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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/134

3:00 p.m., September 27, 1991

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

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
G. K. Arora	L. E. N. Fernando
	Chen M., Temporary
	Duan J., Temporary
C. S. Clark	C. M. Towe, Temporary
	Q. M. Krosby
	J. Prader
E. A. Evans	
	N. Kyriazidis
M. Finaish	A. F. Mohammed
M. Fogelholm	I. Fridriksson
H. Fukui	
B. Goos	B. Esdar
J. E. Ismael	T. Sirivedhin
	J. C. Jaramillo
	F. A. Quirós, Temporary
	I. Martel
	P. Bonzom, Temporary
A. Mirakhor	
	L. J. Mwananshiku
D. Peretz	P. Wright
G. A. Posthumus	Z. Trbojevic
	Y.-M. T. Koissy
A. Torres	R. Marino
	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant

Also Present

IBRD: G. B. Lamb, Policy and Review Department. African Department: P. S. Heller, R. C. Williams. Central Asia Department: O. J. Evans, J. Schulz. European Department: A. Chopra, A. K. Lahiri. Exchange and Trade Relations Department: J. T. Boorman, Director; J. Ferrán, Deputy Director; T. Leddy, Deputy Director; M. E. Edo, M. A. El-Erian, M. Fisher, A. Jansen, G. G. Johnson, S. Kanesa-Thasan, G. R. Kincaid, M. G. Kuhn, K. H. Lee, A. Leipold, P. Mylonas, R. M. Schramm, P. J. P. Szymczak, P. R. Wade, J.-Y. Wang. External Relations Department: S. J. Anjaria, Director; V. R. Khanna, S. Nawaz. Fiscal Affairs Department: V. Tanzi, Director; K.-Y. Chu, R. Hemming, D. P. Hewitt, K. Nashashibi. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; P. L. Francotte, A. O. Liuksila. Middle Eastern Department: S. H. Hitti. Research Department: R. D. Haas. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary; A. Tahari. Statistics Department: B. Ozer. Treasurer's Department: D. Gupta, S. M. Thakur. Western Hemisphere Department: S. T. Beza, Counsellor and Director; E. S. Kreis. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. A. Ahmed, L. D. Dicks-Mireaux, M. B. Chatah, B. R. Fuleihan, M. J. Mojarrad, M. Nakagawa, A. Raza, B. A. Sarr, N. Toé, S. von Stenglin. Assistants to Executive Directors: T. S. Allouba, J. A. Costa, T. P. Enger, N. A. Espenilla, Jr., H. Golriz, S. Gurumurthi, E. H. Pedersen, M. E. Hansen, K. M. Heinonen, O. A. Himani, K. Ishikura, J. Jamnik, J. Jonas, P. Kapetanovic, W. Laux, F. Moss, M. Mrakovcic, J. K. Orleans-Lindsay, R. Powell, S. Rouai, A. Schubert, S. Shimizu, N. Sulaiman, Tin Win, C. M. Towe, J. C. Westerweel.

1. MANAGEMENT OF DEBT SITUATION

The Executive Directors continued from the previous meeting (EBM/91/133, 9/27/91) their consideration of a staff paper on management of the debt situation (EBS/91/154, 9/10/91; and Cor. 1, 9/18/91). They also had before them a background paper on private capital market financing for developing countries (SM/91/193, 9/16/91).

Mr. Arora said that, while he could agree with Mr. Wright that the debt strategy had succeeded very well in the past but that there were some concerns about the future, his own views came from a different perspective, and he would draw some additional conclusions. There were, of course, some very positive features about the present situation. For example, there had been a number of successful negotiations, some countries had acquired access to financial markets, and, more important--as Mr. Evans had pointed out in his statement--nearly 70 countries had embarked on adjustment programs. Moreover, the Fund and the World Bank had played a very important role in managing the debt strategy. At the same time, however, the debt crisis was continuing and might have even intensified, as both Mr. Evans and Mr. Prader had noted in their statements. Mr. Evans had also suggested correctly that important issues would arise if the difficulties in the U.S.S.R. and some Eastern European countries were to intensify. Another interesting point was that the commercial banks were disengaging from lending to developing countries; there seemed to be a feeling among the banks that there was no longer a debt crisis.

Looked at from another point of view, Mr. Arora continued, the growth in the number of countries that faced debt-servicing difficulties continued to be a cause for concern, and the external environment, which was the third pillar of the debt strategy, was becoming worrying. Clearly, there were a number of problems with the debt strategy that had to be solved. In addition, there was the issue, which Mr. Prader had raised, of market failure, which influenced the environment in which developing countries operated. In that regard, he would emphasize only that the countries that were beginning to understand the policy changes that were required, and which were gaining the ability to implement them, were not being perceived by the capital markets as taking appropriate measures. As a result, those countries were not being helped.

As to the future, Mr. Arora remarked, no one could feel satisfied that some marginal changes in the debt strategy would lead to the desired outcome. The issue of debt reduction, particularly official debt reduction, had been raised by many speakers. The recent actions by the Paris Club in relation to Poland and Egypt might point the way, although those two cases had been described as exceptional and were not likely to be adopted as a general model. Nevertheless, Mrs. Martel had stated that the Paris Club was considering further measures beyond the Toronto Terms that were already being applied. At the same time, however, Mr. Fukui had said that debt reduction would make the question of new money problematic, a view that would have to be taken seriously by all participants in the strategy, coming as it did from a capital surplus country. If that were the case, however, the only way for many countries to service their debt would be to go on rescheduling and to look for more official financing to facilitate adjustment and growth.

There was considerable doubt about whether it was wise or realistic to assume that more official financing would be available to help countries adjust, Mr. Arora considered. For that reason, it was important that the Fund contribute to the adjustment process with as much vigor as the debtor countries themselves, which might require additional liquidity under official or international auspices. Mr. Prader's constructive proposal about an allocation of SDRs was worth considering, particularly if official financing was not available and if commercial lenders continued to withdraw. Such a proposal could be implemented in practice, because it ensured not only that the developing countries would continue to make adjustments in their policies but also that they would be helped in their effort by international assistance.

Some of the suggestions made by speakers about the Fund's role in offering advice regarding debt reduction to both official and private lenders deserved further consideration, Mr. Arora stated. Mr. Dawson had said that offering advice to commercial banks on the amount of debt reduction might jeopardize the role of the Fund. He himself was not so sure that that was the case, however, because if the Fund had not decided to help countries solve their debt problems in the early 1980s, governments and commercial creditors would have had to deal with the problems themselves. One could only speculate about what would have happened in that event, however, as the Fund had, indeed, committed resources to solving the problems. Moreover, the Fund had learned that there was a point beyond which countries could no longer adjust and, at the same time, service their debt--in other words, allowance had to be made for adjustment fatigue. Beyond that point, the result would only be lower growth, with lower levels of investment and consumption, which would further reduce a country's capacity to service its debt in the future. In that context, the Fund surely had a role in informing commercial creditors of the amount of debt reduction that was consistent with external viability and the adjustment path being followed by a country; doing so would also offer an opportunity to point out to the commercial banks that, in the absence of a certain amount of debt reduction, the country would have no prospect of attaining medium-term viability and that the servicing of its commercial debt would be at risk. The suggestion that the Fund should not advise commercial creditors on such matters did not take into account the fact that the Fund already advised the Paris Club, and there was no reason why there should be a distinction between official and private creditors. As Mrs. Martel had said, the Fund should be worried about the comparable treatment of debt; accordingly, if the Fund could advise official lenders, it should be able to advise private lenders as well.

Another suggestion, which had been supported by several speakers, was that the Fund should share information with commercial lenders so that they could be in a better position to view a country's capacity to service its debt and its prospects for external viability, Mr. Arora recalled. That suggestion was, however, somewhat difficult to understand, because the markets were supposed to be omniscient in relation to economic developments. There was a danger that information--and it was not entirely clear what kind information would be needed--obtained from the Fund could be used to twist the arm of debtor countries, especially as the Fund was not seen as a viable intermediary by the markets, as was reflected by the fact that, despite all of the Fund's efforts and those of the developing countries, commercial lending had not increased, which had been the original objective of the debt strategy. Therefore, there was a danger that the developing countries could be exposed to undue risk if the proposal to share information with commercial lenders was accepted. He suggested that Directors consider the matter carefully before making it Fund policy, because the behavior of commercial banks had not been such as to inspire the confidence of the developing countries or the indebted countries.

The debt strategy had reached a critical point, Mr. Arora commented, and the role of the Fund must not be diluted. The modified financing assurances policy should be continued and should be implemented with a degree of flexibility. In that context, he agreed that the strength of an adjustment program was very important, but to make approval of even a strong program contingent on certain financing assurances--or to make use of the technique of approval in principle--could risk serious economic disorder in developing countries. While the developing countries as a group did not account for a major share of world output--and, consequently, disorder in those countries might not mean a great deal for the world economy--the preservation of economic and social order must remain high on the Fund's agenda if it was to contribute to the furtherance of international cooperation. Therefore, notwithstanding the limitations of the debt strategy, he would strongly urge that the Fund continue to support the strategy and that its role not be diluted.

Mr. Fukui remarked that, as he had already stated, the legal situation in Japan did not allow the Government to make a straightforward contribution to official debt reduction, but that did not mean that the Government would not look favorably on the provision of new money to debtor countries to ease their official debt problems.

Mr. Chen made the following statement:

> I would like to thank the staff for providing an extremely helpful paper for today's discussion. In addition, information contained in the world economic outlook papers on this issue is also useful in assessing recent developments on debt reduction strategies in a general global setting. Experience with the strengthened debt strategies since the last review has shown that

a certain degree of progress has been made, as evidenced by a slight decline in total external liabilities. Recent encouraging developments have been marked by the concerted efforts of official bilateral financing on the part of Paris Club creditors to adapt their policies in response to the protracted difficulties of the heavily indebted low-income countries, with an increasing number of countries obtaining debt rescheduling. Nonetheless, notwithstanding these positive signs, the pace of progress is far from satisfactory, and the overall debt burden of the developing countries continues to be the major concern of the international community.

The general economic situation in most heavily indebted countries has not shown significant improvement. This situation could deteriorate further as a the legacy of the debt crisis, which continues to exert severe pressures on the developing countries' ability to attract new flows of foreign capital. Uncertainties about the external economic environment also affect the outlook for the developing countries. The projected rise in external debt in 1992 could pose a greater challenge for the progress of the debt strategy.

We are still disappointed by the slow process of negotiations between debtor countries and commercial banks on debt reduction packages. The reluctance of banks to participate in financing packages, owing to reasons stated in the staff paper, has contributed importantly to delays in the adoption of adjustment programs and, to some extent, has added pressure on further financing support from official sources. The progress and effects of the strengthened debt strategy thus far are still very limited and may be severely interrupted, particularly in view of the restrained level of global savings that faces the world economy today. Under these circumstances, completion of Fund-supported programs in the context of the debt strategy could be very difficult.

I am in general agreement with the staff's analysis of recent developments, and I will therefore make just a few brief comments on some of the points in the staff paper. The objectives of the debt strategy, as pointed out by the staff, remain a revival of access to spontaneous official and private flows to debtor countries, and a return to satisfactory economic growth--and these are, in turn, key elements for achieving and maintaining external viability.

While it is accepted universally that improved economic policies in debtor countries are of fundamental importance in securing these objectives, a source of serious concern remains that a considerable number of debtor countries, even those with strong adjustment policies, are still facing increasing difficulties in working their way out of their debt problems. A further buildup of debt has made it more difficult for many indebted countries to implement adjustment programs, which, in turn, reduces their chances of external viability and normal access to capital market financing. Therefore, we wish to stress again the importance of a continuation of more far-reaching restructuring of official debt and of consideration of a case-by-case approach in cases for which flexibility is needed.

The increasing difficulties faced by many indebted countries in gaining normal access to credit markets point to the vital importance that official creditors continue to show greater flexibility in providing support through rescheduling existing debt and through direct bilateral loans and grants and guaranteed export credits. For many heavily indebted lower-income countries, more fundamental restructuring will be needed to achieve medium-term viability in addition to addressing immediate cash-flow problems.

In this connection, official bilateral financing will be indispensable, in that it could bring about an improvement in market access for developing countries and a restoration of viability and sustained growth. For those countries with large stocks of commercial bank loans, official creditors' timely financial support could play a more important catalytic role in promoting the smooth progress of negotiations between the debtor countries and commercial banks. It is encouraging that Paris Club creditors have recently added new initiatives to the debt strategy, and other official creditors have responded in an active manner.

It is our strong belief that the progress achieved thus far should be consolidated in order to promote, in the future, an even distribution among as many debtor countries as possible. In this connection, the continuation of concerted efforts on the part of official creditors will certainly provide assurance for this purpose.

Finally, a few words on the role of the Fund in the debt strategy. We continue to support the increasing involvement of the Fund in the process of debt relief for the indebted developing countries. Under present circumstances, it is clearly important that the Fund should continue to strengthen its catalytic role by adapting its policies in an innovative manner. In this regard, we welcome the new elements emphasized by the Fund in monitoring performance and assessing viability. In addition, consideration of the use of the contingency clause is an encouraging development in the context of implementation of the debt strategy. We hope that this contingent element could be developed in a way consistent with the objective of medium-term viability and that it could contribute to the alleviation of pressures on the heavily indebted developing countries implementing adjustment programs.

Mr. Finaish made the following statement:

The main staff paper before us updates the operational experience in implementing the debt strategy since our last review of the subject in April 1991, and it reviews the role of the various participants and the Fund's involvement in the debt strategy. While there have been a few noteworthy developments in the past few months, as several debtor countries reached agreement with commercial and official creditors, no major factors have emerged to warrant a modification of the Fund's role in the management of the debt strategy. The staff, therefore, concludes that developments since our last review confirm that the Fund's role remains appropriate and no modifications are suggested. The staff paper does, however, raise a few interesting issues, which I would like to address.

Of the few developments in the past few months, the Paris Club restructuring of the debts of Poland and Egypt are particularly noteworthy. In both agreements, creditors addressed the issue of viability in a comprehensive sense in the context of a feasible adjustment program. The staff has provided a very useful description of the two agreements. I also agree fully with the argument that the debt reduction in these agreements reinforces the strategy of debt subordination and should not raise doubts as to the prudence of new lending in the framework of a credible adjustment program.

As far as the low-income countries are concerned, there is almost universal recognition that the debt relief offered thus far is not sufficient. It is our hope that the proposals that are currently being considered for these countries can be agreed upon promptly.

Perhaps what I found most interesting in the paper is the treatment of the issue of viability. As the staff correctly points out, the fundamental importance of improved economic policies in debtor countries in achieving and maintaining external viability is universally accepted. While the significance of fiscal means to service domestic and external debt was always understood, the staff now appears to be emphasizing the financial credibility of the government vis-à-vis both resident and non-resident providers of financial resources. The staff observes that viability is not exclusively a balance of payments matter and that it cannot be conceived narrowly in terms of eliminating the need for exceptional balance of payments support. Indeed, it goes further by connecting viability "to the entire range of economic and financial relations, involving assessment of sustainable levels of growth and feasible paths of adjustment." I, for one, would find it difficult to take issue with this notion.

At the same time, the staff also emphasizes that the conditions for attaining viability are connected to intangibles of confidence, and it suggests reliance on market indicators, such as secondary market prices for bank claims, yields on bond issues, spreads on short-term commercial bank trade or interbank credits, and domestic real interest rates. It is worth noting, however, that the involvement of multilateral institutions with countries with debt problems is aimed at improving confidence and, thereby, reviving access to spontaneous financial flows to these countries. The rationale for the intervention of multilateral institutions is the existence of market failure in the area of sovereign debt. Action by these institutions is aimed at correcting the condition of market failure, and it will inevitably have to occur when a country's viability is not seen as assured by participants and when market signals are not necessarily positive.

An important issue that has emerged, which is mentioned in the staff paper, is the comparability of treatment between official and commercial bank creditors in cases of debtor countries that owe large sums to both. While official creditors, both bilaterally and through the Paris Club, are moving to more imaginative solutions, the banks are evidently in a mood of withdrawal, owing in large part to factors unconnected to the situation of the debtors. In several cases, as suggested by the footnote on page 9 of the staff paper, the banks evidently want to take advantage of improvements in the secondary market price of bank claims in the wake of assistance provided by official bilateral creditors and the international financial institutions.

This reluctance on the part of the banks creates a situation in which official lenders and international financial institutions, including the Fund, are being called upon to bear an increased financing burden and the attendant risks. It is to be hoped that issues of comparability of treatment in these cases will not further complicate an already complex set of constraints on the resolution of the debt problem. However, as far as the Fund is concerned, the application of the modified financing assurances policy becomes even more essential in such cases. In the absence of progress in a number of unresolved cases between banks and debtor countries, however, it would appear inevitable that the Fund's involvement in these cases would continue to stretch the financing assurances policy.

The retrenchment of bank financing poses a fundamental problem that must be addressed: the increasing shift of the burden of the debt problem to official creditors. The reluctance of banks to make loans to developing countries is due to a large extent to the problems many of them are facing with nonperforming domestic, as well as foreign, loans and a financial environment that is fragile in many industrial countries. They have also been constrained by their efforts to adhere to more stringent regulatory standards. In response to the question posed by the staff in this regard, it would appear essential to allow scope for more flexibility with mandatory provisioning requirements in favor of countries that have restructured and whose implementation of sound economic policies has led to improvements in their prospects.

The Fund may have a useful role to play in encouraging bank involvement by sharing economic assessments of countries with the aim of facilitating accurate risk assessments by financial market participants. This role may be particularly useful in cases of countries that have not restructured but who are nevertheless experiencing difficulties in obtaining financing from international markets owing to inaccurate market perceptions of their prospects. At the same time, there is a risk that requests for Fund assessments may become a standard condition for extending loans to developing countries, and modalities would have to be found to balance these considerations.

Mr. Mirakhor considered that commercial creditors should pay special attention to the plight of countries that had avoided debt restructuring but that continued to face difficult problems; otherwise, those countries would be forced to try to restructure their debt.

The Deputy Director of the Exchange and Trade Relations Department remarked that the staff paper had, perhaps, not been clear enough on the issue of the provision of information to market participants. In program cases, particularly those that involved concerted financing and negotiations with banks, there was already ample scope for the provision of information to the banks. In many of those cases, there were explicit links between progress under a Fund-supported program and the provision of bank financing or continued participation in debt reduction agreements. In the staff paper, the staff had tried to address a certain problem faced by countries that had not gone through a debt restructuring and that might or might not have in place a Fund-supported program; that problem was abrupt changes in bank sentiment about a country, which might not be consistent with the staff's assessment of developments in that country. The paper had attempted to investigate whether there was a way that the Fund could be helpful, with the consent of the country, in providing information that would help to solidify the financial situation. Clearly, there were risks involved and arguments could be made against such a role, and he understood the points that Mr. Arora had raised; indeed, the issue had been discussed on a number of occasions in the past. There was no desire on the part of the staff for the Fund to become a rating agency, and, in any event, there were obvious questions about whether an effort on the Fund's part could turn market sentiment around, even if that sentiment was not rooted in fundamentals. Nevertheless, the problem had been observed in a number of cases recently, and, while the staff did not have a specific proposal, it would like to continue to consider whether there were some additional steps that the Fund could take in certain situations.

A number of Directors had commented on the passage on page 10 of the staff paper that described possible reasons for the delays in concluding bank financing packages, the Deputy Director recalled. One of the factors contributing to the delays might be that the banks recognized an opportunity to capitalize on an increase in secondary market prices as countries' situations improved. Accordingly, they were not particularly interested in rushing into agreements at present. The paper also stated that when a country had a sound program and was embarking on a fundamental adjustment effort, it was important that the Fund and the official community continue to provide support. In such cases, there could be an implicit--or even an explicit--shift of financial burdens and risks to the official community. Indeed, the data on external debt for the restructuring countries over the previous six or seven years showed that, while it had not been overpowering, there had been a shift in the share of financing between the banks and the official sector, particularly the multilateral institutions. In one sense, however, the data masked the degree of the shift, because they did not take into account official transfers, which had been very large in the previous four or five years. Against that background, it was clear that the banking sector had undoubtedly withdrawn from lending, which was not readily discernable from the debt statistics. To some extent, there had been a compensating increase in private financing through nonbank channels, only some of which was picked up in the debt statistics, which was largely non-debt creating. In looking at the aims of the debt strategy, it was clear that it was not intended to place the banks back into a position where they could return to financing development in developing countries. On the contrary, it was to be hoped that, over time, nonbank private financing would take over a much larger share of that financing, which would have to be rooted in sound programs in the borrowing countries.

The staff agreed wholeheartedly with Mr. Wright that the Fund should not rush in with programs simply in the hope of stimulating an agreement with banks or, indeed, financing an agreement with banks, the Deputy Director remarked. In order for the Fund to continue to provide support to countries under the modified financing assurances policy, there would have to be strong programs in those countries, which would also have to offer the promise of a restoration of external viability, assuming that the remaining financing materialized. Mr. Fukui had asked whether the Fund and the official sector, by showing their readiness to proceed in the absence of a bank agreement, provided incentives for the banks to stand back and wait for the situation to improve so they could capitalize on it. That situation was, indeed, a potential problem. It was, perhaps, most evident in the Polish case, where, almost overnight, there had been a very significant increase in secondary market prices, which was a complicating factor that the Paris Club would have to grapple with in coming to a judgment on the comparability of treatment of external debt.

The staff tried to work with countries to devise instruments and packages that would attract the banks and hasten agreements on bank financing packages, the Deputy Director said. The approach was a market-based one, however, and it was not possible to command the participation of the private sector, which was not the staff's intention in any event. The provision of official financing would clearly encourage the banks to reach a quick agreement, but the staff was not entertaining such a proposition. Mr. Fukui had asked whether support by the official community might create disincentives on the part of the debtor to reach an early agreement. In practice, however, that had not been the case. Official support was conditional on performance under a Fund-supported program, and both the staff and the Board paid close attention to continued efforts by debtor countries to come to an agreement with the banks, a point that the countries themselves were well aware of. Furthermore, as a practical matter, the countries themselves were quite eager to come to an agreement with the banks; indeed, he had not discerned any reluctance on their part to try to work toward an agreement with the banks. Nevertheless, those countries wanted to work toward an agreement that in the end was both reasonable and compatible with medium-term viability.

In response to Mrs. Martel's question, the staff had not yet given up on its efforts to persuade the Board of the benefits of introducing more fungibility in the use of Fund resources, the Deputy Director stated. In recent discussions, the Board had signaled its readiness to exercise some flexibility on the issue of fungibility when it was merited, and the staff would not hesitate to bring such cases to the Board should they arise. On a closely related issue, Mr. Evans had alluded to the fact that there were instruments that, even if fungibility was exercised, could not be covered under the guidelines for the augmentation of resources. In its paper, the staff had characterized that situation as an empty cell in the matrix of instruments that were eligible for Fund support, and the staff would like to come back to the Board on that issue in the not too distant future.

With respect to the banks' retrenchment in lending to developing countries, the Deputy Director commented, the banks were responding in part to balance-sheet considerations, which were themselves driven largely by domestic developments. The staff did not consider the regulatory provisions on provisioning a significant factor in the retrenchment, although the staff had raised the issue in other contexts. The question that the staff had tried to raise in the paper was whether, at least in some countries, greater flexibility in relaxing the regulations as a debtor country progressed under a program would be helpful in restoring access to the capital markets. A number of countries already had regulatory provisions that would permit a resumption of lending without requiring provisioning, as long as the country was under a Fund-supported or other internationally supported program. While he would not overemphasize its potential importance, he would agree that the level of provisioning was not being determined by domestic regulations or the banks' positions. Moreover, there was, as Mr. Posthumus had pointed out, a fairly selective group of Asian countries in which banks were continuing to build up their exposure.

The question that Mr. Posthumus had raised about the treatment of countries that were in the process of disintegration was an interesting one, the Deputy Director observed. The staff would look into earlier cases to see whether there were any lessons for the future.

The Fund had not offered any advice on debt reduction in commercial bank restructuring cases, the Deputy Director said, although it continued to be involved in cases handled under the auspices of the Paris Club. In the context of bank restructuring agreements, the staff had merely specified the basic financial parameters of the program and the cash-flow requirements. The amount of debt reduction that resulted from those agreements had been negotiated by the parties themselves and had not stemmed from a pronouncement by the staff. In the Paris Club, the staff had been asked to provide scenarios on the implications of particular amounts of debt reduction for the medium-term outlook. As a mechanical exercise, it was possible to take a medium-term scenario and factor into it a certain debt reduction and repayment stream, thus generating an estimate of the effects on the balance of payments. To go beyond that level of analysis, however, was a much more difficult proposition.

While he, unlike Mr. Prader, did not consider that there was no value in further research into the relationships between debt reduction and other variables, it was clear that trying to assess the potential effects of debt reduction on a country's performance over the medium term--in order to arrive at an estimate for the needed amount of debt reduction--was beyond the staff's capability at present, the Deputy Director remarked. Nevertheless, the staff's research would continue, and there would be cases in the near future for which the staff would be asked to prepare debt reduction scenarios. In doing so, however, the staff would make clear its underlying assumptions and would maintain a degree of humility about the validity of the exercise.

The staff would continue to monitor actions by non-Paris Club creditors, the Deputy Director said. It was interesting to note that, while information was not yet systematically available, the actions of those creditors had, by and large, surpassed those of the Paris Club.

The World Bank did, indeed, provide technical assistance on debt management, the Deputy Director stated. The World Bank maintained a financial advisory service and provided technical assistance out of its finance complex, as it had a great deal of experience in financial management techniques. The Fund did not offer technical assistance per se, but it frequently provided advice in the context of program and consultation discussions with member authorities.

With respect to the nonrestructuring countries that were relatively heavily indebted to official creditors, the Deputy Director commented, Colombia and Indonesia, which Mr. Ismael had mentioned in his statement, had quite different debt profiles. The common characteristic of those two countries, however, was that they had avoided the rescheduling and debt reduction trap despite some difficulties. The staff would look into the various techniques and instruments that were under consideration in the official sector, which might be used in a concerted approach to debt reduction for those countries.

Finally, he had found nothing in Mr. Evans's statement that he would disagree with, the Deputy Director of the Exchange and Trade Relations Department considered. Indeed, his statement was an interesting look at the increasing number of countries facing debt-servicing difficulties that had programs with the Fund, which was in itself an encouraging development.

The Acting Chairman made the following summing up:

In reviewing recent developments in the debt strategy, Executive Directors were generally of the view that the basic elements needed to resolve the debt problems of all heavily indebted countries are in place or are moving more clearly into view. They welcomed the progress made by some heavily indebted countries in carrying out sound adjustment programs, restructuring their indebtedness, and gradually regaining access to spontaneous capital flows. They were also encouraged by the further progress being made on approaches to debt restructuring, particularly with respect to official bilateral claims. Nevertheless, a number of developing countries continued to face very difficult debt situations, the resolution of which will require determination and perseverance by all the parties involved. The gradual withdrawal of commercial sources of financing from the debt strategy was noted with some concern. Official creditors and the Fund were now shouldering a greater share of the financing burden, and Directors stressed that it was critical to foster a favorable climate for private flows.

A main objective of the debt strategy is the restoration of access to spontaneous private and official flows for debtor countries, in the context of satisfactory economic growth and financial stability, which are key aspects of external viability. In commenting on the contributions of the various parties to the achievement of these objectives, Directors stressed the continued central importance of the debtor countries sustaining their implementation of sound macroeconomic and structural reform policies. It was pointed out that a large number of countries that have faced debt-servicing difficulties are now, in fact, engaged in Fund programs, and that this provided a sound basis for overcoming debt problems. At the same time, when existing debt burdens threaten to undermine the process of adjustment, comprehensive debt restructuring on a timely basis has an essential role to play in countries' efforts to regain external viability.

Directors noted that official bilateral creditors have continued to support indebted countries' adjustment programs with both new financing and debt restructuring, and that efforts are under way to strengthen approaches to the latter. They welcomed the Paris Club debt-reduction agreements for Egypt and Poland, which seek to provide a definitive resolution of the debt problems of these countries in the context of sustained performance under programs supported by the Fund. While a few Directors stressed the exceptional nature of these two cases, others noted the need for the continued case-by-case examination by the Paris Club of the debt situation of some lower-middle-income countries. All Directors welcomed the Paris Club's active discussion of more far-reaching debt relief measures for low-income rescheduling countries, and they encouraged the participants to move to implement such measures as a matter of urgency. They also welcomed the debt relief measures adopted to date by a number of non-Paris Club official bilateral creditors, and they urged these creditors to continue to implement actions at least comparable to those adopted by the Paris Club in individual cases. Finally, Directors noted that to the extent that debtors and bilateral creditors may seek Fund staff analysis of the potential contributions or implications of debt reduction to external viability over the medium term, it would be advisable for the staff to indicate--always with the necessary caveats--ranges and broad orders of magnitude, rather than to seek precise estimates for particular debtors. Some Directors considered, however, that the staff should avoid prescriptions of debt reduction, which should continue to be a matter for the parties to the negotiations. Several Directors also noted that contingency and recapture mechanisms might be helpful in dealing with the uncertainties about the amounts of needed debt reduction, and the staff should continue to consider the potential and practicality of such mechanisms.

Turning to commercial bank claims on developing countries, Directors observed that comprehensive debt and debt-service reduction packages, implemented with official financial support, have played an important role in the restoration of some countries' access to spontaneous market financing. In the context of sound economic and financial policies, such packages have contributed to a sharp reduction in risk premia, and have been followed by significant inflows of foreign direct and portfolio investment and by capital repatriation. The relaxation of credit rationing vis-à-vis some countries has been accompanied by a notable improvement in interest rate and maturity terms on new bond issues. A number of Directors also thought that there might be scope for greater flexibility in some creditor countries' provisioning requirements in order to facilitate market re-entry. At the same time, it was recognized that it was important to maintain sound prudential standards. In monitoring performance and assessing progress toward viability, Directors encouraged the staff to place due emphasis on whether private financial flows and confidence were turning around at an early stage, as a key aspect of regaining viability involves restoring the financial credibility of the government vis-à-vis both domestic and foreign investors. In this regard, appropriate reliance on market indicators could be helpful in certain cases.

Directors reaffirmed the role of the international financial institutions in the implementation of the debt strategy and in underpinning the process of indebted countries' return to external viability. In this regard, Directors confirmed the main elements of the guidelines for Fund involvement in the debt strategy. These guidelines, as operated in the context of the restructuring packages devised to date and implemented in close collaboration with the World Bank, have for the most part provided sufficient flexibility in supporting the cost-effective commercial bank debt and debt-service reduction operations in a number of cases. However, some Directors continued to support greater fungibility in the use of set-asides and augmentation in the Fund's support for debt and debt-service reduction operations.

While welcoming the progress in developing the instruments of the debt strategy and in implementing the strategy in individual cases, Directors cautioned that this does not mean that the debt problem has been overcome. A number of developing countries continue to face heavy debt-servicing obligations and severe difficulties in restoring growth and viability. Directors urged debtors and creditors to continue to work together expeditiously toward agreement on financing packages consistent with the cash-flow and medium-term financing requirements of the underlying economic programs. They recognized, however, that the negotiating process between debtors and commercial banks has often been protracted and may continue to be so, in part because, in the present environment, the banks in many cases appear not to consider early agreement to be an urgent matter.

Directors noted that the likelihood of a substantial passage of time between the initiation of negotiations and the conclusion of bank debt restructuring agreements gives rise to a number of problems. These include the continued accumulation of arrears to the banks themselves, with potentially adverse effects; strains on the Fund's policy on financing assurances, which several Directors noted with particular concern; and the resulting shift of financing burdens and attendant risks to the official sector, including the Fund. The Executive Board has discussed these problems in past reviews, and it has considered several specific cases in the most recent past. In such cases, where the debtor country is sustaining its policy efforts and maintaining a cooperative negotiating framework, Directors continued to feel that it was important that the country have sufficient time to reach an agreement with its bank creditors that is consistent with medium-term viability. They stressed, however, that Fund support in these circumstances must be directed to strong programs for which timely Fund support is essential for program implementation and constitutes an important step in the country's progress toward external viability.

Directors emphasized the importance of continued international financial support for countries that have managed to maintain access to spontaneous flows as a result of their sustained pursuit of judicious policies. Official creditors have shown their willingness to maintain support through export credits or concessional financing, although concern was expressed that some well-performing middle-income countries could become increasingly constrained by the burden of official debt servicing. The experience of some of these countries confirms that financial markets may remain very cautious when called upon to provide spontaneous financing and tend to respond quickly to any deterioration in the economic or political situation, which could make it more difficult for these countries to sustain their economic policies. Moreover, it appears that markets may in some cases be slower in recognizing improvements in performance and prospects. Several Directors noted that this, in turn, may undermine the sustainability of the improvements, and they felt that where it was considered useful, and with the approval of the member concerned, the Fund could seek appropriate means whereby financial markets could be made more aware of a country's performance and prospects. In such circumstances, prompt and decisive adjustment measures in debtor countries, supported by appropriate financing, are needed to maintain or restore favorable market perceptions and market access.

In sum, Directors considered that there has been encouraging progress on a number of fronts in the implementation of the debt strategy. Severe debt problems remain, however, for a number of

Fund members, and the resolution of those problems will require the full cooperation and contribution of all participants in the strategy. In this regard, Directors stressed the importance of a favorable external environment, and they gave particular emphasis to the contributions a positive outcome of the Uruguay Round could make to members' efforts to regain external viability.

2. MILITARY EXPENDITURES AND ROLE OF FUND

The Executive Directors considered a staff paper on military expenditures and the role of the Fund (EBS/91/155, 9/10/91).

Mr. Peretz made the following statement:

I very much welcome the initiatives proposed in the staff paper. The Fund is, I believe, well placed to play a modest but important role in international efforts to contain and reduce levels of military spending in the world. Perhaps I can first make a few comments about the wider context before turning to the Fund's special mission. Without getting into the question of whether or not a reduction in military spending is desirable in any one country, I would hope that we could all agree that a worldwide reduction in military spending would be to the benefit of everybody.

The London Economic Summit declaration on conventional arms transfers, which my own authorities, of course, strongly support, included five main points. First, the need for some transparency in arms sales; the main proposal here is for a United Nations register of arms sales. Second, consultation between leading arms exporters on guidelines to be applied on the transfer of conventional weapons. Third, restraint by arms exporters in arms sales to areas of potential conflict. Fourth, the need for moderation in all countries in their levels of military spending. Fifth, concern about the debt buildup in some countries that has been connected with military spending.

As Directors are aware, the declaration also welcomed the attention that the Managing Director and the President of the World Bank have been giving to excessive military spending in the context of reducing unproductive public expenditures around the world. So much for the wider context. Let me turn now to the Fund's particular role, which I see as limited but nonetheless important.

First, I have no difficulty with the concept that public expenditures in this area are a legitimate subject for Fund surveillance. It seems to me a no less legitimate area than the interest the Fund currently shows in the interaction between other areas of public spending and economic growth--for example, agricultural and industrial subsidies, or, on a different plane, the split between capital and current expenditure.

In many countries, military spending is a very significant proportion of public expenditure, and, of course, its economic return is difficult to determine. While the Fund is not in a particularly good position to evaluate the national return from such expenditures, it is clear that they frequently divert resources from other pressing public spending needs and from the rest of the economy. Moreover, as the paper reminds us, such spending has significant negative externalities.

Accordingly, I believe military expenditures are a suitable subject for Fund surveillance. I do not think it is necessarily a suitable area for Fund conditionality; that is a different issue. Nevertheless, there seems to be a strong case for seeking better data to enable the Fund staff to develop a better understanding of the interaction between military spending and economic growth, so that the Fund can give advice to members in the context of surveillance discussions, when appropriate. This seems to me no more or no less appropriate than the kind of advice the Fund already gives to members--which my own authorities certainly always value--on particular areas of public spending, such as subsidies or spending on employment and training measures.

Second, as I have already said, I certainly would not wish to see any extension of conditionality in this area. Conditionality is normally applied at a much higher level of aggregation of key macroeconomic variables. I think that this should remain the case. It would not, I think, be in keeping with the Fund's mandate to set performance criteria to deal with military spending, just as there are never performance criteria in Fund programs relating, for example, to levels of civil service pay or expenditures on environmental matters. It should be for member countries themselves to evaluate the costs and benefits of military spending and to make decisions. Where there is a Fund program, these decisions could, of course, help meet fiscal targets. That is a different matter. I should, perhaps, add that, as the paper notes, some donor countries are taking account of the levels of military spending in their bilateral aid programs. That is a matter for the countries concerned. I would just note that the United Kingdom should be included in the list of donor countries that are, indeed, doing that at the moment.

Third, the Article IV relationship the Fund has with all its members makes the Fund uniquely well placed to collect data in this area. I also welcome the intention to cooperate with other international institutions on data collection, and I hope the staff will be able to use existing national accounts classifications. By using the Article IV process, the Fund will be collecting data from all member countries, industrial and developing countries alike. I welcome this. My own authorities would see no difficulty at all in complying. I should, perhaps, say in passing that I assume the only sanction for noncompliance would be a statement in the staff report for the Article IV consultation that the data had not been provided. I certainly would not press for any sanction greater than that, but perhaps that is something the staff could clarify.

Information, when collected, would provide a basis for improved analysis in the Fund and in member countries themselves. It could, in some circumstances, help to decrease tensions and assist in efforts to reduce military spending on a regional basis. For all these reasons, therefore, I very much support the proposals in the staff paper.

Mr. Mirakhor made the following statement:

From a purely economic standpoint, there is no doubt that military expenditures compete with productive claims on national resources, and, to the extent that such expenditures are reduced and channeled to more productive uses, economic growth can be enhanced. This proposition is equally true for both industrial countries and developing countries. There can be little doubt, therefore, that policies that reduce military expenditures are most welcome. There is also no disagreement with the need for the Fund to stress, as it has done, to all countries the economic importance of reducing military expenditures.

The paper before us envisions for the Fund the role of collecting and analyzing data and persuading members to channel military expenditures to nonmilitary uses. This is an admirable quest, and there can be no disagreement with its spirit.

As noble as the intentions of the paper appear to be, its recommendations, if adopted, may not only have far-reaching implications for member countries but may also, in a fundamental way, change the character of the Fund. Although the paper appears to provide an opportunity for the international community, at long last, to get a handle on the arms race, there are downside risks associated with these recommendations that deserve careful consideration. Military expenditures do have economic consequences, but decisions on these expenditures are not determined by economic considerations alone. In the not too distant past, industrial countries, even when faced with serious budgetary and balance of payments difficulties, continued to increase military expenditures on national security grounds. This is not to suggest that the developing countries should pursue similar activities. What must be recognized, however, is that the new circumstances that are mentioned by the staff as a factor for increased attention by the Fund to military spending have not changed the potential sources of regional conflicts and threats to the territorial integrity of weaker nations. It must be remembered that regional tensions led to increasing military expenditures in the first place, and they continue to be the source of these conflicts, which must be eliminated. Here, the Fund has neither the jurisdiction nor the expertise to do so.

Moreover, existing asymmetries in the military balance of power among countries in various regions, which enhance insecurities, require concerted effort by the community of nations to remove the regional tensions, reduce the imbalances, and begin a process of disarmament and demilitarization. For these reasons, the United Nations appears to be the proper forum for addressing these problems. Possibly, the Fund could be mandated and empowered by the United Nations to address the economic issues raised by the paper before us.

With a decision to take on the additional responsibility of becoming a monitor of military expenditures all over the world, the Fund would face enormous problems in collecting the relevant data. For one thing, even the quantity and the quality of economic and financial data currently collected, which are not as sensitive as the military data from the national security standpoint, differ from one country to another.

How is the uniformity of treatment in the collection of data to be assured? Noncooperation or distortions in data supplied by one member and provision of accurate and detailed data by another could seriously undermine national security interests of the complying country. It would be one thing not to have data on certain economic aggregates, such as international reserves, for some countries, but it is quite another story when the provision of data on military spending and the accuracy of that data varies from one country to another. It is not clear how compliance would be ensured.

In the case of program countries, it would be possible to specify the requirement as a condition. However, this would add yet another constraint to the already formidable list of conditions that the staff paper on the review of the SAF and the ESAF, and the Board discussions on the same subject, indicated have so far limited countries from the use of existing facilities.

On the grounds of national security considerations, many countries' military establishments do not share the detailed breakdown of expenditures and military imports with economic ministry officials, who normally deal with the staff. In such circumstances, how will the information be obtained? Will attempts be made to reach the primary sources of information--that is, the military establishments--or will an institutional change in these countries be urged? Even if one country complies with the requirements and provides data on its military expenditures, are there necessary instruments to ensure that another country having adversarial relationships with the first will not be in a position to undermine the national security of the first country?

What is also unclear is how to account for weapons that have been, and continue to be, stockpiled by some countries in other countries. It is possible that these weapons will not be reported as military expenditures by the host country but used whenever their country deems it necessary. How are regional or bilateral military arrangements to be treated? Will the individual countries involved in those agreements be asked to provide data on military acquisitions resulting from these agreements?

In the context of another dimension of the issues raised by the staff paper, one wonders whether the framers of the Articles of Agreement considered military expenditures to be within the purview of the authority of the Fund, the stated purpose of which is to promote international monetary cooperation among members. In this context, Article VIII, Section 5(b) states that "Members shall be under no obligation to furnish information in such detail that the affairs of the individuals and corporations are disclosed." One can only wonder whether the framers, who were so concerned about the disclosure of information that may harm corporate and individual affairs, would be less sensitive to matters having national security and sovereignty implications. In these circumstances, the question arises whether this Board has jurisdiction and authority to require members to provide information that has the potential to compromise national security.

Incidentally, the staff has stressed the importance of transparency for well-informed public policy choices and for the formulation of macroeconomic policies consistent with economic growth objectives. Internally, at the top levels of decision making, most governments do have access to information on aggregate military expenditures. Provision of this data to the Fund will not add to the information base of the economic decision-making authorities in the country. The transparency of information would, therefore, be meaningful and of value only to the Fund if it were authorized to collect such information. In other words, the term transparency is used in a different sense in the paper than it is normally used in the Fund--in the case of budget transparency, for example.

Finally, this chair is in agreement with the idea that the time has come for the community of nations to take seriously the notion that the world can no longer afford the luxury of the arms race in any form. We also understand the justifiable concerns of the multilateral financial institutions and the official donors that provide concessional financial assistance to countries, which want to have the assurance that the resources they provide are being used efficiently and for the purposes they intended. Nonetheless, we believe it is imperative that the Executive Board reflect very carefully on the issues raised by the staff paper before us, which have serious implications for national security and national sovereignty, and, therefore, may not fall within the purview of the powers delegated to the Fund by the membership at large.

Again, as was stated earlier, it seems to us that the issues can be dealt with more efficiently and properly if the United Nations were first to resolve some of the underlying political tensions that have led to the arms race, and, in that process, mandate the Fund to collect, analyze, and monitor military expenditures. With reference to the comments made by Mr. Peretz, I would note that the countries represented at the London Economic Summit are also members of the Security Council of the United Nations. I think they can affect the necessary decisions in the United Nations and then have the United Nations mandate data collection by the Fund, if they so choose.

Mr. Bonzom made the following statement:

At the outset, let me stress that this chair welcomes the excellent staff paper on military expenditures and the role of the Fund. This is a good opportunity for the Board to discuss a very important issue. First, I would like to elaborate briefly on the general approach to the problem. Second, I will focus on specific issues related to the Fund's involvement.

The staff paper estimates that global military expenditures have reached almost $1 trillion, or 5 percent of the world's GDP in 1988. Excessive military expenditures in the world at large can thus be seen as an enormous diversion of scarce resources from social programs, economic development, and private sector activity. Moreover, excessive military expenditures in one country can lead neighboring countries to increase their own defense budget, thereby increasing the risk of instability and overt conflict. When a country engages in a military buildup, in addition to the risk of loss of life, it suffers from reduced production, exports, and receipts from tourism, shattered infrastructure, and lost confidence from domestic and foreign investors.

Taking excessive military expenditures into consideration is of special interest in the case of countries in the midst of adjustment. Military expenditures may account for a substantial part of excessive external borrowing. Moreover, increased public spending on defense has sometimes offset reductions obtained under adjustment programs in other areas of government expenditures. More generally, excessive military expenditures can distort the labor market and discourage civilian and, specifically, private sector careers. However, the staff rightly points out that economic theory does not provide a clear indication of the optimal level of military expenditures, which are not to be condemned in themselves. Indeed, military expenditures support a public good, national security, which cannot be dispensed with in the interest of economic growth. As is well known, this category of goods raises complex issues of allocation and appropriate levels of associated taxation.

It is also worth mentioning that not all unproductive expenditures are military expenditures. In his recent speech to the Economic and Social Committee of the United Nations, the Managing Director made it perfectly clear that unproductive expenditures also include prestige products, excessive red tape, and spending associated with protectionism. In this respect, further reflection and action may also be needed, and we look forward to the future discussion on the productivity of public expenditures. All these arguments tend to show that the crux of the matter is not related to military expenditures per se but to excesses in such expenditures.

It also very clear that a judgment--and, in this case, a very political judgment--is necessary to assess whether military expenditures are excessive and to gauge external threats. As is also made clear in the staff paper, a significant reduction in military spending can only stem from a balanced and verified process of international cooperation, the scope of which is beyond the ability of this institution. Judgment on these matters used to rest, and still rests, mainly with national governments. So, for the Fund, which is basically not a political organization, it would certainly be inappropriate to deliver such judgments on a country-by-country basis.

This does not mean that there is not significant scope for concrete steps to be taken by the Fund. In this respect, and as I broadly agree with the proposals for concrete steps contained in the staff paper, I would like to focus on four possible courses of action. First, there is certainly a need for further studies on the links between military expenditures and the economy. Are military expenditures resilient to financial strains, or can they be considered as separate goods? Is the trend toward a reduction in military expenditures in developing countries continuing? Continued research on such topics, the results of which could mainly appear in working papers, will prove very useful for traditional Fund work.

Second, data collection is also much needed. The Fund is, without doubt, well placed to gather standardized information and to point to inconsistencies and under-reporting. As mentioned in the staff paper, this could lead to better designed programs and improved follow up. In this regard, the fact that only 64 members provide the Fund with data on the functional uses of public expenditures is a source of concern. We also agree with the staff that the right balance has to be struck between the need for transparency and the imperatives of national sovereignty.

Third, and crucially important, we would welcome efforts to strengthen the institutional capabilities of member countries. This would ensure that, in national decision making processes, economic and financial rationality is weighed appropriately against other objectives of government action.

Fourth and finally, we very much encourage the staff to study the huge problem raised by the transition from a military to a civilian economy. There will be transitional costs in such cases, and distributional effects will be at work. This major issue raises complex questions about capital reallocation and capital depletion, workers' training, regional imbalances, and so on and so forth. The Fund could help individual countries and the international community as a whole to better understand the problems involved and to develop a rational strategy for this particular kind of adjustment.

Mrs. Krosby made the following statement:

My authorities' approach to the global issue of excessive military spending is explicitly expressed in the Political Declaration of the 1991 London Economic Summit. As Mr. Peretz noted, the relevant section of that Declaration emphasizes that excessive military spending diverts scarce resources from economic development. Such spending can also lead to debt accumulation without creating the means for repayment. The Declaration supports the intention of bilateral aid donors to take into account disproportionate military spending when establishing aid programs. It also welcomed the increased attention that the Managing Director and the World Bank President have given to excessive military spending as a form of unproductive public expenditure.

At the outset, it needs to be stressed that, for all nations, military expenditures are policy matters of the utmost political importance. The security considerations that give rise to such expenditures are essentially matters of national sovereignty. It is the macroeconomic consequences of such spending, however, that lead to an appropriate Fund interest in reviewing military spending.

External evaluation of the economic consequences of a nation's security spending creates unavoidable tensions for an international organization such as the Fund. This inherent tension does not argue for ignoring the economic problems, but it does argue for this institution proceeding with considerable circumspection. We must be extremely sensitive not to overstep our mandate, lest we be perceived as intruding excessively on national sovereignty and become embroiled in debates about what constitutes an appropriate level of national security. This would undermine the technical and apolitical nature of this institution, which has provided the enduring foundation for its success in promoting sustainable growth.

In his recent public statements, the Managing Director has already established one essential dimension of the role the Fund can play in the issue of excessive military spending: leadership in mobilizing international opinion. By lending the prestige of his office to an articulation of the economic policy choices involved in excessive military spending, the Managing Director has helped to set the terms of reference for international and national debate.

The Fund's surveillance role places it in a unique position to focus international attention on the fiscal, development, and payments aspects of military expenditures. The staff paper suggests ways in which the Fund might usefully expand its coverage of military spending considerations in Article IV consultations and the world economic outlook exercise. These proposals fall into three areas: first, discussion of military spending levels with governmental authorities in the context of macroeconomic and structural policies; second, improved transparency of data on military expenditures in order to improve economic analysis; and third, assessment of the economic cost and implications of military spending.

On the whole, we believe that the staff suggestions are reasonable and suitably cautious. Surveillance is emphasized, which is appropriate. Conditionality is not addressed, nor should it be. Care has been exercised to avoid putting the Fund in an awkward and untenable position, and this must be insisted on.

Data collection and dissemination should be the least controversial aspect of the suggestions. As the staff notes, a substantial number of member countries already routinely provide a considerable amount of the desired data. Asking the other members to provide comparable, timely, and comprehensive statistics would be in keeping with our continuing efforts to improve the quality of statistical reporting. We agree that the staff should request such information in order to improve the transparency of analysis of military spending. The staff paper, on page 11, uses the phrase "insist on obtaining" military spending data. Given the sensitivity of this subject, it might be better to rephrase this passage to read, "expect the cooperation of member countries in obtaining the data."

We agree that policy discussions with member country authorities can appropriately include an assessment of the macroeconomic consequences of military spending and the implications of alternatives. As in other aspects of Fund consultations, the analytical skills the mission can bring to such assessments can be useful to the authorities even when difference remain over the actual course of policy.

I confess to being somewhat uneasy with the formulation in the staff paper to the effect that the staff would assess the costs of military spending but refrain from an evaluation of the benefits. We fully agree that the staff does not have the mandate or the expertise to make determinations on what constitutes an appropriate level of military expenditures. Nor are there standard economic criteria to judge whether a given level of military expenditures is appropriate or excessive. This is reason enough to stand aside from any attempt to make such determinations. We should, instead, confine the analysis to quantifying what is done and help in evaluating alternative resource allocations.

Still, there is a basic imbalance in an analysis that purports to assess costs while remaining agnostic on benefits. The bias from such an analysis will inevitably be against military spending. While we might all prefer that the need for military force never arose, recent events in the Middle East are too recent to be ignored. For some, the lesson of that experience is that some countries were too ill prepared, rather than overequipped.

We will need to be very careful to guard against an unwarranted presumption that all military spending is inherently wasteful. Democratic procedures are an essential safeguard to ensuring that the benefits of an appropriate level of military spending are identified. Our efforts to clarify the facts and the economic basis for such an identification can aid democratic choice. Even where democracy is not well established, the weight of international opinion can only improve the choices made.

Mr. Posthumus made the following statement:

The subject of military expenditures and the role of the Fund is an exceptionally difficult one for cool and common sense analysis and discussion. Why? In the first place, it is clear that military expenditures are, from an economic and human point of view, a waste of resources. No Governor, Central Bank President, Finance Minister, or even Executive Director can, therefore, afford to create even the suspicion that he or she is not against such waste. Second, for many countries, national security considerations are genuine; they involve political choices to waste resources so as to be, or to feel, safe and secure. To that extent, military expenditures are not wasteful; the choice is a political one.

The Managing Director has raised the issue of military expenditures in public, and he is right to do so, because it is an important issue, which should be tackled, and political decision-makers in all countries should face the issue of the terrible waste of resources that goes with military expenditure. Indeed, the Managing Director's efforts have earned the recognition of the Group of Seven in their declaration on arms transfers and nonproliferation, as Mr. Peretz helpfully reminded us.

However, the Board is also responsible for safeguarding the integrity of this monetary institution in the sense that it ensures that the Fund does no less and no more than is necessary to fulfill its monetary purposes. The Board should have been involved before and not after the intention to widen the Fund's tasks had been announced. The issue is not whether military expenditures are an important problem but what the role of the Fund is and how far that role should go.

We agree with the staff that excessive military expenditures are not only damaging in themselves, but are also detrimental to economic growth and development. Therefore, we support a contribution from the Fund to addressing this problem, as long as it is given in accordance with the Fund's character as an apolitical monetary organization. Basically, the choice whether scarce resources should be used for military purposes or for other objectives is a political one, for which considerations of national security clearly play a dominant role. Nevertheless, excessive military expenditures can have undesirable economic consequences, such as high levels of total government expenditure, leading to a crowding out of other types of expenditures, with, as a corollary, criticism of Fund programs. As these risks are a cause for legitimate concern for the Fund, developing economic analyses in this field would be a useful first step.

In the staff paper, two areas of potential Fund involvement can be distinguished: a contribution to better economic analysis of the benefits and costs of military expenditures; and an improvement in data collection. We can support more attention to analyses of the economic costs of military expenditures in general studies, like working papers and the world economic outlook exercise, provided this does not duplicate the work of other international institutions. These might improve the knowledge on this topic, thus contributing to better-founded decisionmaking in individual countries. We are, however, more reserved on explicit analyses in Article IV consultations. It does not seem in accordance with the Fund's Articles of Agreement to investigate government outlays at such a disaggregated level. I doubt that it is completely correct to say, as the paper does, that the Fund has focused on helping to strengthen the capacity of governments to make well-informed public policy choices. We are not in the business of advising on priorities in the budget. The only area where substantial Fund involvement in specific expenditure categories takes place is in the field of subsidies, because subsidies can affect significantly the functioning of the price mechanism, which is an important aspect of Fund surveillance.

If data from other institutions or from the countries themselves are unavailable or inadequate for a proper assessment of the economic situation by the Fund, the staff may request an improvement in the quality of the data--on an aggregate level. We do not believe that requesting more specific information will be productive, either because the member state may not cooperate or because military expenditures are recorded under different headings. In any case, there would be serious doubts about the international comparability of such figures. Were the staff to insist on receiving more specific military information, it could endanger the frank and open character of the consultation discussions and, thus, the quality of the Article IV exercise.

In this context, I have a few questions. It is stated on page 9 of the staff paper that Fund missions could request members to provide data that would identify broad military aggregates separately. Reference is then made to Article VIII, Section 5(a), namely, that the Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on a specified list of items. Can management or the Board simply decide that military expenditures, trade, and production are also the minimum information necessary for the effective discharge of the Fund's duties? How could we have discharged our duties over the past 45 years after having apparently forgotten this minimum requirement? Do present and prospective members have to provide military information as a consequence or condition of membership? The collection of specific military data, which are generally politically sensitive, should preferably be conducted by a political organization. This is in accordance with the spirit of the proposal, referred to in the 1991 London Economic Summit communiqué, for a universal register of arms transfers under the auspices of the United Nations.

Finally, my Netherlands authorities point out that the authorities in donor countries could also contribute to a reduction of excessive military expenditures in developing countries by taking the level of these outlays into account when furnishing development assistance.

Mr. Goos made the following statement:

There is no doubt that each country has the right to protect its legitimate security interest through military expenditures. However, in quite a number of cases, it appears that such expenditures exceed reasonable levels. As a consequence, the process of economic development and growth in industrial and developing countries alike is deprived of significant resources. There are appalling figures on the amount of money that is being spent on military expenditures, and there are also some staggering figures in the paper before us. With regard to developing countries, their military expenditures are almost four times higher than total official development assistance flows.

Undoubtedly, official development assistance flows fail to meet their purpose if they help finance excessive and, hence, wasteful military spending, particularly because, in a number of cases, military spending constitutes a threat to peace instead of meeting security interests. Therefore, we fully support the idea that military expenditures should receive more attention in the dialogue between donors and recipients at both the bilateral and multilateral level. This is not to say that our concern would be limited to military spending in developing countries; it also extends to wasteful excesses in those outlays in industrial countries. Accordingly, we feel that the relevant international institutions should aim at improving the comprehensiveness and transparency of data on military spending. At the same time, it appears that the Fund could make a useful complementary contribution to that effort in the context of its Article IV consultation discussions with its members. Moreover, I would agree with previous speakers that better information on such spending could, indeed, improve the Fund's capability to assess fiscal, trade, and debt developments, including their sustainability.

However, I should also like to stress that it would be inappropriate for this institution to get involved in an assessment of the appropriateness of specific levels of military expenditures, nor should the Fund introduce in its arrangements conditionality on military expenditures. Those matters should be left to other, more competent institutions or to bilateral peer pressure, on the basis of more transparent data. This concern, I believe, cannot be overemphasized for two main reasons. First, the development of an independent expertise in the Fund for assessing the appropriateness of military expenditures would definitely be incompatible with the mandate of this institution. Second, given the sensitivity of security issues, it could undermine the willingness of members to cooperate with the Fund. As I already indicated, however, I find it perfectly legitimate for the Fund to alert its members to the economic consequences of military spending and to advise them on the appropriate policies to counter the possible adverse effects on the economy resulting from a reduction in the military establishment or military production lines.

Having said that, I can endorse the staff's views underlying the issues for discussion. These views seem to be consistent with our general position. However, I would be grateful if the staff could elaborate on some of the qualifications expressed in the paper in regard to the proposed approach. For example, I am not sure what is meant by the reference on page 8 of the staff paper to the staff aiming, as a first step, at improving the comprehensiveness of macroeconomic data. What are the subsequent steps that the staff has in mind? In the same vein, there is a reference on page 9 to initial data requests focusing on aggregate military expenditures. What request does the staff intend to raise in subsequent stages?

Moreover, I am not clear about the intended purpose behind the statement on page 10 that some of the broad implications of the analysis could be reported to the Executive Board, although the treatment would need to reflect the preferences of individual members. This statement gives rise to two concerns: first, that the staff might, indeed, intend to get involved in a discussion of the adequacy of military expenditures; and second, that the staff intends to provide the Board with only selective information on actual military spending. I strongly feel that both of these points would, if true, be unacceptable.

Finally, I have two further observations, which were also raised by previous speakers. First, the staff rightly stresses that, in trying to improve the transparency of data on military spending, the Fund will have to rely on the cooperation of its members. This raises the obvious question how the Fund could enforce such cooperation if a member were not willing to provide the necessary information. In this context, if information is provided, how does one ensure that it is comprehensive and accurate? Of course, this raises the concerns that were expressed by Mr. Mirakhor and others. My final point is that I would encourage the staff and management to urge members to improve the comprehensiveness and currentness of the data that are reported in Government Finance Statistics.

Mr. Mirakhor noted that Mr. Goos had said that he was concerned about excessive military spending, but that he opposed Fund involvement in determinations of appropriate levels of military expenditure. He wondered how it would be possible to determine what constituted an excessive level of military spending without knowing the appropriate level of military spending.

Mr. Goos remarked that he had tried to stress that assessments of the adequacy of military spending were none of the Fund's business. The Fund should limit its operations in that field to data collection, but it should be willing and able to advise members on the macroeconomic consequences of military spending, regardless of the level of aggregation. Moreover, the Fund should also be able to advise members on the possible macroeconomic implications of reducing military expenditures, production, and exports. The assessment of the appropriate level of military spending for a country should be left to other bodies, including the United Nations, and to bilateral relations. Indeed, as the staff paper had noted, donor countries were already trying to link official development assistance to the level of military spending in recipient countries.

Mr. Prader made the following statement:

The topic of military expenditures leads the Fund into unchartered and, potentially, very turbulent waters, and, as a prudent sailor, it has to move with great care. On the one hand, the appropriation of scarce public funds for military purposes is a matter of public choice, to be decided by the policymakers of the respective country based on their own set of political preferences, and the Fund should not be allowed to pass judgment on the adequacy of such expenditures. On the other hand, there can be no doubt that the composition of government expenditures has important repercussions for the future growth path and the external situation of an economy. Therefore, it is a question of direct relevance to the Fund and its mandate to support adjustment with growth.

Nevertheless, I would have preferred that the discussion on the unproductive use of public expenditures was not restricted to military expenditures. In procedural terms, is there an intention to have a more general discussion on the productivity of public expenditures, and, if so, when? Would it not have been better to tackle the present, more specific question after the discussion on the general issues?

The upcoming Interim Committee meeting might be more fruitful if it did not focus exclusively on military expenditures in its discussion of the productive use of scarce resources. Moreover, our desire for additional data from member countries would be more understandable, and better received, if it were presented and discussed as part of a larger agenda than just military expenditures. In any case, in order to avoid misunderstandings, we have to make it very clear from the outset why we need this data and what we are going to do with it.

Having said this, I want to turn now to the specific issue. At the outset, it is important to put the dimensions of military spending into perspective. Military expenditures, on average, account for about 16 percent of central government expenditures and about 4 1/2 percent of overall economic activity. Behind those averages, however, hide some much higher ratios, reaching up to 42 percent of GDP. These are dimensions that unquestionably are of macroeconomic importance, and the staff's calculations indicate the potential benefits from even a rather modest reduction. Nevertheless, this area is at present a large black box for the Fund, thus excluding an important part of the economy from surveillance by the Fund.

The increasing interest of the Fund in the problems of global savings and governments' use of those scarce savings, and the related question of the economic implications of unproductive public expenditures, logically leads to the Fund's interest in the composition of public expenditures. Different forms of government spending have different effects on medium- and long-term growth, and attempts to reduce fiscal imbalances by cutting government expenditures need to take that into account.

It was somewhat encouraging for me to note that some very rough calculations showed that the countries having Fund arrangements are, by and large, not among the big spenders on the military. According to the available estimates--as reported in the recent working papers on military expenditures (WP/91/53 and WP/91/54, May 1991)--between 1980 and 1988, countries with Fund arrangements devoted on average--this is an unweighted average--about one half of one percentage point less to their military than the average of all countries, and about one and a half percentage points less than the more representative comparison, the group of developing countries. Nevertheless, the range for countries with Fund arrangements spans from 0.6 percent of GDP to 17.6 percent of GDP.

There is not only a domestic financial dimension to military expenditures but also an external one, as there is considerable international trade in military goods. For developing countries, on average, about 7 percent of their imports are military--in some countries the figures are much higher--using up scarce and valuable foreign exchange reserves. As was pointed out correctly in WP/91/54, in a country that has severe foreign exchange restraints, purchases of military equipment have an extremely high opportunity cost. In a recent case of a major debt-cancellation exercise, the cancellation of military debt by one creditor country resulted in less generous concessions by that country on the remaining debt. As a consequence, even forgiving military debt has negative repercussions on civilian debt--military imports are not a free lunch, although they sometimes appear to be.

More systematic and reliable data collection on this important component of government expenditures would also be a very valuable input for bilateral official development assistance donors in their decision making concerning the allocation of scarce official development assistance funds. Unlike the Fund, donors are allowed to make value judgments when allocating their foreign assistance, and they might appreciate this additional information. This is especially true in light of the empirical finding in WP/91/54 that external financial assistance increases military spending by increasing the resources available to the government.

The special appeal of reducing military expenditures is the immediate positive impact on fiscal balances, as well as the freeing of resources for more productive uses. It is, however, not a panacea. Mr. Posthumus already referred to that point during the discussions on the world economic outlook (EBM/91/129 and EBM/91/130, 9/23/91; and EBM/91/131 and EBM/91/132, 9/25/91), but I want to underline it as well. Shifting resources requires adjustment, and adjustment takes time; we can, therefore, not expect very quick positive effects from reducing the military sector. Nevertheless, the sheer size of the resources now tied up for this purpose indicates the potential for a more growth-oriented and efficient reallocation of government resources worldwide. The most immediate effect could be achieved in importing countries by eliminating military hardware imports. Even that measure, however, will lead to adjustment needs in the--mainly industrial--producer countries.

With the caveats mentioned at the beginning of my statement, I support the proposition that, in the context of Article IV consultations, the staff should also try to obtain aggregate data on military spending, together with data on all other quantitatively relevant components of government spending, for all member countries, not just the 64 that are already providing that data on a timely basis. In addition, the external accounts--imports as well as exports--should also include data, at an aggregate level, on military imports and exports. The same applies to foreign assets and liabilities. As I mentioned in my introduction, however, the demand for additional data on this subject should be part and parcel of a more comprehensive agenda. Therefore, the data requests should not be made before the Board discusses the more general issues raised by the analysis of the productivity of public expenditure, which might lead to additional data requests. The analysis of the Fund concerning military expenditures should, in any case, remain on an objective and economic level, without trying to interfere with the political value judgments made by the policymakers of the respective countries, and military spending should not be the subject of the Fund's conditionality. All duplication of the efforts of other institutions should be avoided. The only goal must be to enable the Fund to fulfill, in the best possible way, its bilateral as well as multilateral surveillance mandate for the benefit of the entire membership.

In concluding, I would like to support the proposal of the French chair that the staff study the process of conversion from military production to civilian production. This could be of interest to many countries, particularly the former centrally planned countries.

Mr. Towe made the following statement:

Let me say that the timing of this discussion seems especially fortuitous, in that it follows on the heels of Board consideration of the world economic outlook, during which special emphasis was placed on the need to address global imbalances between savings and investment. In those discussions, the obvious advantages to both the developing and industrial countries of a global consolidation of fiscal expenditures was clearly identified.

These earlier discussions, as well as the startling figures cited in the paper before us today, clearly demonstrate the importance that should be attached to a multilateral reduction in military expenditures. They also strengthen the stress placed by the 1991 World Development Report, the April 1991 Development Committee communiqué, and the London Economic Summit communiqué on the negative consequences of excessive military expenditures for economic development and poverty alleviation. My authorities strongly support these principles, and my Canadian authorities have encouraged their implementation in both bilateral and multilateral arenas.

Given the increased global awareness of the costs of excessive military expenditures, the issue of the appropriate role of the Fund needs to be addressed. The Fund has a well-defined mandate to monitor economic developments in its member countries and to provide advice to aid members' macroeconomic and structural policies. Moreover, the recent discussion of savings and investment imbalances, as well as the growing need to ensure the efficient allocation of savings, suggests that the Fund has a role in identifying situations in which global resources are being misallocated.

These responsibilities clearly require access to information that impinges on fiscal policy, the balance of payments, and the efficient use of resources. In our view, for the Fund to fulfil its role and provide effective advice on macroeconomic adjustment, members should be prepared to provide data on the fiscal and external accounts that fully encompass all relevant transactions, including those for military expenditures.

The staff has not shied away from addressing such issues in the past. I am sure that the staff already makes every effort to increase the transparency of its data, by obtaining information on the level and composition of military expenditures. Moreover, I am also confident that issues related to excessive military expenditures are already addressed in the context of Fund programs and Article IV consultations. For example, I recall that Pakistan's structural adjustment arrangement contained commitments to contain military expenditures within certain limits. We fully support this aspect of the Fund's activities, insofar as it promotes the objectives defined by its Articles of Agreement: to facilitate employment, income growth, and the development of members' productive resources.

Let me repeat, therefore, that we support the view that the Fund should require full and complete balance of payments and fiscal statistics in order to adequately gauge the macroeconomic implications of members' policies. Clearly, this requires not only aggregate data regarding expenditures and revenues, but also a comprehensive functional breakdown of both. We would not expect the staff to provide competent policy advice without information regarding, for example, the share of domestic and international trade taxes, details regarding the level of fiscal subsidies, or information regarding the public sector wage bill. It seems no less vital that the staff be provided with information, on a standardized basis, on, perhaps, the most unproductive form of fiscal expenditure--defense spending.

Nonetheless, we would urge a very deliberate approach in this regard. We note the paper's reference to the possibility that the Fund's efforts could contribute to a lessening of regional tensions, and that information obtained by the Fund staff could complement efforts to establish a register of international arms transfers under the auspices of the United Nations, and we acknowledge that such information could provide bilateral donors with important information to help direct aid flows. However, the paper suggests a possible role for the Fund in the area of analysis of the costs of excessive defense expenditures. While the paper is careful to note that this activity would be circumscribed, we are concerned that an emphasis on such analysis could extend the Fund beyond its mandate and distort its character as a monetary institution. Moreover, given the demands that are likely to be placed on this institution as a result of developments in Eastern Europe and the U.S.S.R., we would caution against the Fund undertaking significant new responsibilities, which may not significantly increase its ability to provide effective policy advice.

In this context, the paper was vague regarding the costs to the Fund of undertaking any new responsibilities in this area. We wonder whether it would be appropriate to devote staff resources to such issues before the budgetary costs and trade-offs are defined.

Finally, while it is suggested that the Fund should insist on military expenditure data, I wonder whether the staff could elaborate on the sanctions that could be imposed to enforce this insistence. It seems that neither Article IV nor Article VIII requires the provision of such information, except with regard to exports and imports. Indeed, the requirement of Article IV, Section 3(b) that Fund surveillance respect members' domestic social and political policies seems to preclude any such insistence. Perhaps the staff could comment on this point.

Mr. Al-Jasser made the following statement:

As the staff paper before us indicates, recent developments around the world have led to increased attention to military spending and to questions regarding its appropriate level. Indeed, with the dramatic decline in East-West tensions, a serious debate has emerged with respect to the potential size of the peace dividend and the uses to which it should be put. Needless to say, any reduction in global tensions, with the consequent increase in security and reduction in the potential for war and death, is always welcome news. However, the question before us today is whether the Fund should be involved in this highly intricate political process.

The first and foremost reference to determine whether the Fund has any role in this area is the Articles of Agreement. Clearly, any reading of Article I suggests that the Fund does not. The Fund's success and efficiency has been built upon a carefully prescribed mandate, which has allowed it to focus its efforts efficiently and respond to the needs of its membership in a prompt and effective fashion. The Fund should not allow these scarce and valuable qualities to be compromised. Therefore, it is crucial that the Fund avoid any involvement in issues that are well beyond its mandate, irrespective of their importance. Indeed, it is quite obvious that the Fund has absolutely no comparative advantage in dealing with military expenditure issues. This is particularly important at a time when there has been a dramatic increase in the demand for Fund assistance and when the staff of the institution is seriously overburdened. If the issue here is the provision of data, then, as the staff paper indicates, we already receive such data from 64 members. An improvement in that record could definitely be achieved without this debate, which gives the impression that the Fund is widening its original mandate.

The staff paper indicates that considerable gains for both individual countries and the world community at large could emerge from a balanced multilateral reduction in resources devoted to the military. I fully agree with this statement. The staff also states that "no loss of national or international security need occur, provided that uniformity of implementation could be defined and verified"; and it further explains that uniformity need not imply equal spending rates or spending reductions. The logical question that follows is who will determine whether uniformity has been achieved. Furthermore, the staff provides an illustration of the level of savings that could be achieved if regions with high levels of military expenditures reduce their military spending to world averages. The main problem with such illustrations is that they cannot explain the reasons behind variations in military spending across the various regions in the world and at different points of time. Moreover, the most serious problem here is that the Fund may find itself, willingly or unwillingly, embroiled in such analyses and judgments.

When the Fund advocates trade liberalization, be it in a program or in a world economic outlook discussion, it does so with the strong recognition that such policies, irrespective of whether they are implemented unilaterally or multilaterally, have clear benefits to the country that undertakes them. The same cannot be claimed for military expenditures. This underscores the fact that such recommendations require expertise in defense economics, national security policy, and military strategy, all of which are beyond the expertise of the staff, and should remain so.

More significantly, given that military expenditures are, to a large extent, influenced by exogenous factors, the necessity of ensuring uniformity of treatment in the Fund's dealing with such issues is overwhelming. Clearly, this cannot be achieved, as the Fund does not exert its influence equally on all countries. Users of Fund resources are by far more dependent on the Fund than other members, be it in their exposure to conditionality or in the requirement to provide data. These issues would become particularly worrisome in situations in which regional conflicts develop.

It is critical for the Fund to avoid entering into a "Pandora's box" of military expenditures, because this may seriously affect our relations with member countries and their willingness to approach the Fund for policy advice. Indeed, the credibility of the Fund and its prestige have been built upon its principled position of not involving itself in political and national security issues--a stance that must be jealously guarded. The fact remains that, in many countries, military expenditures are extremely delicate issues that constitute a key element of the political fabric. If Fund involvement is perceived to threaten such a balance, this may lead to substantial internal opposition to cooperation with the Fund, thereby endangering the whole process of economic adjustment as well as multilateral surveillance.

Finally, the staff paper presents several arguments justifying Fund involvement in this issue, ranging from the importance of making governments aware of the costs of military expenditures to analyzing the implications of military expenditures for the balance of payments and medium-term viability. These arguments are not convincing. Clearly, national authorities are as aware as the staff of the costs of military expenditures, but they are more aware of their national security considerations.

In conclusion, the staff asks for guidance from Executive Directors regarding the Fund's future role in this area. In a nutshell, the Fund should not waste its resources in areas that are beyond its mandate and the expertise of its staff and that could jeopardize the institution's relations with its members. We would be better advised to leave this political and security issue to the United Nations, given the mandates of the General Assembly and the Security Council.

Mr. Mwananshiku made the following statement:

It is true that the composition of government expenditures has implications for economic growth and the prospects for external viability. It is also true, as the staff asserts, that a more thorough discussion of military spending would improve the decision-making process in the areas of macroeconomic and structural policies.

Military expenditures can be a drain on national resources, competing as they do with development resources. I am, therefore, broadly in favor of reducing such expenditures, taking into account realistic individual national security concerns. In this respect, I would like to note that defense expenditure reductions by major countries could release a considerable amount of resources, which could make up a substantial part of the present shortage in global savings. Indeed, major countries could make a contribution to the reduction in arms spending in developing countries by tightening the regulation of trade in military hardware and by stopping the enticement of developing countries to buy arms. Most developing countries would not have large military debts if arms producers were not so willing to extend credits to purchase arms.

The question for the purposes of today's discussion is whether the Fund is the appropriate institution to deal with the matter of arms reduction in a successful manner. The proliferation of armaments is a very complex issue; although the staff presents it as one that can be tackled under the rubric of economic efficiency, I fear that the Fund could be getting itself into deep and uncharted waters. Military expenditures are a sensitive political question, which only a political body can deal with.

Indeed, a few questions come to mind. How would the determination be made to strike a balance between the need to furnish information and the need to protect national security? How will the information so obtained be protected? How does the staff intend to ensure equal treatment for all countries? How could the Fund enforce its surveillance over countries that do not use Fund resources? While a number of Directors have indicated that their countries would be willing to provide information, is it not likely that the burden would fall largely on developing countries, particularly those using Fund resources?

In sum, I agree that military expenditures should be curbed and resources reallocated to more productive uses. I am, however, not sure whether the Fund is best suited to effectively bring about the desired change.

Mr. Koissy made the following statement:

We agree with the general observation that recent international events and, in particular, the coming to an end of the so-called cold war, together with the general easing of international tensions and ideological and other conflicts, have made it easier for the international community to discuss openly the issue of military expenditures, including their size and appropriate level in the composition of public expenditures in national budgets. These issues have now become urgent global concerns.

For Eastern Europe and the U.S.S.R., the political and economic transformation taking place has made the discussion of such an issue crucial. It has been impressed upon these countries that, in order to release resources for the ongoing transformation, the authorities should significantly reduce military expenditures. The authorities in these countries may comply with this advice, particularly as it comes from those former rivals who are now in a position to offer the required financial and technical assistance to ensure the success of the economic transformation process.

The industrial countries have to set an example for the Eastern European countries and the U.S.S.R. that, indeed, there is a budgetary trade-off between military expenditures and other expenditures, which could release resources for social and other economic services and improve the welfare of the people. The staff have stated in the paper that the communiqué of the recent London Economic Summit has noted that, "while all countries are struggling with competing claims on scarce resources, excessive spending on arms diverts resources from the overriding need to tackle economic development." We hope that this quotation from the communiqué of the Group of Seven sets an example; steps already taken by some of those countries to reduce defense outlays are, indeed, welcome.

As for us in the developing world, we have no option but to heed the advice of those who are in a position to produce and supply the military hardware to our governments, with guaranteed foreign financing or bilateral economic assistance linked to military assistance on concessional terms. The intentions of some of these donors have been noted by the staff; for example, the staff paper indicates that "the German and Japanese Governments have recently indicated that their development agencies will take account of military spending in allocating ODA."

As it is now generally accepted that the issue of military expenditures can be discussed openly from the perspective of their economic consequences for individual nations and the global economy, we agree with the staff that there is an important role for the Fund to play in its surveillance role and in its other role of providing advice to member countries, particularly in the fiscal and external sectors, where outlays on the military need to be reflected. In playing this role, the Fund should take into consideration the security concerns of members, as probing into the subject of military spending and defense outlays is a very sensitive undertaking. The Fund, therefore, has to proceed cautiously when deciding to request members to provide data, even as broad aggregates. The demand for data should also be related strictly to the Fund's surveillance activities.

Let me now turn to the question of the availability of data on military expenditures in public finance accounts, particularly through the most widely used source, Government Finance Statistics, which is published by the Fund. The inadequacies or paucity of data on military spending, including their completeness and timeliness in official publications, is not surprising. Most of such data are classified information maintained by governments as official secrets. The staff has implied, on page 11 of the paper, that the Fund's efforts to assist members in strengthening institutional capacity to make sound policy choices in the macroeconomic and structural areas have been incomplete and subject to possible errors of analysis without a discussion of military spending. Can the staff elaborate on the implications of this statement? In any event, our view is that, for the present, the staff should continue to rely on the usual data sources, such as the Stockholm International Peace Research Institute (SIPRI) and the U.S. Arms Control and Disarmament Agency, until member countries gain some confidence that releasing such highly classified data to the staff for economic analysis will not jeopardize their national security.

One important point that I would like to emphasize--especially on behalf of those members in my constituency with Fund-supported programs--is our concern that military expenditures would be used in setting performance criteria and benchmarks, as has happened in the case of the buildup of foreign exchange or the accumulation of external reserves. We would like to be assured that this is not the ultimate intention of the Fund.

In conclusion, let me state that it augurs well for the international community that military expenditures are being discussed openly and that their adverse economic impact on other resources for economic development is being analyzed. The Fund has a role to play in gradually ensuring that such assessments are reflected fully in its surveillance responsibilities. However, the Fund has to be cautious in this highly sensitive area, where data are highly classified, and we are, therefore, not in favor of the Fund insisting on obtaining from all countries standardized data on military spending for economic analysis. The sensitivities of the national authorities should be borne in mind in pursuing the staff's suggestions.

Mr. Kyriazidis made the following statement:

Developments in the relations between the major powers over the past two years, as well as events related to regional problems, have brought to the forefront the question of the weight of military expenditures and their impact, not only on political stability, but also on economic progress.

As recognized in the communiqué of the 1991 London Economic Summit, although every state has an inherent right to self-defense and tensions will exist in international relations as long as underlying conflicts of interest are not tackled and resolved, moderation in military expenditures can make a critical contribution to political stability, sound economic policy, and good government. A general movement seems to be developing toward a reconsideration of the appropriate level of defense expenditure, given the relevant security considerations as perceived in each case.

The question that we have to answer is how this institution can assist this general movement within the limits of its statutes and its expertise. I believe that this is a cardinal criterion, because military expenditures touch on very sensitive issues of national policy, which, under the Articles of Agreement, we are precluded from entering into. Besides, there are other serious reasons, such as those developed by Mrs. Krosby, Mr. Mirakhor, Mr. Goos, and Mr. Posthumus.

In this light, I would be prepared to agree that the Fund, within its surveillance function, should be able to--and is justified in its efforts to--obtain from all countries reasonably standardized aggregate data on military spending, which would be sufficient to lead to a proper understanding of the budgetary burden and macroeconomic implications of such spending in an international setting. Most countries have traditionally considered military expenditures as an area where secrecy or, to put it differently, partial transparency was part of the fundamental exercise of sovereignty related to national security. Obtaining the necessary data, even at an aggregate level, will be a rather arduous task, but one that is well worth the undertaking in view of the potential benefits to the global community. The information thus gathered could be useful to the work of other organizations, such as the United Nations or the Conference on Security and Cooperation in Europe, which are competent to deal with the substantive problems that underlie defense policies. The information might also be useful to the World Bank, which is better equipped to deal with structural problems connected with changes in military spending.

I would be wary, however, of the various suggestions for analysis proposed in the staff paper. Of course, to the extent that member countries embark on a major reduction in their military establishments, the Fund can provide advice on the handling of the macroeconomic consequences of the process, such as the effects on GDP, employment, and the balance of payments. This, however, should be done very cautiously within the Article IV process, provided that the choice has already been made by the member country and that advice in this area is sought.

At the same time, however, I am not convinced of the appropriateness of requesting very detailed data, as the staff is proposing. Refusal to provide all the requested data, or the more likely provision of partial answers to the requests of the Fund, could raise the issue of the legality of the Fund's request, thus putting the Fund itself in a rather uncomfortable position.

Concerning the analysis itself, I hold the view that specific recommendations should be avoided, as they cannot be weighed against the main determinant of the expenditures themselves, namely, security considerations.

In sum, I think it would be counterproductive for this institution to give the impression that it is introducing military spending into its conditionality. Also, I think that it would be unwise to establish information on military spending as an obligation of members on the same basis as the information required from member countries under Article IV and Article VIII of the Articles of Agreement.

Mr. Evans made the following statement:

We share the concerns expressed in the London Economic Summit communiqué and elsewhere about excessive military spending as a burden on economic development and social welfare. It is readily apparent that excessive military expenditures constrain the growth of the country that undertakes the expenditure; equally, they constrain the growth of the country that produces the military capacity and that, not unusually, provides part of the financing, without which the expenditures could not occur.

Both of these statements, however--like most made on this subject--are tautological, as they are reliant upon the use of the word "excessive." For the world as a whole, it is not too difficult to judge that a certain level of military expenditures is excessive. For an individual country, however, it is impossible for anyone but that country to reach a relevant judgment, because public choice is involved and a strategic assessment of external threat is required. Such difficulties may not prevent me, as an individual, from making a judgment regarding the level of military expenditure--or production--undertaken by a particular country, but they do and must prevent the Fund from doing so. I am pleased to see that the staff paper acknowledges this, and we should do so clearly in any public presentation of the Fund's role in this area.

With the public choice role precluded, what remains for the Fund? As the paper notes, it may be possible, with considerable care, for the staff to advise members on the economic and financial implications of differing aggregate levels of military expenditures, though to do so comprehensively requires an estimation of the rate of return on military expenditure, which, again, returns us to the field of public choice, which we appear agreed should be avoided. That would seem to leave data collection, and I agree that greater transparency could make an important contribution to the basic objective. There is a question, however, of whether the Fund has a comparative advantage in this field. Clearly, we have the necessary expertise in the Statistics and Fiscal Affairs Departments, but, given the other heavy and increasing demands on their skills, it is not clear to me why the Fund should be undertaking this task rather than the World Bank or the United Nations, given that both of those organizations already do so to differing degrees. I would appreciate the staff's response on this point.

Closely related to that point is the question raised in the paper whether the Fund should insist on obtaining the relevant data. I hesitate to agree to that, mindful of the damage that might be done to Fund-member relations and, hence, to the ability of the Fund to perform its basic functions--many such concerns have been expressed today. It may be, of course, that there could be cases in which the member's refusal or inability to provide the data could, by itself, prevent the Fund from performing its role. But one might compare such a mandatory approach with the language of the London Economic Summit communiqué, most of which was, more wisely, in the manner of moral suasion. I think Mr. Peretz would agree, as he has suggested that sanctions for noncompliance should not go beyond a statement in the staff appraisal to the effect that the data had not been provided. That seems innocuous enough, but even coming to a judgment on whether the data in this field have or have not been provided is no mean feat, as current events amply illustrate. I would like to hear further from the staff on these issues before expressing a final view on the data question.

Mr. Fukui made the following statement:

Given the dramatic change in the world economic structure following the end of the cold war, on the one hand, and the continued--and even increased--demand for resources in connection with the reforms in Eastern and Central Europe, reconstruction in the Middle East, and the prolonged debt problems in other parts of the world, on the other hand, reducing unproductive expenditures and promoting more productive investment are urgent and pressing challenges for every country in the world. This point was highlighted in the context of the world economic outlook discussion. The staff's proposal before us is, therefore, timely and appropriate.

As this chair said in the world economic outlook discussion, it is interesting to know that simply cutting the military expenditures of all countries by 20 percent could produce more than enough resources to finance the demands associated with the reforms in Eastern Europe and reconstruction in the Middle East. Although this is a highly hypothetical calculation, I believe it is quite appropriate for the Fund to continue to make this fact widely known in the world.

In this sense, I can endorse the main thrust of the paper. I think the proposal is within the Fund's mandate, as long as the analysis of military expenditures is carried out in a purely macroeconomic framework and is based on aggregate data.

When it comes to analyzing military expenditures from a macroeconomic perspective and studying their implications for world economic growth, I believe the Fund is one of the most qualified institutions to do so, and it should, therefore, be able to produce appropriate guidelines in a macroeconomic context for the policymakers of the world.

At the same time, I fully agree with the staff that there is a need to improve the comprehensiveness, transparency, and timeliness of the data. In particular, I believe that transparency of the data is essential for the purpose of comparative analysis throughout the world. I hope that the staff will make the maximum effort to improve the quality of its data through the Article IV process.

As the staff rightly points out, however, issues relating to military expenditures inevitably have political implications. This issue is a double-edged sword, and the staff should approach it with caution. In this connection, I am worried about the implications of the following sentence on page 6 of the staff paper: "A general improvement in the transparency of the data could also provide benefits to the world community at large and could make a modest contribution to lessening regional tensions." I believe that the staff should be careful that its analysis of military expenditures does not have political implications. Thus, making "a contribution to lessening regional tensions" should not be within the scope of the staff's work.

As data on military expenditures are generally highly confidential in every country, I cannot help being skeptical about the extent to which the Fund will be able to collect data on military expenditures from its members. Careful consideration will have to be given to how detailed the data needs to be for the Fund's analysis. In the same vein, I also think that the staff should not insist on collecting comprehensive data. As such data can be politically sensitive, demanding too strongly that the authorities provide the needed data could lead to the awkward situation in which the staff's more important contacts with the authorities--namely, discussion of the nonmilitary aspects of the economy--would be disturbed.

This leads me to the importance of cooperation with other institutions. The staff is right to stress this point. Taking into account the Fund's limited human resources, it is important for the staff to make maximum use of the expertise and data of other institutions, particularly other international organizations, through close cooperation with these institutions. However, the staff should also be aware that if the data that the Fund collects from the authorities are made available to other institutions, this might make the authorities less cooperative in providing the Fund with data. The framework for this cooperation should also be considered very carefully.

Finally, on the possibility of the staff contacting officials other than those from ministries of finance and central banks, I admit that sometimes such contacts will be necessary. However, any such contacts should be made through the financial authorities and with their consent.

Mr. Arora recalled that Mr. Posthumus had wondered how the Fund had carried out its responsibilities for 45 years without having felt compelled to ask for data on military spending. A passage in the staff paper referred to a similar theme, namely, that recent developments around the world had led to increased attention to military spending and questions regarding its appropriate level under the new circumstances that were emerging. As a summary of post-war world history, however, that passage seemed to reflect a certain bias; it seemed to say that, as long as there was--in purely geopolitical terms--a bipolar world, it was alright not to worry too much about military spending, but that the end of that political structure meant that military spending had become a cause for concern. In his view, that was a rather puzzling statement. If military spending was bad, it had always been bad; it had not suddenly become a subject worthy of concern.

The Fund was presented with a dilemma, Mr. Arora stated. There was no question that excessive military spending, however one might define "excessive," was a serious problem for economic development and growth. Nevertheless, while the staff was proposing only that it collect and analyze the relevant data, it was inevitable that the next logical step would be taken--that is, judgments would be made on the situations of individual countries. It should be clear that such a development would imply a serious derogation of sovereignty, which was, in his view, an essential element for stability and world peace. If it was acceptable to call for the derogation of sovereignty in the area of military expenditures, however, it should also be possible to make suggestions regarding the derogation of sovereignty in other areas, such as economic and monetary matters. After all, the initial vision of the Fund had been based on a derogation of sovereignty that would allow the Fund to assist countries in solving their balance of payments problems and, in so doing, develop certain instruments for achieving its aims, which it had not yet been prepared to do.

Therefore, Mr. Arora continued, it was to be hoped that the Board could reach a consensus on the limits of the derogation of sovereignty that was implied in the staff paper, which had been very carefully worded, with the exception of the word "insisting," to which Mrs. Krosby had rightly taken exception. It was important to remember that there was no model for determining with any degree of accuracy the appropriate level of military spending. Of course, in a theological sense, it was clear that even a relatively low level of military spending in a country that had a serious balance of payments problem could be considered inappropriate. In those circumstances. the argument for reducing military spending would be quite compelling, but it would not be based on economic analysis.

Many speakers had recognized that, while the Fund might collect data and information on military expenditures, under no circumstances should those expenditures become a part of Fund conditionality, Mr. Arora stated. The broad recognition of that point indicated how sensitive the issue was. Moreover, as Mr. Al-Jasser had noted, there were serious legal questions about the Fund's role in the area of military expenditures. He agreed that it was useful for the Managing Director to raise the issue publicly, as the Group of Seven had also recognized, because it would focus public debate and encourage countries to examine the assumptions on which their national security was based and, in so doing, re-examine the composition of their budget expenditures. To go beyond that point, however, would, as Mr. Posthumus had pointed out, endanger the Article IV consultation process. Therefore, the Fund should limit itself at the present stage to focusing attention on the implications of military spending across regions and across countries, bearing in mind that it was difficult to judge whether or not a particular level of military spending was justified.

The staff paper had served a very useful purpose in bringing to the Board's attention the changing circumstances in which the Fund operated, Mr. Arora said. Moreover, he would not base his views only on a purely legal interpretation of the Articles of Agreement, although that was important. In his view, the Fund's role should be limited to moving public opinion to accept greater transparency of public expenditures generally, making available to countries the data from which they could make informed judgments. In that regard, there should be no difficulty in compiling the necessary data, because, to the extent that the Fund did not have data on certain expenditure categories, other organizations did. As was widely understood, policymakers in every country were aware of the cost of maintaining a certain level of military spending. Therefore, while it would be entirely appropriate for the Fund to continue to be involved in that area informally--which was inevitable, given the Fund's role in assisting members to adjust their economies--a more formal requirement with respect to military expenditures would not serve the Fund's purposes, and he would urge caution in coming to a decision on the matter.

Clearly, the Group of Seven and the donor community were beginning to take military expenditures into account in their aid decisions, Mr. Arora remarked, and, to the extent that they succeeded in convincing countries of the need to reduce those expenditures, that was entirely appropriate. He could not agree, however, that the Fund should be given formal authority to ask for, or to insist on, such data, particularly if it would then take an adverse view of members that did not cooperate. Such an arrangement might create very serious problems for the Article IV process, because defense spending was not yet discussed explicitly, except when included in very broad aggregates. To a certain extent, the Fund's credibility with the authorities would be damaged, and the inclination of the latter to provide other data to the Fund would be inhibited. In the same vein, Mr. Peretz's suggestion that the Fund should call attention to members that did not provide the required data during an Article IV consultation was a cause for concern.

Mr. Fogelholm remarked that the issue of the Fund's role in the area of military expenditures was very difficult to resolve. It was clear that excessive military spending was bad and uneconomical, and no one could support such a policy; no one would want to support military expenditures as such, either. The question was, of course, how those concerns could be integrated into the work of the Fund. Mr. Prader had rightly asked why the Fund needed the data and what it would do with them. The answers to those questions had not been forthcoming, in his view, because there did not seem to be a clear-cut need for the Fund to collect data on military expenditures. To have a meaningful impact, conditionality should be applied to military expenditures, but Directors were not willing to go that far. Clearly, in the context of a Fund-supported program, it would be essential for the Fund to be able to say to a country that, if public expenditures were too high and could not be sustained over the medium term, military expenditures should be cut first, as they did not serve any social or economic objective. No one was proposing such a course of action, however, nor was anyone willing to apply sanctions against those countries that could not or would not provide the requested data.

It had been suggested that the Fund should perform macroeconomic analysis of military expenditures at a very high level of aggregation, Mr. Fogelholm recalled, but for that purpose, the Fund did not need to gather the data independently. Sufficient data were already available at an adequate level of aggregation, such as those prepared by SIPRI, which were fairly reliable and were clearly adequate for Fund macroeconomic analysis. If the Fund was to do macroeconomic analysis on military expenditures, it would be studying the self-evident, because the results of that analysis were already clear; military expenditures were obviously damaging economically, and the Fund's work would only provide the relevant figures. Whether the Fund should devote resources to achieve a result that was already well known was an open question.

For those reasons, Mr. Fogelholm said, he wondered what purpose would be served by collecting data on military expenditures. If the Fund did not use the data itself for country analysis, then presumably it was collecting the data for others. If that was true, he wondered whether the Fund was the best-equipped organization to collect such data. The Fund might have access to the data--perhaps better access than many others--but it was not clear that the Fund was the appropriate organization to collect the data; the World Bank, the United Nations, and other organizations were better equipped for that purpose. In sum, the present discussion seemed to echo many of the concerns that had been voiced during the earlier discussion on the Fund and the environment, in which it was concluded that the basis for the Fund's role in that area was doubtful from the perspective of the Articles of Agreement.

Mr. Finaish made the following statement:

I believe that we all agree with the proposition that all efforts should be made to reorient resources away from military spending toward more productive uses. Given the scale of global resources devoted to military spending and the potential benefits that would accrue from multilateral arms reduction, I think this is an objective that everybody can support, as it is in the interest of the world as a whole to reduce spending on armaments. As I said on previous occasions, however, real progress toward this objective is unlikely to be achieved in isolation of the broader political and security considerations underlying military spending. The persistence of tensions in many parts of the world, which have often erupted into armed conflict, underscores the need for evolving more effective methods for ensuring regional and international security and for resolving conflicts. If the concept of collective security and strengthened international cooperation, as envisioned in the United Nations Charter, is made more effective, I believe it could pave the way for countries to make a serious reassessment of their military postures and defense needs.

While I can certainly agree with the underlying principle that there is a need for a balanced multilateral reduction in the resources devoted to the military and an urgent need to reorient expenditures toward more productive uses, I would like to raise a few questions for clarification. A preliminary concern is the connection between the data recommendations in the final section of the paper and the preceding sections, which raise issues that open up major areas of controversy. Are we expected to restrict our attention to the data-related questions or should we be addressing some of these larger issues? There appears to be a difference of objectives between the two parts of the paper. The first part seems to emphasize the need to reduce defense spending and how the Fund can help contribute to achieving that laudable objective. The tail end of the paper appears to be arguing that there is a need for military spending data in order to enable the Fund to perform its responsibilities more effectively. It would be useful if the actual focus of the work the Fund intends to do was better delineated.

A second question arises in regard to the assertion that a general improvement in the transparency of data could contribute to a lessening of regional tensions and, thereby, result in easing pressures for military spending in other economies. But how should the Fund ensure that countries already involved in regional conflicts will provide information that they fear would allow adversaries to gauge more accurately the strength of their forces? What degree of disaggregation should the Fund be aiming for so as to reconcile the imperatives of state security with the Fund's desire to help "to strengthen the capacity of governments to make well-informed policy choices?"

A third issue is the consistency of current Fund practice with what is now being proposed for the provision of information about military expenditures. The Fund has traditionally shown exceptional regard to the security considerations of members. In particular, exchange restrictions under Article VIII are accepted at face value when imposed for reasons of national or international security. How could the Fund insist on obtaining "reasonably standardized and aggregate data on military spending" if a member were to invoke a security clause on grounds analogous to those contained in Decision No. 144-(52/51), adopted August 14, 1952--a decision that has stood for almost four decades?

A fourth issue relates to the implications for Fund staffing of developing within the institution an expertise to give advice on the appropriate level of defense spending, assuming that members are prepared to concede such a role. The staff tries to address this question by suggesting that, while in principle Fund involvement should cover all members, the initial focus should be on countries with "relatively high levels of military expenditure." How are such levels to be determined? If cross-country comparisons are involved, how does one choose appropriate comparator groups? Would such comparisons not implicitly assume that military spending is justified only in relation to external threats, while, for many countries, especially those with severe domestic security problems, there are domestic imperatives governing spending levels; how are these concerns to be taken into account?

Yet another issue is how to reconcile a focus on countries with relatively high defense budgets with the mandate of the Fund, which is concerned with the smooth functioning of the international financial system and with the promotion of global prosperity. Would this mandate not suggest that the focus should be more on countries where absolute levels of military spending are large relative to the international economy? A 10 percent reduction in military spending by one or more of the major industrial countries is apt to be far more significant for the efficiency of the use of world resources than a similar or even larger percentage cut on the part of a large number of smaller countries.

Finally, there is an issue of jurisdiction vis-à-vis the World Bank Group, which, as noted in the opening paragraph of the staff paper, has been "closely involved with the assessment of the size and composition of overall public expenditures, as well as with specific sectoral programs." How does the staff propose to coordinate with the Fund's sister institution to avoid or minimize the potential for duplication?

Let me conclude by stressing that the purpose behind these questions is not to belittle the importance of the objective of reducing military expenditures. Rather, it is my wish to make sure that any proposed involvement by the Fund is feasible, constructive, and consistent with the mandate of the institution.

Mr. Ismael said that there was no doubt that military expenditures had macroeconomic implications. He was convinced that a reduction of military expenditures would increase domestic and global savings and contribute to greater economic efficiency. Nevertheless, he had serious doubts whether the Fund was the appropriate institution to monitor and promote arms expenditure reductions; it probably lacked the expertise and the mandate for that purpose. Finally, it had to be recognized that military purchases had been facilitated by the availability of financing from arms-exporting countries. The terms and conditions of arms-import financing had played a crucial role in purchasing decisions; even grants, which were not a burden on the recipient country, were still a drain on public savings in the donor country.

Mr. Zoccali commented that he welcomed the Managing Director's recent initiatives on the subject of military expenditures, and he fully supported the proposition that well-informed public policy choices supported good governance by improving the productivity of public expenditures. Like Mr. Prader, however, he would have preferred to have had the benefit of a prior discussion on the relative dimensions of unproductive expenditures more generally. Nevertheless, he looked forward to the further analysis that was anticipated on that issue, and he hoped that it would cover the impact of domestic support and subsidization schemes, which also had a direct bearing on a member's fiscal policy stance, its balance of payments, and the external and trade environment. As to the role of the Fund in the specific area of military expenditures, it was important to recognize the special nature of the public good in question and the political character of the allocative decision that was involved. That being said, the need for comprehensiveness, transparency, and timeliness of the data should not be treated differently from other unproductive expenditures, nor should military expenditures be considered outside the surveillance process. Finally, in his view, a specific assessment of military expenditures that went beyond macroeconomic perspectives would fall outside the Fund's specific mandate and, therefore, should be left to bilateral relations or more political bodies. Like Mr. Peretz, he shared the view that Fund sanctions or conditionality would not be appropriate in cases of perceived excess military expenditures. In that connection, it was to be hoped that the allocation of staff resources would bear that view in mind.

Mr. Torres stated that he had been pleased that Mr. Fogelholm had reminded Directors of the discussion on the environment, because he, too, had begun to sense the similarities between that discussion and the present one, although there were important differences as well. In both discussions, Directors had been concerned about whether the staff's proposals were consistent with the Fund's mandate, whether the Fund had a comparative advantage in the field, and whether there would be duplication of the efforts of other international organizations. An important difference between the two discussions, however, was the additional concern in the present case about the danger of undermining the willingness of members to cooperate with the Fund, thereby endangering the Article IV process.

It was clear that the potential welfare gains for the world economy and for each country stemming from a reduction in unproductive expenditures were so large that it was necessary to understand better the economic implications of military spending, Mr. Torres remarked. While he would have preferred to discuss military expenditures in a broader context, he agreed that it was reasonable to undertake macroeconomic analysis of military expenditures along the lines that had been proposed, rather cautiously, by the staff. Nevertheless, he had some doubts about the proposal for data collection. Initially, it had seemed very reasonable to argue that Article IV consultations were unique and appropriate vehicles to collect accurate data from all members; in fact, the Fund was probably the only institution that had such a large constituency from which to obtain data. Given the reactions of some Directors during the discussion, however, he was not sure whether Article IV consultations were the most efficient instrument to collect the necessary data. He wondered whether it was necessary, in order to undertake macroeconomic analysis, for the Fund to initiate the process of data collection, given that the data were already collected by other institutions. The Fund should, perhaps, limit itself to a more relevant exercise, such as studying the macroeconomic implications of one important component of unproductive expenditure--namely, military expenditures--which could be an important contribution to creating progressively and cautiously an environment in which it might be conducive to take further, more interesting actions.

Mr. Quirós recalled that the issue of military expenditures had been a topic of prolonged discussion during the early 1960s, when the international community became dedicated to the task of economic development. It was at that time that the former Secretary General of the United Nations, U Thant, had established his well-known program known as "the Three Ds," that is, decolonization, disarmament, and development. The issue of military spending was a complicated one, because it involved economic, social, and political elements, including important and difficult aspects of national security and international law. As the Fund was involved in studying the macroeconomic implications of government expenditures, it was necessary to look at military expenditures in light of their bearing on a member's fiscal policy and balance of payments. Like many Directors, he felt that the staff should be entrusted with gaining an overall view of the issue, but he did not feel that the staff should be involved in direct discussions on military spending. That was something that could and should evolve from the expected additional strengthening of the United Nations in the future. The guidelines for the Fund's role in that area should come from the United Nations; other institutions like the World Bank and the Fund would then be in a position to study the macroeconomic implications of military spending decisions for economic growth, development, output, income, trade, savings, investment, and employment.

Ms. Duan stated that her authorities shared the concerns of some speakers about the role of the Fund. The Fund should be extremely cautious in dealing with the very sensitive issue of military spending, which was not within the Fund's traditional area of expertise. The Fund should proceed very carefully, and its role should remain consistent with its mandate.

The Director of the Exchange and Trade Relations Department stated that the staff was under no illusion about the sensitivity and complexity of the issue of military expenditures. There seemed to be two strains of thought running through Directors' discussion, which mirror issues raised in the staff paper. The first was related to concerns about the level and appropriateness of military expenditures, and whether recent international political developments presented opportunities for reductions in such expenditures. There had also been a sense that transparency in the area of military spending would support judgments that needed to be made by others on that political issue. He agreed completely with Mr. Goos and other speakers that it was not appropriate for the staff to make judgments on the level and appropriateness of military spending.

The second strain of thought concerned the macroeconomic implications of military expenditures, the Director said. Judgments on the extent to which a certain level of expenditures was excessive were extraordinarily difficult to make, and they were particularly difficult in the area of military expenditures, where, by definition, they involved decisions about national security. Clearly, the staff did not have a role to play in that latter area. At the same time, however, there was a role for the Fund in analyzing the macroeconomic implications of government expenditures, whether thought to be productive or unproductive. He would argue that, where military spending was substantial, the Fund could not analyze comprehensively the macroeconomic situation of a country unless it had all the data related to such spending, including those on domestic spending, imports, external debt, and debt service related to the purchase of imports on credit.

Many speakers had queried the nature of the data to be collected and the purposes to which that data would be used, the Director recalled. At present, however, the staff could not define precisely what that data would comprise, although it was safe to say that the data would not in any way allow judgments to be made about the military capabilities of a particular country. Even if the Fund were to request a somewhat disaggregated level of data--say, for example, data on wages and salaries, or the share of imports in the aggregate figure for military spending to permit consistency checks against the balance of payments--the data would not be such as to pose serious problems of national security. The data would be less sensitive than the data that were already published by SIPRI and other organizations on the military capabilities of various countries. The Fund would be guided not by a concern about the appropriateness of military spending, but by the need to analyze the macroeconomic implications of such spending.

There were a number of ways for the staff to check the consistency of data on the budget, balance of payments, debt, and monetary aggregates, the Director observed; a financial programming framework could frequently provide a clue to consistency problems in one or several areas. In certain cases, the staff had known that data on military imports, for example, had escaped customs reporting, because there had been indications in the monetary accounts of omissions in the balance of payments. Similarly, there were other sources of data on military expenditures, but the staff could not rely solely on them for its own analysis, because such data could not easily be incorporated into the staff's budget framework or be carried over to the balance of payments and the monetary accounts for consistency checks. Moreover, comparisons had shown that data from different sources were not necessarily compatible; indeed, the differences could be as great as 20 percent in any one year. Given that the Fund was the institution primarily responsible for conducting the analysis of a country's macroeconomic situation, data on military spending had to be compatible with the staff's statistical framework.

On the question whether the staff should insist on obtaining the necessary data, the Director said, the essential point was whether Directors agreed that it was appropriate for the Fund to insist on the provision of military spending data, which was related to the issue of sanctions for nonreporting. The sanction that the staff had proposed was along the lines of the one mentioned by Mr. Peretz. In the first instance, there could be an indication in the staff report that the data provided by the authorities could not be reconciled with data from other sources; similarly, if the staff knew from a different source that debt service was being seriously understated and that there was reason to believe that the missing data were related to unrecorded military debt, that view could be cited in the staff report. In neither instance, however, would the staff propose a particular sanction; the staff would merely report its findings to the Board. It would be for the Board to decide, in the context of the Article IV discussion, whether the staff had been provided with sufficient data for the Fund to carry out its surveillance responsibilities. The Board could also, if it wished, question whether a member had met the obligations of membership in terms of the provision of the necessary minimum data for the analysis of the member's economy.

There was, indeed, a relationship between the issue of transparency and certain initiatives that were under way among aid agencies, the Director commented. However, the staff would not, nor did it desire to, make decisions on the appropriateness of the level of military spending in a particular country. The aid agencies wanted to link at least some of the assistance they provided to judgments on the appropriate level of military spending, but those judgments would be made by the political authorities of the countries that provided such assistance. Data transparency, by providing clearer indications of military spending levels in certain countries, might be one input to those judgments, but it was not the staff's intention to begin work in the area of military expenditures in order to lead to Fund decisions about excessive levels of military expenditures. Rather, the staff's intention was to prepare comprehensive macroeconomic analyses to assist the authorities, particularly in cases in which they might be downsizing the military structure, with implications for sectoral adjustment, labor market operations, and so on. From that perspective, the degree of data disaggregation that would be requested from the authorities would be a function of the issues that needed to be addressed. To analyze labor market developments properly, for example, the staff would need to know the magnitude of the labor to be released from the military sector. If a country was reducing exports of military equipment and the domestic production thereof, it was necessary to have some disaggregated information about the military establishment in order to carry out macroeconomic analysis.

The staff was reviewing the division of labor between the World Bank and the Fund, the Director of the Exchange and Trade Relations Department noted. Working groups had been established in both institutions to begin discussions on how the two institutions would approach the issue and how the staffs could cooperate in the collection and standardization of data.

Mr. Orleans-Lindsay noted that the staff paper implied that the Fund's efforts to assist members in strengthening the institutional capacity to make sound policy choices had been incomplete and subject to possible errors of analysis, because the staff had not discussed military expenditure matters with national authorities. He wondered whether the staff could elaborate on that point, especially whether the staff had been leaving something out of its analysis owing to a lack of data.

The Director of the Exchange and Trade Relations Department replied that, in some cases, the presentation of military spending data in the staff's analysis had been fairly extensive. With respect to some of the industrial countries, there was wide agreement that the data that were presented in the staff reports for the Article IV consultations were transparent on the military side; in some cases--such as a recent consultation with the United States--military expenditures had been subject to analysis in an appendix of the relevant background paper. In his view, the problem was one of not knowing whether or not the staff had a comprehensive picture. In many instances, military debt was not recorded with other debt statistics, and the interest cost of military debt had been higher than the average interest cost of the remaining debt, which had led to an underestimation of the external fragility of the economy. In some cases, the lack of information was such that the staff could not properly perform the macroeconomic analysis that was necessary for financial programming. The staff could, therefore, be more confident of its analyses if a transparent set of military aggregates was embedded in the macroeconomic data. As the staff paper noted, the issue was a sensitive one, and the staff intended to move very cautiously. The matter would need to be reviewed regularly by the Board to ensure that the staff's treatment of individual country situations remained appropriate.

Mr. Kyriazidis asked how the staff would proceed if a decision was reached on the Fund's role in the area of military expenditures.

The Director of the Exchange and Trade Relations Department responded that, if the Board endorsed the staff's proposals, the staff would proceed cautiously along the lines that he had outlined.

With respect to the question that Mr. Finaish had raised on whether the staff's proposals were consistent with the provision of Decision No. 144, which permitted a country to take certain actions for reasons of national or international security, it did not appear that that particular provision was relevant to the present issue, the Director stated. The staff paper had made it clear that presentation of the data would be subject to the preferences of the authorities. If the authorities, for whatever reason, informed the staff that there were particular sensitivities associated with the requested data, which resulted in a blanket refusal to provide the data, that would pose certain difficulties. The staff would then make its presentation to the Board without the data, noting to the Board that the staff had conformed to the wishes of the authorities. It would then be a matter for the Board to decide, based in part on the staff's own judgment, whether the staff had been given enough information to conduct the macroeconomic analysis, or programming, that was necessary in the case of that country.

Mr. Finaish remarked that, in the past, the Fund had been very sensitive to the issue of security. If one country claimed that a second country had taken certain actions that affected international security or the national security of the first country, the first country would be able to invoke Decision No. 144 and impose restrictions--for example, the freezing of assets of other countries. If the Board did not react to those measures, the Board's silence would be interpreted as approval or consent; in fact, measures taken under that decision had never been challenged. The only time that the decision itself had been brought to the Board for discussion had been in January 1986, in the context of a dispute between the Socialist People's Libyan Arab Jamahiriya and the United States. Even before that discussion, however, he and other Directors had complained that the decision had often not been invoked for reasons of national security but for political reasons, and that, historically, it had been misused against small countries. Moreover, the decision itself, which had been adopted in August 1952, called for periodic reviews of its operation and reserved the right of the Board to modify or revoke at any time the decision or the effect of the decision on any restriction that might have been imposed pursuant to it. The point that he had tried to make in those earlier discussions was that, as the decision was being misused and it affected the conduct of international trade and financial relations, it should be reviewed at least once, but that had never happened.

The point that he had raised in the context of the present discussion, Mr. Finaish continued, was that, unlike measures taken pursuant to Decision No. 144, under the staff's proposal, it was far from clear that the Board would give a member the benefit of the doubt if the member were to decline to provide detailed information on its military expenditures for national security reasons. He wondered whether the Board would need to review the consistency of Decision No. 144 with the staff's proposals, because it appeared that national security considerations would be treated somewhat less sensitively than they had been previously.

Mr. Peretz remarked that he was puzzled that some Directors felt that publication of aggregate data on military spending would compromise national security. If a member considered that to be the case, it could always decline to provide the information, much in the way that some countries had declined to have Article IV consultations for considerable periods of time. He agreed that sanctions should not be imposed against a country that declined to provide the requested information. For its part, however, the staff would only be fulfilling its duty if it reported to the Board holes or inconsistencies in national statistics that had an important bearing on the economy; indeed, if the staff was not already reporting such information, he would like to know why.

Mr. Mirakhor said that he had hoped to be reassured by the staff that it would be sensitive to the issues of national security and national sovereignty, and he wondered how that sensitivity would be manifested operationally. Ultimately, it was for the country to decide whether or not its national security or national sovereignty was going to be impinged. The staff had noted that aid agencies already wanted to obtain some analysis from the staff; moreover, in the context of the discussion on the management of the debt situation at EBM/91/133 (9/27/91), the staff had proposed that it should be allowed to provide advice on a member's economic situation to commercial banks and other creditors. He was concerned that official donors would argue that they had a right to know exactly what the situation was in certain countries vis-à-vis military expenditures. In his view, there was a contradiction between, on the one hand, the provision, collection, and presentation of data and, on the other hand, the assurance that the national security of a country would not be compromised; for example, information provided to the Board one day often was the subject of an announcement in the press the next day.

Mr. Goos observed that Mr. Peretz had said that it would be up to the country to decide whether or not to provide the information, and he wondered whether leaving that decision to the country would be contrary to the purpose of the proposal. If transparent and comprehensive data were required, then the Fund should find a way to ensure that all countries disclosed the necessary information; to do otherwise would impinge on the obligation of the Fund to maintain equal treatment of members. It was also important to bear in mind the clause in Article IV, Section 3(b), which was echoed elsewhere in the Articles of Agreement and was embodied in a number of policy decisions, that the principles adopted by the Fund should "respect the domestic social and political policies of members," and that "in applying these principles the Fund shall pay due regard to the circumstances of members." Such escape clauses had been respected by the Fund in the past, and he was concerned that if a country could hide behind such a clause with respect to the disclosure of data on military expenditures, there was a danger that the staff would have only partial data, which would not be an improvement on the present situation. On the ability of the staff to derive figures for military spending through consistency checks across different accounts, he wondered whether that mechanism would provide the necessary data that were needed for the staff's analysis.

The Director of the Exchange and Trade Relations Department commented that the staff paper had indicated that the entire exercise depended on the goodwill of the countries concerned; clearly, there could be no way forward without a consensus. He would agree with Mr. Goos that there were limits, which would be reached reasonably quickly, in the staff using macroeconomic financial programming and consistency checks, as well as data sources from SIPRI and others, to ascertain whether it had received full information. In that context, there was a useful role for thinking about the degree of disaggregation of data that was required to bring to the Board the transparency that it wanted. Many speakers had referred rather loosely to "the data," but the data had not yet been defined; that would have to be worked out as the exercise proceeded, as Directors would want to react to the kind of data that was included in the consultation reports and whether it was sufficient for the needs of the Fund, first and foremost, in conducting surveillance.

Mr. Posthumus said that he wondered whether there were some aid agencies that already linked decisions about the level of assistance to a specific country with military expenditures, and whether some of those agencies that did not have military expenditure data had asked the Fund to provide that data. With respect to the question whether the staff could "insist" on the provision of data on military expenditures, he was not sure that that was the case; moreover, the staff could not infer from Article VIII, Section 5(a) that it could require members to provide data on military aggregates.

The Director of the Exchange and Trade Relations Department responded that, to the best of his knowledge, aid agencies had not approached the staff for information about the military expenditures of a particular country. The involvement of the aid agencies in the area of military spending was new; for example, it was only within the previous six months that there had been statements from the Japanese and German authorities to the effect that one of the factors to be taken into account in deciding on aid allocations would be the military expenditures of recipient countries. On the legal basis for the Fund's mandate in the area of military expenditures, he would only note that the staff was proposing to obtain information on only broad military aggregates, separately identified, such as the changing size of military manpower in the context of an analysis of domestic labor markets. In other cases--to support an analysis of import elasticities, for example--it might be necessary to know something about the import components that were subject to zero price elasticities, such as military spending.

Mr. Kyriazidis said that he would have some difficulty with requiring members to declare information on their military manpower in order to analyze labor market conditions, as such a requirement might run into very serious difficulties in many countries. Information on military manpower was often considered one of the most sensitive military secrets of a country, and he wondered whether the Fund could require countries to disclose that information on the grounds that it was needed for structural analysis of the labor market. In his view, such information was not "aggregate data," and the Fund should limit itself to aggregate fiscal data.

The Director of the Exchange and Trade Relations Department stated that it was useful to distinguish three different cases in which data on military expenditures could be requested from the authorities. There would be cases in which there was no indication of a need for that data to conduct the staff's traditional analysis; in those cases, there would be no additional data request. In other cases, in which countries were engaged in downsizing military establishments, for example, and in which they might well want the staff's assistance--as had been the case in recent months--the staff might have to request from the authorities information on, say, broad indicators of labor market activity. If the authorities wanted assistance in analyzing the economy at that level, they would presumably be willing to provide that kind of information. There was a third kind of case, lying somewhere between the first two cases, in which large changes--in the pattern of imports, perhaps--could not be explained, but there was some evidence that those changes were related to changing levels of military expenditure. If the authorities wanted the staff's analysis to be helpful, they might want to provide that kind of information, but it would not necessarily follow that that information would be presented in the staff report.

Mr. Kyriazidis remarked that he did not, of course, disagree with the Director of the Exchange and Trade Relations Department that, if a country was downsizing its military establishment and requested the assistance of the Fund, it would need--and would probably be willing--to provide the necessary information. The question that he had tried to raise was what would be required as standard information to be provided by members, and what could be provided on a voluntary basis for specific purposes.

The Director of the Fiscal Affairs Department said that it was important to keep in mind that military expenditures, which accounted for about 5 percent of world GDP and about 30 percent of the tax revenue of developing countries, had always been a black hole for the staff, as the staff had been precluded from asking questions in that area. Clearly, there were sensitivities involved, and some countries did not want to discuss the details of their defense programs, but the staff had no intention of asking a country how many guns or planes it had. Moreover, most industrial countries already disclosed information on the level of defense spending, although they tended, appropriately, to keep secret the details of particular weapons systems. While it was true that the Fund had not collected information on military expenditures during the previous 45 years, had it done so, the staff's analyses would have been better. Furthermore, the international political situation had changed. In the past, the Fund operated in a bipolar world in which countries in one group had not been members of the Fund; in that context, information disclosed by one group would have been useful to the other group. Those conditions no longer maintained, however, and the argument for avoiding the issue of military expenditures had lost its force.

With respect to the reasons for compiling data on military expenditures, the Director continued, the Fund was the only institution that compiled government finance statistics with a functional breakdown of expenditures. At present, however, the statistics for defense expenditures contained numerous gaps, and if the Fund was to continue to compile government finance statistics, it would need to fill those gaps. It was expected that the staff would ask only for data on total expenditures and some strictly limited aggregates. For example, it would be useful to know what proportion of expenditures was due to imports or was being financed by abroad.

In his view, the Fund did not have, nor should it seek, the competence to advise a country on the appropriate level of defense spending, the Director of the Fiscal Affairs Department considered. The Fund should, however, have some competence to tell a country that, if it spent 10 percent, rather than 5 percent, of GDP on defense, there would be certain economic implications for the balance of payments, foreign debt, and so on. Those kinds of judgments were made in other areas, and there was no reason why they should not be made in the area of defense spending. No one could argue that a particular country should be spending less on the military; indeed, Adam Smith had listed defense as the primary function of government. Nevertheless, while defense was a public good within a country, it became a "public bad" in an international context. If all countries could decrease defense spending by 10 percent, there was no question that everyone would be better off. By contrast, if only one country decreased its defense spending by 10 percent, the security of that country might be adversely affected.

Therefore, the Fund should be trying to induce an across-the-board reduction in defense spending by calling attention to the issue through the provision of better data, which might encourage countries to look carefully at the cost of military spending. That point raised another issue related to the public choice argument. If information on a country's military expenditures was not readily accessible to the minister of finance, for example, the Fund, by requiring that such information be disclosed, could strengthen the hand of the finance ministry or the central bank vis-à-vis other ministries, which was an important point that could not be ignored.

Mrs. Krosby commented that the staff's proposals called only for the provision of data on military expenditures; the staff was not asking for the authority to make value judgments on that data. In reality, it was the responsibility of individual Directors to pass judgment on the significance of the data, taking into account the views of their authorities. Moreover, the judgments made by individual Directors, in consultation with their authorities, on the level of military spending in a particular country were likely to influence that Directors' views on, for example, the use of Fund resources by that country.

Mr. Peretz noted that sooner or later the Fund would have either 1 or 15 new members where the issue of military spending was going to be very important and where shifting the associated resources into the civil sector would be one of the largest single macroeconomic policy issues.

Mr. Fukui said that he had been impressed by the explanations of the staff about the intentions of the Fund in the area of military expenditures. It had been made clear to him that the staff's macroeconomic analysis contained an important missing link, as certain aggregates related to military expenditures were not always available. Such a situation was regrettable. If one of the functions of the Fund was to try to produce a clear picture of the macroeconomic situation of a country, then military expenditures, in terms of aggregate data, should be properly incorporated into the staff's analysis. In that sense, the macroeconomic approach to dealing with military expenditures was well within the mandate of the Fund. Moreover, if that important aspect of the analysis were to be set aside, the Fund would not be fulfilling its function as the institution responsible for the exercise of surveillance over members' economies. Military data were, of course, confidential in each country, but many countries--including the United States and Japan--already published figures for a variety of military expenditure aggregates, such as the number of military personnel. He wondered why other countries could not produce the same type of basic, suitably sanitized, information.

Mr. Al-Jasser remarked that he had detected a divergence of views among the staff in its responses to Directors' questions. The Director of the Exchange and Trade Relations Department had reassured Directors that the staff would not make any judgments on the level of military spending in a particular country. Nevertheless, as Mr. Towe had pointed out, in a recent staff paper on Pakistan's request for use of Fund resources, the staff had apparently made a judgment about the level of military spending. There had also been an occasion when, in a staff report for an Article IV consultation, the staff had expressed the view that there was a need to reduce military spending. He wondered, therefore, whether the present discussion was intended merely to obtain the Board's stamp of approval for an existing practice. He had also noticed that the Director of the Fiscal Affairs Department had said that he would be happy to see the Fund encourage governments to reduce military spending. In his view, however, that was a dangerous area, which the Fund would be well advised to avoid. Furthermore, it was not the responsibility of the Fund to try to strengthen the hand of one ministry at the expense of another, as the Director of the Fiscal Affairs Department had suggested.

The Fund had built its reputation and credibility on the fact that it had a well-defined mandate, Mr. Al-Jasser said, and on that basis, it had been able to discuss with members their macroeconomic policies and give them advice that had always been well received. In his view, the Fund should jealously guard its mandate; otherwise, it would become like many other international organizations, which had stretched their mandate too thin and had lost their credibility. In that context, he fully agreed with the staff that the Fund did not have, nor should it ever seek, expertise in the military field. The Fund could not, in any event, make value judgments about the appropriate level of military spending in a particular country, because circumstances were always different in each country and were subject to change. Moreover, it was somewhat disingenuous to suggest that it was important for the staff to look at military expenditures because they had definite macroeconomic implications. Ultimately, one could argue, everything had macroeconomic implications. For example, during the recent discussion on the Fund and the environment, income distribution had been the subject of much debate. Clearly, it would be helpful to know something about income distribution in order to analyze aggregate demand in an economy, but the Board had not drawn the conclusion from that observation that the Fund should reprimand a country, in the context of an Article IV consultation, for having too skewed an income distribution. It had to be accepted that issues of national security were essentially political in nature and were not necessarily founded in sound economics.

The staff paper indicated that 64 members already provided data to the Fund on military expenditures, Mr. Al-Jasser noted. He wondered whether those data were sufficient to meet the needs of the staff proposal, and whether the staff should limit its activity in the area of military expenditures to securing comparable data from the remaining members.

Mr. Arora recalled that the Director of the Fiscal Affairs Department had referred to a black hole in the fiscal accounts of both developing and industrial countries. In his view, there were two aspects to that situation. On the one hand, as the Fund's relationship with different groups of countries developed in the present international political environment, the imperatives of adjustment were already putting the staff and developing countries into situations in which they were beginning to interact on issues related to defense spending. Without a specific mandate, therefore, the Fund's activities in that area would inevitably grow, and it would increasingly have access to data on those spending aggregates in the course of advising governments on the policies required to lift their economies out of difficulty. In that light, an explicit mandate of the kind proposed in the staff paper might create more misgivings and uneasiness than was warranted by actual events.

On the other hand, Mr. Arora continued, if the Fund was given an explicit mandate, the Fund would inevitably get into the kind of problems that Mr. Goos had talked about: some countries would provide the data, others would simply refuse to provide them, while others would decline to release the data for reasons of national security, which would raise questions about the uniformity of treatment of members. From a purely practical point of view, he agreed that military spending was not a category of expenditures that could be excluded from consideration in terms of macroeconomic analysis. It should be recognized, however, that the issue was enveloped by a long history of bilateral, regional, and global entanglements of one kind or another, and it was not easy for national policymakers to suddenly allow an encroachment into an area that had been rigorously guarded. Over time, those inhibitions could, perhaps, be shed, but it would be a mistake to try to make a frontal assault on an issue of national sovereignty, which could prove to be unnecessary in the long run.

Mrs. Krosby stated that the issue of the Fund's role with respect to military expenditures was not a moral one; rather, it was akin to the relationship between doctor and patient. In reaching a view on the condition of a patient who was in distress, a doctor would not make a value judgment on the patient's lifestyle but would offer a considered response based on empirical data. In her view, that was the kind of relationship that the Fund should be able to maintain with its members.

The Director of the Exchange and Trade Relations Department said that, in the case of Pakistan's recent request for use of Fund resources, it should be clear that no judgment had been made on the appropriateness of the level of military spending. The level of military spending as a component of the budget had been mentioned in the relevant staff paper only because there had been budgetary problems during the previous year stemming from military expenditure exceeding budgeted levels. The level of military spending had been the authorities' choice, and the staff had sought merely to ensure that they adhered to that level of spending, or that there would be offsetting measures if there were any slippages. The staff had said nothing about whether such spending had been good, bad, or indifferent. With respect to the public choice issue, the staff had tried to point out that in order to make effective public choices, in which governmental decisions were made with a clear understanding of all of the government's priorities, good information was essential. The black hole in the statistics, to which the Director of the Fiscal Affairs Department had referred, was a reflection of the fact that there was a black hole in the decision-making process as well; priorities were not always accurately measured against each other in governmental circles, because military decisions were often made by those other than economic policymakers. In that context, he agreed with Mr. Peretz that the staff's proposals might well strengthen the hand of members' ministries of finance.

The Director of the Fiscal Affairs Department commented that he would disagree with the view that, by asking for data on military expenditures to fill the gaps in its government finance statistics, the Fund would be violating its mandate. He would draw the opposite conclusion, namely, that the Fund would be pursuing its mandate by being able to do better macroeconomic analysis. If military expenditures were equivalent to only 0.2 percent of GDP, they could probably be ignored; as they were in many cases on the order of 5-10 percent of GDP, however, he wondered how the staff could produce powerful analytical work if it was not confident about the data or if it did not have the data at all. Currently, 64 countries provided data on military expenditures for Government Finance Statistics, which was less than half of the membership. Many of those countries were industrial countries, so the proportion of reporting developing countries was much smaller. In any case, the data that were available from other sources strongly suggested that the data reported to the Fund did not fully reflect the situation in some countries. Moreover, the data that were reported to the Fund covered only the budget; much of a country's military expenditures were contained in extrabudgetary accounts, giving rise to another problem.

He agreed with Mr. Arora that it would take time for members to feel comfortable reporting military spending data to the Fund, the Director said. Clearly, many countries were not yet in a position to report the necessary data, and they would need time to develop a comprehensive picture of their military spending. That process would, as had been noted, strengthen the hand of the finance ministries. It was also clear that some countries would provide full data and some countries would not. The Fund would have to be careful with what it did with the data, therefore, especially in a regional context, where there could be rivalries among countries. With that in mind, it was to be hoped that members would see the benefits of full disclosure to the Fund; in an adversarial relationship, perhaps the worst situation for a country was not knowing exactly how much a rival country was spending on the military, because that would probably induce the first country to spend more on the military than it would otherwise. Of course, it would be much better if both countries could be induced to lower their military expenditures simultaneously. He would have no hesitation in making a value judgment that all countries would be better off if military spending was cut in every country by 10-50 percent. He would not, however, be willing to make a judgment that a particular country should be spending less on the military, because that depended on what other countries were doing. It was his hope that the Fund was pursuing a policy that, over time, would bring about--albeit with some difficulties--an across-the-board reduction in the global level of military spending.

Mr. Posthumus remarked that while, in one sense, he could not disagree with the explanation of the Director of the Fiscal Affairs Department, the Director had not fully accepted the point that it was not clear why the Fund should be heavily involved in the area of military expenditures. Moreover, the Director had indicated that by getting involved in that area, the Fund would immediately become entangled in decisions on whether or not to publish military spending data for a particular country, which was a political issue that should be resolved in some other way. It was not necessary to argue about the importance of military expenditures, because that was not the point. While he was confident that an agreement could be reached on the Fund's role in the area of military expenditures that would command wide support in the Board, he did not feel that Directors' concerns had yet been met.

The Director of the Fiscal Affairs Department said that he would only emphasize that the Fund had a responsibility for evaluating members' macroeconomic policies, but it could not pursue powerful analyses if it did not have full information. Moreover, the Fund was the only institution that published government finance statistics for most countries.

Mr. Kyriazidis stated that the black hole that had been mentioned was related to the Fund's published statistics on military expenditures. It should not necessarily be assumed that governments themselves suffered from the same black hole; indeed, as Mr. Al-Jasser had noted, governments knew very well how much they spent and what the opportunity costs of that spending were. The question for the Fund, therefore, was whether the black hole in its statistics should be eliminated. The Director of the Fiscal Affairs Department had said that he would not hesitate to make a value judgment on the benefits for the world of a reduction on the order of 10 percent in global military expenditure. It was not clear, however, that such a reduction would make all countries better off, as that would depend on how the relative security of each country was affected within its own region, given the security threats it faced. Therefore, such value judgments could not be made in every case.

Mr. Al-Jasser said that the observations that had been made to the effect that the staff's proposal would strengthen the hand of one ministry at the expense of another reflected the fact that the issues related to military expenditures were not only macroeconomic; indeed, they went well beyond that. Accordingly, the Fund should be humble about the limits of its mandate, and it should leave questions of international security to the United Nations. Of course, if the United Nations reached a decision on a register of international arms transfers, the Fund should be willing to support that effort by conducting its own analysis.

The Acting Chairman remarked that a distinction should be made between, on the one hand, the need for the Fund to be given all the data necessary to arrive at total government expenditures and, on the other hand, the question whether that data should be provided in a disaggregated form, which would permit ascertaining the relative share of the military in government spending. The existence of a black hole in the Fund's statistics was more likely in cases in which the precise level of military expenditures was not known. There had been cases, for example, in which the finance minister and central bank governor had been caught by surprise by a sudden creation of extrabudgetary accounts, indicating that expenditures had been authorized without their prior knowledge. While it was true that, in many such cases, those expenditures had been for the military, the important point was that expenditure had been undertaken but had not been reported.

There did not appear to be any disagreement with the proposition that the Fund should have comprehensive data on government expenditures, the Acting Chairman considered. There was, of course, some difference of view on whether the Fund could ask a country to identify separately the level of military expenditures. If, however, the issue was presented in terms of whether the Fund should be provided with all the relevant information to enable it to make judgments about a country's budget expenditures, external borrowing, and imports, there would probably be no disagreement. On the question of how the Fund would use detailed information on military expenditures, there had been some very important differences of view, although there appeared to be a strong consensus against the Fund making judgments on whether or not a certain level of military expenditures was excessive. Many Directors had expressed the view that those judgments should be left to individual governments; some Directors had stated that they needed to be provided with data on military expenditures in order to enable them to reach their own conclusions about the appropriateness of military expenditures. In that context, the issue of uniformity of treatment of members would have to be addressed. For example, if it were agreed that the Fund should be provided with data on military expenditures at an aggregate level, he wondered how the staff could be sure that the relevant aggregates provided by one country included all of the elements that other countries treated as military expenditures. Therefore, in a reporting sense, it would be difficult to come to a view on total military expenditures without first disaggregating the relevant data.

The present discussion seemed to suggest that the staff should continue to seek comprehensive data from all countries, the Acting Chairman remarked. Moreover, there seemed to be agreement that, if asked by the country concerned, the Fund should be able to assist in analyzing the effects of changing levels of military expenditures. Beyond that initiative, however, there had been very sharp differences of view on the question of how, and to what extent, the Fund should get involved in analyzing the impact of military expenditures. In sum, it appeared that the majority of Directors would be very reluctant to try to reach any conclusions on the role of the Fund in the area of military expenditures without first having some time to reflect further on the issue.

Mr. Peretz commented that he could accept that the Board would not reach any conclusions at the present meeting. Nevertheless, the purpose of the discussion had been to provide some guidance on the role of the Fund in the area of military expenditures; while great differences of view had been put forward, it was his impression that it would be possible to offer some guidance that would command wide, if not universal, support in the Board. With that in mind, the Acting Chairman might wish to prepare a formal summing up of the meeting, which could be taken up by the Board during the following week after some reflection.

After a further brief discussion, the Executive Directors agreed to meet again on October 2, 1991 to consider a statement, to be prepared by the Acting Chairman, that could serve as a basis for reporting to the Interim Committee on the status of the Board's deliberations on the role of the Fund in the area of military expenditures.

The Executive Directors then concluded for the time being their consideration of military expenditures and the role of the Fund.

APPROVED: March 31, 1992

LEO VAN HOUTVEN
Secretary