing inflation under more flexible exchange rate regimes and, in particular, under those regimes that targeted the real effective exchange rate, even in those cases in which fiscal targets had been met. Other Directors stressed that the appropriateness of exchange rate arrangements should be judged in the context of the policies and objectives of the program as a whole, including not only the inflation objective, but also the growth and balance of payments objectives. In many circumstances, a trade-off was seen under different exchange rate regimes in achieving various macroeconomic objectives, at least in the short run.

On interest rate policies and financial sector reform, Directors stressed that it was important to establish appropriate interest rate levels as early as possible in the program period, in order to mobilize financial saving and to ensure that such savings were channeled efficiently. There was an issue of how to achieve positive rates, which could be judged only given the public's expectations about inflation. Measures that would lead to a major improvement in expectations at the start of a program could obviate the need for a sharp increase in nominal rates. It was also important that conditions in the financial system be appropriate for the effective implementation of indirect monetary policy instruments. Technical assistance could also play an important role in identifying and promoting the necessary institutional changes. Finally, a more comprehensive presentation in staff reports of the details and timing of financial system reforms and the specific objectives of measures taken was needed. Progress in that area should be monitored in the context of program reviews.

Directors noted the increased importance attached to promoting private capital inflows, including through policies aimed at reversing capital flight. Measures geared toward macroeconomic stability and confidence building, including the establishment of appropriate interest and exchange rate arrangements, were seen as crucial.

Directors expressed a range of views on future approaches to the evaluation of program experience and future reviews of conditionality. Some speakers supported the cross-sectional analysis of the experience in Fund-supported programs, while some others stressed the usefulness of studying a more limited number of cases. A few speakers recommended that future reviews focus specifically on the progress made by countries under Fund-supported programs in moving toward medium-term viability. Directors noted that steps were being considered by the staff and management to improve the Fund's capabilities in evaluating its policy advice, assessing countries' experiences with particular policies, and tracking the approaches that countries had taken and problems that had been encountered. The possibility of establishing an evaluation unit, including options with respect to its mandate procedures, and reporting requirements, would be considered later in 1991.

2. Operational Issues Related to the Use of Fund Resources

With respect to first credit tranche conditionality, some Directors were of the view that it was difficult to distinguish between first and upper credit tranche conditionality, and how the principle of a liberal attitude toward requests for transactions in the first credit tranche was being applied. Those Directors observed that the first credit tranche could play a greater role in supporting members' adjustment efforts before economic problems became more difficult. Most Directors, however, stressed that in assessing requests for first credit tranche transactions, the Fund must satisfy itself that there were--as in all cases of the use of Fund resources--adequate safeguards for the temporary use of Fund resources. Therefore, they agreed that the policy content of "reasonable efforts" had to be assessed in the light of the size and pace of adjustment that would be regarded as sufficient to establish those safeguards. In light of the experience of members in the 1980s, most Directors were of the view that the Fund's conditionality on the use of its resources in the first credit tranche was broadly appropriate.

While noting that first credit tranche transactions had not so far put the Fund's resources at undue risk, most Directors expressed concern that the provisions for the "floating" of the extended Fund facility and compensatory and contingency financing facility (CCFF) might give rise to the possibility of a request for a first credit tranche purchase when Fund exposure was already relatively high. It was agreed that those provisions should be reconsidered in the context of the upcoming general review of access policy. Most Directors also agreed that quarterly targets for main financial variables should be included as a standard element of first credit tranche programs in the future.

Directors agreed that there was no need for major changes in the provisions of the extended Fund facility (EFF) at present. They believed that it would be useful to retain flexibility regarding the circumstances in which a lengthening of an arrangement beyond the initial three-year period would be considered to be appropriate. In cases in which the prospective additional Fund financial involvement would clearly be more than one year, they agreed that a new Fund arrangement would be the preferred approach.

Most Directors believed that experience to date with contingency provisions in Fund arrangements outside the CCFF had been encouraging. Directors agreed that, for the present, contingency provisions should continue to be formulated on an individual country basis, but with close attention to the general policies of the Fund and to the need to avoid undue complications of program formulation and monitoring procedures. A few Directors suggested that the possibility of incorporating contingencies exclusively in the context of arrangements be explored. Directors requested that those issues be revisited at the next review of the CCFF.

With respect to prolonged use of Fund resources, Directors noted that the number of prolonged users had remained largely unchanged since the last comprehensive review of the subject in early 1986. However, it was observed that access policy had succeeded in reducing the average outstanding use of Fund resources--including structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF) resources--by members identified earlier as prolonged users. Directors generally agreed that it would not be appropriate at present to introduce rigid rules on access based on various indicators of prolonged use. Nevertheless, they noted that under the 1983 access guidelines, access for prolonged users should continue to be guided by the need to reduce their outstanding use of Fund resources over time in the context of growth-oriented adjustment programs and the strengthening of balance of payments viability over the medium term.

Directors observed that such an approach would serve to protect the revolving character of the Fund's general resources and help ensure the timely repayment of SAF and ESAF resources. At the same time, they noted that this approach might affect how other official creditors operate, and the sharing of members' financing needs over time with other creditors, including private creditors. In that connection, a few Directors called upon the staff to look into ways of meeting the concerns of other creditors involved with prolonged users of Fund resources that would not entail the commitment of additional Fund resources--such as through Fund-monitored programs without financing.

While it was agreed that an arbitrary definition of prolonged use for operational purposes should be avoided, in cases in which it was generally accepted that the member had made prolonged use of Fund resources, further Fund support would be considered on a case-by-case basis, in light of a comprehensive review of past programs, as well as an assessment of the factors behind past program slippages. Those assessments would be included in staff papers on requests for Fund arrangements. Directors also agreed that in cases in which progress toward external viability had been slow, continued Fund financing might require strong policy justification, including a front-loading of policy measures, and would need to take clear account of the prospects for external viability.

The Executive Board agreed that the guidelines on conditionality continued to provide an appropriate basis for Fund policies on the use of its resources.

Mr. Finaish commented that he had requested a review of first credit tranche conditionality because some of his authorities had raised questions about the liberality that was supposed to be attached to access in that tranche. He did not disagree with what the staff had said in the paper on the first credit tranche and its use, but perhaps there was a broader range of situations to which the first credit tranche could be applied. Of course, when the balance of payments need was relatively small and the need for adjustment commensurately small, there was clear justification for access to the first credit tranche, and of course, the Fund should be conscious of the need for balance of payments viability and repayment capacity. However, practical experience had shown that countries that met all those requirements, that had the intention of making structural reforms--if they had not already done so--but that did not have an economic system that could be called a free market one, were denied access to the first credit tranche on the grounds that the system had distortions. They were advised to pursue other types of Fund involvement that were seen as more useful in their cases.

An overconcern about distortions, even though a legitimate concern for the Fund, should not stand in the way of access to the first credit tranche in such cases, Mr. Finaish concluded. Use of the first credit tranche as a means of encouraging countries to take the first step in the right direction should not be excluded.

The Executive Board agreed to consider a proposed decision on a lapse of time basis. 1/

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/91/97 (7/22/91) and EBM/91/98 (7/22/91).

2. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/91/186 (7/18/91) is approved.

APPROVED: January 15, 1992

LEO VAN HOUTVEN
Secretary

1/ The decision was adopted on July 31, 1991 (EBS/91/101, Sup. 2, 7/29/91) and was recorded in EBM/91/106 (8/1/91).