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Minutes of Executive Board Meeting 90/111

3:00 p.m., July 11, 1990

R. D. Erb, Acting Chairman

Executive Directors

M. Al-Jasser

C. S. Clark

Dai Q.

T. C. Dawson

E. T. El Kogali

R. Filosa

M. Finaish

M. Fogelholm

M. R. Ghasimi

J. E. Ismael

J.-P. Landau

Mwakani Samba

G. A. Posthumus

Alternate Executive Directors

L. E. N. Fernando

C. Enoch

D. Sparkes, Temporary

G. C. Noonan

Zhang Z.

B. S. Newman, Temporary

S. B. Creane, Temporary

J. Prader

J. O. Aderibigbe, Temporary

S.-W. Kwon

M. J. Shaffrey, Temporary

R. J. Lombardo

R. Marino, Temporary

N. Kyriazidis

I. H. Thorláksson

M. J. Mojarrad, Temporary

B. Goos

L. I. Jácome, Temporary

J.-F. Cirelli

C. V. Santos

S. Yoshikuni

K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor

B. R. Burton, Assistant

L. Collier, Assistant

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Also Present

Embassy of New Zealand: D. Gill, Economic Counsellor. IBRD: R. W. Zaborski, Europe, Middle East and North Africa Regional Office. Administration Department: H. Wiesner. African Department: M. Touré, Counsellor and Director; P. A. Acquah, A. Bourhane, J. K. Bungay. European Department: P. B. de Fontenay, Deputy Director; D. J. Archer, K. B. Bercuson, I. M. Jones, B. J. Smith. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; E. Brau, M. V. Carkovic, M. E. Edo, K. G. Fitchett, M. G. Gilman, S. Kanesa-Thasan. External Relations Department: S. W. Kane, H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: G. Elouzone, Participant. Legal Department: W. E. Holder, Deputy General Counsel; P. L. Francotte, R. Leckow, J. K. Oh. Middle Eastern Department: S. H. Hitti, M. R. Rached, B. K. Short. Research Department: J. A. Frenkel, Economic Counsellor and Director; M. Goldstein, Deputy Director; J. M. Boughton, M. A. Wattleworth. Secretary's Department: C. Brachet, Deputy Secretary; G. Djeddaoui, A. Tahari. Treasurer's Department: G. S. Tavlas. Bureau of Statistics: M. Wasfy. Advisors to Executive Directors: M. A. Ahmed, M. B. Chatah, A. Gronn, Z. Iqbal, K.-H. Kleine, P. O. Montórfano, A. Napky, D. Powell, A. Raza. Assistants to Executive Directors: T. S. Allouba, S. K. Fayyad, B. S. Fuleihan, S. Gurumurthi, M. E. Hansen, A. Hashim, J. Heywood, O. A. Himani, P. Kapetanovic, K. Kpetigo, M. Mrakovcic, H.-J. Scheid, J.-P. Schoder, J. C. Westerweel.

1. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director reported briefly on the Houston Economic Declaration, with reference to a study of the Soviet economy to be undertaken by the Fund, the World Bank, the OECD, and the designated president of the ERBD, in close consultation with the Commission of the European Communities. The participants would be convened by the Fund, and the study should be completed by the end of 1990.

2. NEW ZEALAND - 1990 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/90/110, 7/11/90) their consideration of the staff report for the 1990 Article IV consultation with New Zealand (SM/90/105, 5/31/90). They also had before them a background paper on recent economic developments in New Zealand (SM/90/108, 6/8/90).

Mr. Cirelli said that he endorsed most of the comments made by previous speakers. Even though the far-reaching restructuring process was still under way--as the authorities themselves recognized--and economic performance had been mixed since the previous year, the overall outlook for the New Zealand economy seemed to be better than it was at the preceding Board meeting, in 1988. However, the slow response of the economy was puzzling. Nevertheless, the actual positive results could be attributed in large part to the complete and continuing commitment of the authorities to restructure an economy that had been characterized by an exhaustive array of regulations, large macroeconomic imbalances, and a poor productivity record.

With that in mind, one had to acknowledge that the authorities' extensive efforts had already borne some fruit, Mr. Cirelli noted. Recent developments included the steady and impressive reduction of the fiscal deficit; the reinforcement of monetary policy, especially the establishment of an independent central bank; and the ability to reduce dramatically the public debt, all major achievements. Moreover, in spite of the economic difficulties experienced last year, the authorities had demonstrated their credibility in the implementation of the policies they had embarked upon. They should continue to build upon that success.

Indeed, many signs pointed to the fact that the present restructuring process had not been completed, Mr. Cirelli observed. Given the poor supply-side response evidenced by the modest real growth in the past year, the maintenance of a prudent policy mix was warranted if inflationary pressures were to be avoided and the authorities were to avert a deterioration of the external balance, which remained fragile. In addition, an expansive financial policy would certainly lead to further external sector degradation and would endanger the objective of price stability.

Therefore, the competitiveness of the economy needed to be enhanced to pave the way to a more stable balance of payments, Mr. Cirelli recommended. Enhancing competitiveness would require continued efforts to secure the conditions necessary for a stronger, sustainable growth. Maintaining the momentum of microeconomic reform, improving labor market flexibility, and reducing policy uncertainties would strongly support the authorities' objectives. He would not comment on the role that lowered import restrictions might play in the process or on the trade policy followed by the authorities, as he shared previous speakers' views. While he would not challenge the assertion that protectionism might be dangerously on the rise in the world, it was always tempting to point one's finger at others in that regard, and it was not easy to escape that temptation entirely. He shared, however, Mr. Shaffrey's remarks regarding the need for a favorable outcome of the Uruguay Round.

He was impressed by the willingness to pursue reform that the authorities had shown and he encouraged them to continue, Mr. Cirelli stated. Like the staff, he thought that--given the nature of New Zealand's economy--there was no choice other than to implement financial policies aimed at bolstering confidence and private sector initiatives, even if the results in terms of output increase and unemployment reduction were still not very large. The slippages that had occurred at the end of 1989 attested to the fragility of the economy and the need not to depart from attempts to reform and to rationalize it, and to consider those efforts in a medium-term framework.

Mr. Newman said that he commended the New Zealand authorities for the depth and breadth of their economic reform effort, and their steadfastness in pursuing it despite difficult economic circumstances and apparently limited short-run results. He hoped that New Zealand's example would provide a model for other countries embarking on structural reform. In light of developments at the economic summit meeting of G-7 member countries then being held in Houston, he hoped that New Zealand's efforts in trade liberalization would provide an incentive to reach agreement at the upcoming Trade Negotiations Committee (TNC) meeting scheduled for later that month that would enable the Uruguay Round to conclude successfully by the end of the year.

The staff paper and several speakers had suggested a number of reasons for the slow supply response, Mr. Newman recalled. Among them were the phasing of the reforms that had led to intersectoral shifts in output and employment but little overall gain; trade liberalization that increased import penetration; and demand management policies for which the necessary restraint was first postponed and then pursued using measures that resulted in a bunching of expenditures. A change in the mix of macroeconomic policies might provide a way out of the conundrum posed with Mr. Cassell's call for fiscal policies to be pursued in a medium-term context, together with continued tight monetary policies to enhance the credibility of the

anti-inflation stance, and Mr. Schoder's concern about the competitive effects of maintaining the nominal exchange rate in the face of declining inflation.

Despite tax reforms to encourage savings over consumption, and the very high interest rates, the household savings rate was low and declining, Mr. Newman noted. Unless that phenomenon was temporary, public savings would have to increase substantially to improve the savings/investment balance and reduce the continuing vulnerability of the economy to external shocks. In those circumstances, a larger financial surplus than the authorities were currently seeking would be necessary; it should focus on controlling social spending, which was rising rapidly.

Consolidation of the fiscal position through social welfare spending reductions could have several potential benefits, Mr. Newman stated. First, it would increase public savings and provide additional incentives for private savings, as households were encouraged to put aside a larger portion of recent income tax savings for a personal safety net. Second, it would permit a reduction in nominal interest rates and thus in high real interest rates, without weakening the credibility of the authorities' anti-inflation effort. Third, it would reduce the risk of an appreciation of the real effective exchange rate. Indeed, while inflation differentials with other developed countries had been narrowed, the continuance of high real interest rates in New Zealand raised the question of whether the 1988 depreciation had been sufficient.

Finally, the time had come for New Zealand to embark on more aggressive labor market reforms to complement measures already introduced in trade, industry, and agriculture, Mr. Newman remarked. Increased labor mobility and wage flexibility were essential if the economy was to benefit from the potential productivity gains resulting from the reform effort. While the recent changes in the Labor Relations Act would facilitate more decentralized collective bargaining, it was only a modest first step with limited impact. His authorities would be interested in learning whether additional measures were contemplated to improve the functioning of labor markets.

The staff representative from the European Department first explained four key provisions of the Reserve Bank Act that underlay its efforts to control inflation. First, the Reserve Bank's objective was clearly defined as seeking price stability. However, no mechanism for achieving price stability through monetary policy had been established. The Reserve Bank could finance the fiscal deficit using monetary means if it so chose, but doing so would, of course, be difficult to reconcile with its goal of reducing inflation to 0-2 percent by 1992. In fact, the Reserve Bank had not been involved in financing the budget deficit for a number of years. Second, the Act defined the conditions under which inflation targets would be renegotiated, namely, variations in indirect taxes, substantial shifts in the terms of trade, problems with the price index, or the occurrence of natural disasters; the effects of rising wage costs inconsistent with the

inflation target were notably absent. Third, the Act included a mechanism whereby the Government could exercise its sovereignty over monetary policy, but still be held accountable. If the Government were to direct the Reserve Bank to pursue a different objective, it would be required to submit the new objective to Parliament for debate and endorsement by a simple majority. Fourth, the Act required an ongoing review process, in which the Reserve Bank provided bimonthly progress reports with projections of inflation and evolving five-year plans to achieve price stability. It was notable that the Act had received broad cross-party support, although the opposition preferred less ambitious inflation targets.

The authorities expected inflation to fall to 3-5 percent by the end of 1990 and to be accompanied by a moderate economic recovery, the staff representative reported. However, for the future he fully agreed with Mr. Schoder's analysis of the nexus between monetary policy and the exchange rate in the anti-inflationary drive. In addition, recent large productivity gains had been realized mainly by labor shedding, which was unlikely to continue on the same scale when the economy turned upward and restructuring in manufacturing became more complete. Therefore, wage restraint and labor flexibility would be crucial in determining whether inflation targets could be met. Otherwise, the costs in terms of competitiveness and output and employment caused by the effects of the tighter monetary policy needed to counter these pressures could jeopardize public support.

As for the authorities' medium-term fiscal policy, their principal goal of eliminating the once large financial deficit had been virtually achieved; thus, there was a need for a new medium-term goal of fiscal policy, the staff representative noted. The staff had suggested as an appropriate goal that the tax burden be reduced. Lowering taxes would be consistent with reducing the Government's share of spending in the economy, and could strengthen work and enterprise incentives and, more broadly, the supply side of the economy. The public-debt/GDP ratio had come down quite dramatically, from 80 percent in 1986/87 to its current 60 percent. With the proceeds from the recently announced sale of the public enterprise, Telecom, the authorities should be able to reduce the deficit to 50 percent by the date they had set for themselves. Therefore, the public debt situation no longer undermined confidence in the public sector; indeed, it provided the authorities with additional flexibility on the fiscal side and reduced their vulnerability to any future shocks.

Trade with Australia had developed strongly and favorably for New Zealand under the Closer Economic Relations Agreement between the two countries. The share of New Zealand exports to Australia rose from about 12 percent in 1979 to 18 percent in 1989, while New Zealand imports from Australia had remained constant at about 22 percent, the staff representative remarked. More important, Australia was the main market for New Zealand's nontraditional manufacturing exports, and manufacturing exports had increased from about 2 percent of total exports in the mid-1960s to about 25 percent currently. New Zealand was using Australia as a

stepping-stone in achieving its quest for broader penetration of world markets. The Australian Bureau of Industry Economics had estimated that in the mid-1990s, the benefits to New Zealand from the Australia-New Zealand Closer Economic Relations Agreement (CER) could be on the order of about \$1 billion per annum.

As to the lessons to be learned from restructuring, New Zealand had had very little choice in the sequencing of reforms, the staff representative said. The authorities had seized the window of opportunity, the first in several decades, and had tried to do as much as possible as quickly as they could. As a result, the easier problems were tackled first. Financial deregulation was completed first, with the removal of price, interest rate, and wage controls; the exchange rate was floated; and agricultural and export subsidies were abolished. Consequently, agriculture and exports suffered a serious setback, but other areas, such as financial industries and commercial construction, underwent major expansions in the period 1985-87. That expansion was now apt to be overlooked. In fact, the expansion was so robust that it had taken three years for the authorities' best efforts to rein in the macroeconomic side and begin to bring demand and inflation under control.

The two-track liberalization that several Directors mentioned had delayed manufacturing adjustment, although it now had considerable momentum. That delay had in turn slowed completion of the overall restructuring and contributed to a loss of confidence, the staff representative continued. However, he thought that given the authorities' timetable, restructuring was taking place reasonably quickly.

Labor market reforms had been delayed, and the staff agreed with the assessment of some speakers that reforms, overall, had been half-hearted, the staff representative remarked. As a result, production had been less responsive to market forces than it would have been had the labor market been more flexible.

Finally, the fact that the flow of resources to and expansion in production of the sector in which New Zealand had the greatest comparative advantage, agriculture, had not been more substantial despite its earlier adjustment, could be attributed to several factors, the staff representative said. One was biological; livestock numbers could not be expanded beyond a certain rate. Other reasons reflected the sheer scale of the adjustment that was being undertaken by the farm sector. However, it should be stressed that foreign protectionism in agriculture had severely restricted New Zealand's capacity to develop and expand in its natural area of comparative advantage.

Mr. Shaffrey said that the slow resupply response of domestic producers could be attributed to the business uncertainty that occurred after the Government tackled so much at one time, not only making major structural reforms but also mounting a concerted effort to correct the major

macroeconomic imbalances. Inflation was a case in point; the inflation rate was in the process of dropping from a level well in excess of the OECD average before the adjustment to a target below the OECD average. A better economic performance would be registered once the economy stabilized. The goal of policy should be to achieve stabilization by what he referred to as the "three Cs"--credibility, consistency, and continuity. Once investors could identify the risks and benefits, they would be more likely to make major investments in response to new opportunities made possible by the liberalization process.

The optimal pace and sequencing of reforms was theoretical and still open to debate, Mr. Shaffrey noted. At the outset of the reform process, political speed limits were recognized as a concern--that had to be addressed by building a constituency for change and a reasonable degree of credibility--not as exogenous factors. Developing a change in public attitudes took time. For example, public reaction to a graduated but significant drop in tariffs in March 1990 had had little impact. In contrast, even up to two years ago, the announcement would have been seen as revolutionary.

Delivering the "three Cs" from a macroeconomic perspective, the Government was firmly committed to a fiscal policy with medium-term objectives, Mr. Shaffrey commented. He agreed with Directors' comments on the revenue and expenditure mix. As for taxation, the broadening of the tax base and the elimination of tax breaks were mainly responsible for the increase in the aggregate tax burden. As the staff representative had remarked, there was bipartisan political support for the Government's monetary policy; members of Parliament belonging to the Opposition had been instrumental in having price stability provisions of the Reserve Bank legislation strengthened. In addition, the legislation provided for the dismissal of the Governor of the Reserve Bank if the bank failed to achieve its specified inflation targets. Monetary policy reforms in New Zealand were more far-reaching than in any other developed country to date.

In reply to Mr. Cassell's comments on the supervision of financial institutions, Mr. Shaffrey observed that the intensive supervision in the United Kingdom had not proved a prophylactic against the financial difficulties experienced by specific financial institutions there. New Zealand's major concern was the protection of the system's stability and, to that end, it had adopted the BIS capital adequacy standards.

The lesson to be learned from New Zealand's experience was that the simultaneous implementation of macroeconomic stabilization measures and microeconomic reforms caused tension in the short term, but were mutually reinforcing in the medium term, Mr. Shaffrey concluded. For the decade ahead, New Zealand's economic prospects were brighter than they had been for some time, and the country was in a better position to achieve sustained growth than it had been for many years.

The Acting Chairman made the following summing up:

As background to their comments on recent developments in New Zealand since the last Article IV consultation, Directors recalled the major reforms that New Zealand has been undertaking since 1984. Directors noted, however, that the performance in 1989 was disappointing; the economic recovery of early 1989 lost momentum in the second half of the year, with an unanticipated increase in inflation and interest rates contributing to a setback in confidence during the course of the year.

Directors also noted that the growth in domestic demand in 1989 had been associated with a sluggish increase in output; the result was a substantial widening of the external current account deficit. In addition to the constrained supply of agricultural exports and a surge in import-intensive investment, the external weakening reflected structural factors such as the reduced ability of domestic producers to increase output during the process of economic restructuring. While tariff reductions would ultimately lead to improved efficiency, Directors emphasized that safeguarding the external position in the period ahead would require continued improvements in competitiveness and cost cutting.

Directors noted that the short-term economic outlook was for a moderate recovery and they believed that the medium-term prospects were encouraging on the basis of the extensive economic restructuring of recent years. Directors stated that continued restructuring and deregulation should be underpinned by sound macroeconomic policies set firmly in a medium-term framework in order to strengthen investors' confidence and achieve the ambitious inflation target. Most Directors concluded that in the present circumstances stimulatory financial policies would not yield durable benefits, but would likely be reflected in a further deterioration of the external balance.

Directors commended the authorities for their pursuit of a fiscal consolidation strategy over recent years. The favorable budget results for 1989/90, when the financial deficit had been reduced to about 1 percent of GDP, had resulted from a strong set of policy actions. Directors also endorsed the authorities' goal of strengthening the budget further and attaining a financial surplus in 1990/91, noting that in light of the Government's public commitment, a less ambitious path would undermine credibility. In that context, it was emphasized that the medium-term orientation of fiscal policy could usefully be further strengthened. Directors agreed with the authorities that the action needed to close the budgetary gap should fall on the side of expenditure restraint, particularly in the area of social spending, including unemployment compensation, rather than a continued reliance on revenue gains.

Directors endorsed changes in monetary arrangements that clearly focused monetary policy on the objective of price stability. Directors believed that the formalization of this objective in the Reserve Bank Act served to enhance the credibility of policy. The importance the authorities attached to the exchange rate in the conduct of monetary policy was seen to be appropriate and would be reinforced as the economy moved toward price stability. The objective of reducing inflation to 0-2 percent by the end of 1992 was seen as ambitious and underlined the importance of labor cost restraint as a means of achieving the needed improvements in competitiveness. Directors noted that the recent improvement in unit labor costs had been associated with large-scale labor shedding and stressed that greater labor market flexibility and wage restraint were essential if competitiveness gains were to be achieved in an environment of expanding employment.

Directors observed that the economic restructuring pursued by New Zealand in the past seven years had been the most extensive program undertaken by any industrial country; nevertheless, experience had demonstrated it was taking longer than envisioned initially to restore investors' confidence, and put the economy back on a path of rapid economic growth and increasing employment.

Although it was recognized that the reforms had been broad, some Directors raised questions about the phasing of reforms and wondered whether the rapid reform of the agricultural sector should not have been accompanied by a faster pace of reform in the manufacturing sector and the labor markets. In that regard, New Zealand's experience deserved further study to see what could be learned from that experience and provide valuable lessons for other countries undertaking structural reform.

Directors praised New Zealand's import liberalization and welcomed the authorities' recent decision to extend the tariff reduction program beyond 1992. This provided full advance guidance to industries in their adjustment efforts to improve efficiency in the face of international competition. There was also agreement that New Zealand's economic adjustment would be facilitated by support from other countries especially in the context of the Uruguay Round--that improved access to foreign markets for its exports, particularly for agricultural products, where New Zealand was seen to have a comparative advantage.

It is expected that, under the bicyclic consultation procedure, the next full Article IV consultation with New Zealand will be completed within 24 months.

3. SYRIAN ARAB REPUBLIC - 1990 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1990 Article IV consultation with the Syrian Arab Republic (SM/90/97, 5/21/90). They also had before them a background paper on recent economic developments in the Syrian Arab Republic (SM/90/111, 6/11/90).

The staff representative from the Middle Eastern Department announced that in the previous month Syria had issued a law imposing annual fees on Syrians working abroad. The scale for those fees started at \$50 for an unskilled worker and rose to about \$700 for professionals and business people. In addition, Syrians who resided abroad and had evidence that they had paid the required fee would be allowed to effect some transfers at a favorable exchange rate, and to take advantage of specified import privileges annually as well as upon termination of five years' residence abroad.

Mr. Finaish made the following statement:

The main objective of economic policy in Syria since the mid-1980s has been to adapt the domestic economy to the substantial decline in the inflows of external resources which was associated with the regional economic slowdown. Over the past four years, a strong effort has been made to reduce domestic absorption and enhance production and exports. Fiscal policy has constituted a central element of these efforts. Pricing policy has also played a major role in improving public finances and resource allocation, which, together with other structural measures to promote private sector activity, has led to a significant improvement in the current account position, as the figures below would indicate. That notwithstanding, the Syrian economy has continued under severe pressure owing to the enormity of the problems with which the authorities have been faced. In certain structural areas the authorities have followed a gradual approach aimed to balance economic and social objectives; however, the trend toward liberalization is unmistakable, and the progress already achieved should not be underestimated.

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
	<u>(In percent of GDP)</u>				<u>(est.)</u>
Government expenditure	44	37	30	25	26
Budget deficit excluding grants	18.1	14.2	5.0	2.1	3.0
	<u>(In millions of U.S. dollars)</u>				
Private sector non-oil exports	140	246	301	494	1345
Current account balance	-860	-530	-289	-151	784

Reflecting continued expenditure restraint and a strong revenue effort that included wide ranging adjustments in administered prices and improvements in tax collection, the fiscal deficit--excluding grants--declined to 2 percent of GDP in 1988. The revenue performance was also helped by the significant increase in surcharges on petroleum products and in custom duties following the exchange rate devaluation.

Fiscal policy continued to be tight in 1989. Provisional data point to a further improvement in revenue performance reflecting discretionary measures taken early in the year and strengthened efforts in revenue collection. These measures included substantial increases in the prices of bread and petroleum products and sharp reductions in the rations of essential commodities. Customs duties also rose significantly reflecting the adjustment in May of the exchange rate for customs valuation, and the rationalization of the tariff structure. With continued restraint in government spending, the budget deficit for 1989--excluding grants--is estimated to have been in the order of 3 percent of GDP--notwithstanding the sharp decline in real GDP associated with the weak performance of the agricultural sector owing to unfavorable weather conditions.

Capital spending in recent years has been in line with the authorities' development strategy and has focused on the agricultural sector and on the completion of projects in other areas. In 1989, higher allocations were made for social and personal services and for manufacturing projects with export potential.

The 1990 budget indicates increases of 15 percent and 17 percent in revenues and expenditures, respectively. It should be kept in mind, however, that actual expenditures have usually fallen short of budgeted levels. The authorities expect revenue performance to benefit from the full-year effects of the discretionary measures taken in 1989, and from a further increase in income tax collection from enterprises owing to adjustments in administered prices and a further expansion of the oil sector. A possible decline in external grants would undoubtedly put pressure on the fiscal position, but judging from the authorities' determined fiscal adjustment of recent years, there should be little doubt that the authorities would respond to such pressures if they were to materialize.

Pricing policy has been used extensively over the past two years as part of the effort toward fiscal adjustment and also to enhance production and efficiency. As I mentioned earlier, the prices of a number of important commodities, including bread and petroleum products, were increased substantially in 1989. The

thrust of the authorities' pricing policy will continue to be in the direction of more flexibility, and serious consideration is being given to reducing the number of essential items under price controls.

Procurement prices have been raised sharply over the past two years, with the objective of boosting agricultural production by providing producers with adequate profit margins. Input subsidies are to be reduced gradually both in the agricultural and manufacturing sectors.

Although Syria's exchange system remains complex, the authorities have been moving steadily toward more realistic exchange rates of a transitional nature involving the introduction of new and more depreciated rates, such as the ones introduced in 1989. However, consideration is being given to limiting the system to two exchange rates. An official rate would cover public sector transactions relating to oil, external debt, bilateral agreements, and administrative expenses abroad. Other public sector transactions would be shifted to the "rate in neighboring countries." Private sector transactions would also take place at a market-determined rate. In order to prepare for further steps in exchange rate reform, the public sector is already using a depreciated rate in calculating costs for the purpose of setting domestic prices.

The evolution of Syria's balance of payments in recent years has reflected developments in the domestic oil sector, the policy of import restraint, particularly by the public sector, and favorable trends in non-oil exports. With the coming on stream of new oil fields, oil production has increased to about 370,000 barrels per day. Oil exports, which reached \$1.2 billion in 1989, could have been even larger had it not been for the increase in the use of fuel to compensate for the reduced flow of water to hydroelectric power plants owing to the filling of the Ataturk Dam in the upper Euphrates in Turkey.

Over the past few years, the role of the private sector in Syria's international trade has increased steadily. The share of the private sector in non-oil trade surged from 25 percent in 1985 to 62 percent in 1989; this growth reflected the easing of controls on private sector imports and the incentives being given to private exporters, including an expansion of the list of export goods permitting retention of 75 percent of foreign exchange proceeds and the use of a depreciated exchange rate for the surrender requirement. The current account deficit declined substantially over the period 1985-88. In 1989 the current account registered a substantial surplus owing to the bilateral payments agreement with the Union of Soviet Socialist Republics, which gave a substantial

boost to private exports. Although private exports in 1990 are likely to decline from the exceptionally high levels of 1989, they are projected to remain well above the levels recorded in preceding years. Exporters are expected to benefit from the incentives being provided through the exchange system as well as from the increased availability of inputs, which in the past had been a limiting factor in the export performance.

The authorities recognize that the favorable current account performance in 1989 has not translated into a significant strengthening of the overall external position, given the particular nature of the bilateral agreement mentioned above. They are also aware of the severity of the external debt burden and the need to deal with the problem of arrears. Ultimately, this will depend on the authorities' ability to strengthen the country's tradables sector and exports in particular. In the meantime, they are using any margin that becomes available to contain the problem of arrears. Indeed, in 1989 the commercial bank has remained current on interest payments and has in fact reduced its stock of external arrears. The authorities hope that the performance of the external sector in 1990 will make it possible for more debt to be repaid, including the debt owed to the World Bank.

In conclusion, there can be no doubt that the Syrian economy continues to face enormous difficulties. In recent years the authorities have made great adjustment efforts which were not facilitated by the continued instability in the region and the concomitant demands on the country's resources. The authorities are determined to move further along the road of adjustment and reform but in a manner which finds the appropriate balance of the country's economic, social, and security objectives.

Mr. Al-Jasser said that since the early 1980s, the Syrian economy had been confronted with significant adverse external developments characterized by a marked reduction in the inflow of external resources. In response, the authorities had made a determined effort to adjust the economy to the new realities, while simultaneously attempting to invigorate domestic production. It was noteworthy that their efforts had been undertaken without the financial and technical support of a comprehensive and far-reaching structural adjustment program.

As both Mr. Finaish's statement and the staff report had noted, the drastic reduction in the budget deficit from 20 percent of GDP in 1984 to 2 percent in 1988 attested to a determined adjustment commitment, even though it had led to stagnant growth, Mr. Al-Jasser stated. In addition, the authorities had encouraged greater participation by the private sector

in the economy, which was manifested in the private sector's buoyant manufacturing activity and the marked increase in private sector non-oil exports. Moreover, the increased flexibility permitted in pricing was encouraging.

Nonetheless, the fact remained that much more needed to be done if the economy was to embark on a sustainable growth path, Mr. Al-Jasser observed. While the above-mentioned fiscal consolidation was impressive, the position of the public sector as a whole continued to weaken. Public enterprises should be subjected to strict budget constraint and their recourse to bank credit strictly limited. However, he would like to note that public ownership was not necessarily incompatible with sound commercial management. Moreover, he would encourage the authorities to give serious consideration to the recommendations of the recent Fiscal Affairs Department technical assistance report. An improvement in public enterprise performance, coupled with appropriate tax reform measures, would allow monetary policy to regain its influence on price stability.

Regarding the exchange rate policy, while he welcomed the authorities' intention to limit the multiple exchange rates to two systems, he would encourage the adoption of a unified and realistic single rate, Mr. Al-Jasser said. The resultant introduction of appropriate relative prices would go a long way in invigorating economic activity.

In the longer-term context, the main challenge facing the Syrian authorities was to strike an appropriate balance between the public and private sectors, Mr. Al-Jasser continued. The Syrian economy was endowed with a relatively diversified agricultural and industrial base that was complemented by an expanding hydrocarbon sector. Most important, the economy was blessed with a highly capable entrepreneurial group--an essential ingredient for any economic revival. Hence, a broad decontrol of economic activity coupled with price liberalization would ensure that Syria reaped the full benefits of its economic potential. The fact that the share of the private sector in non-oil trade had increased from 25 percent in 1985 to 62 percent in 1989 attested to that potential.

The measures introduced during the past few years represented an important building block that should be extended in the context of a more comprehensive effort, Mr. Al-Jasser commented. Indeed, the emerging hydrocarbon sector and the consequent increase in public resources should provide the needed impetus for adjustment efforts.

Mr. Aderibigbe made the following statement:

The persistent weakening of the Syrian economy since the early 1980s is attributable largely to adverse exogenous developments, and, to some extent, delays in adopting appropriate policy measures to address the resulting imbalances in the economy. Efforts on the part of the authorities since the mid-1980s to

revive the economy, aided by a strong oil sector performance and increased agricultural output, provided the stimulus in 1988, which resulted in a 12 percent real GDP growth. However, despite the continued expansion of the oil sector and the buoyancy in the manufacturing sector, the growth momentum has not been sustained, with aggregate output contracting precipitously by an estimated 8.5 percent in 1989.

It is against this background that we welcome recent policy initiatives by the authorities to bolster growth in the economy, strengthen public sector finances, and reduce the external sector imbalance. We are also encouraged by Mr. Finaish's statement that the authorities are prepared to persevere and build on the progress made so far in their adjustment efforts. We would like to note in this connection that we are in agreement with the staff's conclusion that Syria needs to undertake a more comprehensive and substantive adjustment effort conducted in a timely manner if it is to achieve a sustainable improved economic performance. My intervention will be limited to only a few policy areas where such sustained actions are required.

In the fiscal sphere, improvement in revenue efforts has no doubt contributed substantially to the considerable reduction in the Central Government's fiscal deficits in 1988 and 1989. However, the overall fiscal position of the entire public sector has remained strained and pressure is likely to intensify in the 1990s as aid flows decline and external debt obligations are met. Thus, the current discretionary measures to improve tax efforts, adjust administered prices and restrain government expenditure should continue and be reinforced by implementing financial reforms of public sector enterprises to give their operations a commercial orientation. Such reforms would enhance their efficiency, increase the operational surpluses they turn over to the Government, and reduce their overreliance on bank financing.

The considerable moderation in monetary expansion in 1989 was largely attributable to low credit growth in the domestic economy. In order to contain demand pressure in the economy, credit policy should remain restrictive and supportive of fiscal efforts. Adequate financing for productive activities should, however, be ensured. In this regard, an improved performance on the part of the financial system would enhance resource mobilization and the allocative efficiency of the financial markets. Interest rates had been held constant at low levels for more than a decade and should be liberalized at an early date. We agree with the staff that the adoption of a more aggressive interest rate policy aimed at positive real rates would stimulate increased financial savings and discourage borrowing for nonproductive and speculative uses. In addition, existing administrative controls on prices and

production, along with other structural rigidities, should be eliminated to promote increased efficiency and the competitiveness of the Syrian economy in the region.

With regard to the external sector, we note that adverse price developments in international oil markets, the effect of unfavorable weather on agricultural production, and the liquidity overhang in the economy have been the fundamental factors influencing the external sector imbalance. Notwithstanding the improvement observed in 1988 and 1989, the staff has rightly observed that the balance of payments position of Syria remains weak, as evidenced by the deterioration in the external reserve position of the Central Bank and the accumulation of external payments arrears. Indeed, the balance of payments outlook in the medium term is fragile. The annual financing gap of about \$1 billion estimated for the period up to 1992 is based on optimistic oil sector performance and a modest growth of non-oil imports, and assumptions that Syria will meet its debt-servicing obligations and achieve a partial rebuilding of the Central Bank's external reserves. In addressing the balance of payments problem, the authorities should strengthen their demand-management policies to reduce pressure on the external sector and encourage the growth of non-oil exports. Developing gas as a substitute for oil is a welcome strategy to achieve a reduction in domestic oil consumption and an increase in export volume. Exchange rate adjustments that reflect a realistic price for foreign exchange and fundamental market forces should continue to be used to boost private sector export earnings and autonomous inflows of foreign exchange. Movement toward a unified exchange rate should continue to receive appropriate attention from the authorities.

Finally, we appeal to the authorities to accelerate the pace of structural reforms and intensify their efforts to improve the quality, coverage, and timeliness of their statistical information. We support the proposed decisions and wish the authorities success in their endeavors.

Mr. Ichikawa made the following statement:

I am in broad agreement with the staff appraisal and support the proposed decision.

We welcome the authorities' efforts in recent years to reduce financial imbalances and strengthen the balance of payments. However, the staff's medium-term scenario, as well as this year's ex ante financial gap, is clear evidence of the shortcomings of the gradual approach currently being followed by the authorities. In addition, the gaps do not include the effect of substantial

noncivilian debt. Given that Syria is well endowed with resources and its economy is diversified, we believe that it could undertake and benefit significantly from comprehensive and more rapid adjustment. I strongly encourage the authorities to formulate a comprehensive macroeconomic and structural adjustment program as soon as possible since the country's large and protracted arrears are posing a threat to the international financial community.

As regards specific policies, I have little to add to the staff's appraisal. I would like, first, to commend the authorities for their vigorous efforts toward revenue enhancement and price correction--despite the weakening of economic activity--while at the same time encouraging further action in line with the Fiscal Affairs Department technical assistance report. Nonetheless, the overall financial position of the public sector as a whole shows limited improvement as public enterprises continue to rely on bank financing. Financial discipline should be established in public enterprises as well as the banking sector in order to reduce recourse to bank financing of public sector deficits. Their financial relationship should be more transparent in order to promote private sector development. While monetary and credit expansion in 1989 was moderate owing to low credit demand by public enterprises as a result of reduced economic activity and price corrections, the lack of an autonomous monetary policy remains a fundamental problem. Furthermore, the establishment of a positive real interest rate structure is essential to restore a sustainable financial balance.

The preceding comments point to the importance of deregulating the economy and in particular, of promoting private activity in the industrial sector by creating a suitable macroeconomic framework and a sufficiently liberalized regulatory environment for private investment. This strategy requires structural adjustment on the external front as well. I share the staff's concern on the underlying long-term deterioration of the external position despite the apparent improvement in 1989 as a result of exceptional factors. I believe that trade and exchange liberalization are essential in order to strengthen the balance of payments position in a sustainable manner. At the very least, simplification of the exchange rate system should be achieved expeditiously. I hasten to add, however, that this measure represents only a small first step in the right direction, and I encourage the authorities to formulate a reliable timetable for exchange liberalization.

Finally, I reiterate my concern about the problem of Syria's protracted arrears, particularly those to the World Bank. At the time of the 1989 Article IV consultation, it was suggested in the Board that the appropriateness of the Fund providing technical and other assistance be reconsidered in the event of unsatisfactory

developments in dealing with the problem of arrears to the Bank by the time of the 1990 Article IV consultation. I tend to share that view, especially in light of the cooperative relationship between the Fund and the Bank and Syria's payment record. Moreover, the current adjustment effort followed by the authorities and the technical assistance being provided by the Fund are both too piecemeal to be effective. The structural adjustment pursued by the authorities should have normalization of Syria's relationship with the Bank as a primary objective. Settlement of Syria's arrears with the Bank would demonstrate the authorities' commitment to proceed with comprehensive adjustment and should be an essential precondition for full-scale effective assistance from the Fund. The Bank's technical and financial assistance alongside assistance from the Fund is also essential. I would appreciate the staff's comments. With these remarks, I support the proposed decision.

Mr. Mojarrad said that the Syrian economy continued to be vulnerable to the adverse international environment that had caused most of its difficulties. Indeed, the drop in exports, remittance inflows, and official grants had all deeply influenced economic activity. In response--as noted by Mr. Finaish's statement--the authorities were to be commended for initiating strong adjustment measures to reduce government expenditures, relax price controls, and introduce flexibility into the exchange system, and they were aware that further fiscal, monetary, exchange, and external sector as well as structural reforms were essential.

On the fiscal front, measures already taken by the authorities to improve the budgetary situation were welcome, Mr. Mojarrad noted. In addition, the tax reforms recommended by the staff were crucial to the strengthening of the fiscal position. The proposed reforms would create new government revenues and enhance domestic savings much needed for servicing the public debt.

On the monetary side, the slowing of monetary expansion was encouraging, Mr. Mojarrad observed. Nevertheless, credit policy and resource allocation needed to be improved to facilitate the financing of productive investments by the banking system. Regarding the exchange system, the measures initiated by the authorities to introduce more flexibility were steps in the right direction, but additional measures were needed to unify the exchange rate system to increase savings and attract more remittances from abroad. However, he shared the authorities' concern that inflationary pressures might result from a substantial depreciation of the currency, especially when many prices were already rising as a result of liberalization. With respect to the external sector, while he noted with satisfaction the improvement in the balance of payments position, he shared the staff's view that the authorities needed to develop effective strategies for enhancing export revenues in hard currencies, strengthening the tourist

sector, and attracting more capital as well as workers' remittance inflows into the banking system instead of into parallel markets. That approach should help the authorities settle their financial obligations and attain external viability.

Structural reforms were crucial to improve the public enterprise sector, Mr. Mojarrad said. There, managements that were free of restrictions were important if efficiency and profitability were to be achieved. Furthermore, given the difficult economic situation in Syria, he believed that the private sector should be more actively associated with the process of promoting investments. He supported the proposed decision.

Mr. Zhang said that the overall economic performance of Syria was largely dependent on the agricultural and oil sectors. Real GDP had grown by about 12 percent in 1988 when good weather conditions had resulted in an excellent harvest, and oil output continued to rise. Although agricultural production in 1989 had declined sharply from the exceptionally high level of 1988 after severe drought and frosts, the strong performance of the oil and the manufacturing sectors had contributed to continued growth. However, the authorities had taken important steps in recent years to contain demand pressures and introduce a measure of realism into the exchange system, through restraints on government expenditures and the implementation of price adjustments, respectively. He was in broad agreement with the staff's appraisal of the Syrian economy and he also found Mr. Finaish's statement comprehensive and helpful. Therefore, he would make only a few brief comments.

Because the economy remained vulnerable to exogenous factors, a tight fiscal policy stance was advisable, Mr. Zhang commented. With regard to monetary and credit policies, since an appropriate interest rate system was a key element of a successful monetary policy, efforts should be directed toward making interest rates conducive to savings and reflective of the real cost of financial resources. He also encouraged the authorities to continue their efforts to introduce a more realistic exchange system so that the international competitiveness of Syrian exports would be enhanced.

Finally, he was of the view that if other countries' recent experiences with structural reforms were introduced into the Syrian context, the adjustment effort should nonetheless be careful to accommodate circumstances specific to Syria, Mr. Zhang observed. The Syrian authorities were striving to stimulate investment and improve efficiency within the framework of their mixed economy. In addition, other factors that had to be appraised were the important role of agricultural policy and the structure of foreign trade and export markets. He supported the proposed decision.

Ms. Creane said that the assessment made at the time of the 1989 Article IV consultation regarding the fragility of the 1988 economic recovery had proved accurate with the decline in real GDP and the return to a deficit on the Government's accounts in 1989. She continued to believe

that Syria had an economy with the potential to respond to a broad adjustment program. Syria's efforts to date to improve public finances and ease price and exchange rate controls were welcome. However, those efforts had not been sufficient to stimulate economic growth, deflate inflationary pressures, and improve the balance of payments position on a sustained basis. Given developments in the world economic situation over the last year, the Syrian authorities should move immediately to develop and implement a well-rounded adjustment plan with a focus on the decontrol of economic activity.

It was hoped that the positive experience of increased private sector activity might be extended by adoption of market criteria for public enterprises, and by imposing constraints on their easy access to the banking sector, Ms. Creane commented. Together with a tax reform along the lines suggested by the Fiscal Affairs Department report--a broader tax reform than was currently envisioned--the operation of public enterprises on a commercial basis would go far toward the necessary tightening of the Government's fiscal position.

Until public sector finances improved, monetary policy would continue to be basically a residual policy, Ms. Creane remarked. She concurred with previous speakers that the creation of positive real interest rates should be the first step in implementing a firm monetary policy. That step should be reinforced by a substantial overhauling of the banking system, ideally by applying market criteria to financial institutions too.

Major changes in exchange rate and structural policies were prerequisites to economic adjustment in Syria, Ms. Creane stated. A six or seven-part exchange rate policy--counting the parallel market--or even an exchange rate policy consisting of two rates would not be able to improve the environment for capital and workers' remittances, and keep exports competitive, on a sustained basis. She agreed with the staff that Syria would be better served by unifying the multiple rates into one rate determined initially and maintained by market forces. Syria should implement other structural reforms, particularly the removal of administered controls on imports and agricultural policy, and the further decontrol of prices.

The staff estimate of a \$1 billion financing gap for 1990 was sobering, particularly given lapsed aid commitments and estimated convertible foreign exchange reserves of less than four weeks of imports, Ms. Creane observed. She echoed the staff concern that Syria institute a schedule for eliminating payments arrears, and was pleased to see from Mr. Finaish's statement the priority the Syrian authorities had given to debt repayment, and in particular the World Bank arrears. She looked forward to seeing Syria move quickly on those promises.

She would like to observe, once again, that the staff had done a commendable job of analysis in the report, given the dearth of information and data available on the current status of the Syrian economy, Ms. Creane

remarked. She urged the Syrian authorities to take a broad look at their economic situation in light of recent regional and world economic developments and to act boldly, move up the start of the next five-year plan, and begin now to formulate and implement a comprehensive reform program.

Mr. Sparkes said that his chair supported the proposed decision. While he welcomed the limited measures taken by the authorities, piecemeal reforms were insufficient to tackle Syria's deep-seated problems. Inadequate data continued to obscure the true scale of those difficulties, but Syria's medium-term prospects would remain poor so long as the authorities delayed implementing the comprehensive reforms outlined by the staff. He endorsed the staff's recommendations on a broad range of reforms, including the introduction of a realistic, unified exchange rate, strengthened public finances, comprehensive liberalization of the economy, and a program for eliminating Syria's external payments arrears, particularly those to the World Bank.

Mr. Cirelli said that the staff report was comprehensive; he shared its main thrust and would support the proposed decision. After the improvement in the economy in 1988, the 8.5 percent decline in real growth in 1989 caused primarily by a significant drop in agricultural output, was disappointing. With the notable exception of the chemical sector, manufacturing reflected a protracted weakness in investment and internal impediments, and was still well below 1985 figures. In spite of some welcome measures taken in 1989 to correct major imbalances in the Syrian economy, particularly on the fiscal side, much obviously remained to be done in light of Syria's medium-term prospects. Additional adjustment efforts required a comprehensive approach with greater reliance on market mechanisms. Overwhelming administrative controls should be eliminated and monetary policy streamlined. The authorities should pursue a fiscal consolidation compatible with external objectives.

To cope with external payments pressures, there had been extensive exchange rate and trade regulation, Mr. Cirelli observed. Those regulations and the resulting imbalances again underlined the need for the Syrian Republic to embark on a comprehensive adjustment to restore demand and supply equilibrium and to allow a real liberalization of the economy. In addition, an adjustment process was much needed to avoid an increase in payments arrears and to settle current ones, notably arrears to the World Bank. By settling those arrears, Syria would be able to take advantage of assistance from multilateral institutions.

The staff representative from the Middle Eastern Department noted that the World Bank and the Syrian authorities were continuing a dialogue to try to resolve the question of arrears. Any agreement would probably require that Syria adopt broad policies for adjustment. The technical assistance that had been provided by the Fund was perhaps best seen in the context of discussions on possible adjustment policies for Syria. That was the only technical assistance the Fund had provided in the past year.

Mr. Ichikawa explained that his comments on technical assistance had been intended to follow up on a suggestion made during the previous Board discussion on Syria. Unless Syria showed that it was committed to adopting a comprehensive adjustment program, technical assistance from the Fund would be less effective.

Mr. Finaish said that he did not know if it was the Fund's policy to withhold technical assistance on the basis of a country's arrears to the World Bank. In any event, no other Directors had supported the idea. He asked the staff for confirmation of his understanding that Syria was not receiving any technical assistance from the Fund currently.

The staff representative said that as Mr. Ichikawa had indicated, during the Board's consideration of the staff report for the 1989 Article IV consultation, the appropriateness of technical assistance to Syria had been raised, given the arrears to the World Bank, in particular whether assistance should be extended after the planned Fiscal Affairs Department mission. The mission did take place and a report was sent to the Syrian authorities. There had been no other Fund missions to Syria since then. As he had mentioned, discussions between Syria and the World Bank were continuing and could result in further requests from Syria for Fund technical assistance. The staff would consult with management on the appropriateness of any such request.

Mr. Finaish said that providing technical assistance at the request of countries that were in arrears to the Fund or the Bank could facilitate the clearing of the arrears. In his statement, he had referred to the considerable effort expended by his authorities to move the economy to a sustainable position. As some speakers had noted, their efforts were reflected in the decline in the current account deficit over the past four years. He also recognized that serious difficulties remained and that the authorities had much to do in the way of reform and adjustment.

The authorities had adopted an approach of gradualism for certain policies, as some Directors had noted, because social implications had necessitated caution, Mr. Finaish commented. Sometimes it was politically more feasible to implement particular reforms in an indirect way and the payoff was better in the long run. He himself thought that a consensus was coalescing in many quarters on the need for reform and for more liberalization. Also, people could not ignore the dramatic changes taking place all over the world; hence, the pace of reform might accelerate in the future.

He had little to add to what he had said in the penultimate paragraph of his statement on the question of debt, particularly the arrears to the Bank, Mr. Finaish remarked. The authorities were aware that it was in the best interest of Syria to settle that problem. The clearance of arrears with the Bank would depend on the authorities' ability to strengthen Syria's external position. A joint Fund-Bank mission had been to Damascus. At the time of the Interim Committee meeting, the Syrian authorities had talked to

the staff at the Bank, and an effort was under way to work out a solution to the arrears with the Bank.

Finally, while the economic situation facing Syria was difficult, the country did have economic potential, Mr. Finaish remarked. It had a strong agricultural sector, a well-diversified and relatively strong manufacturing sector, a potential for tourism, and a population with a reputation for its entrepreneurial ability. Resource production, particularly gas and oil, was expanding. Major international oil companies were actively exploring in Syria with promising results. While the authorities needed to maintain their policy of fiscal restraint and to strengthen the process of reform, exogenous constraints also affected the ability of the authorities to improve economic performance. The recent drought and adverse weather conditions had reduced agricultural production. The instability of the region as a whole had adverse implications for the economy, including a huge defense burden.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to the Syrian Arab Republic's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1990 Article XIV consultation with the Syrian Arab Republic, in the light of the 1990 Article IV consultation with the Syrian Arab Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Syrian Arab Republic maintains the restrictive measures described in SM/90/97 in accordance with Article XIV, Section 2, except that the Syrian Arab Republic continues to retain multiple currency practices and exchange restrictions, including those evidenced by external payments arrears, that are subject to Fund approval under Article VIII, Sections 2(a) and 3. The Fund encourages the authorities to take the necessary steps for the elimination of arrears on current payments and transfers, to unify the exchange rates, and to liberalize other exchange restrictions on current payments and transfers. The Fund urges that the restrictive features of a bilateral payments agreement with a Fund member be eliminated as soon as possible.

Decision No. 9498-(90/111), adopted
July 11, 1990

The Acting Chairman made the following summing up:

Directors were in general agreement with the thrust of the staff appraisal for the 1990 Article IV consultation with the Syrian Arab Republic. They noted the authorities' efforts to

contain demand pressures, introduce greater realism into the exchange system, and increase the supply response of the economy and the scope of private sector activity. While these efforts, in combination with a significant increase in oil production, had yielded positive results, the Syrian economy remained in a vulnerable position. Directors therefore called for a significant strengthening of adjustment policies in order to address the structural weaknesses and imbalances in the economy and promote sustained economic recovery.

Directors observed that expenditure restraint and price adjustments, together with a greater revenue mobilization effort, had reduced the Central Government's budget deficit. However, in view of the continued high reliance of the public sector on bank financing, they urged the authorities to take additional action to increase public sector savings, particularly through additional revenue mobilization and an improvement in the financial position of public enterprises. They also recommended tighter monetary and credit policies and financial sector reforms to improve the allocative efficiency of the credit system, including the adoption of positive interest rates in real terms.

Directors expressed concern about the continued existence of external payments arrears. Stressing the significance of Syria maintaining access to international financing, Directors urged the authorities to work toward an early settlement of external payments arrears; they gave particular emphasis to clearing up arrears to the World Bank. The authorities were encouraged to improve the quality, coverage, and timeliness of data.

Directors urged the authorities to unify the exchange rate at a level reflecting underlying market conditions to secure competitiveness and reduce the need for administrative controls, including those on trade and exchange. Despite the recent improvement in the balance of payments and the anticipated increases in oil exports, the external prospects remained unfavorable and large financing gaps were expected over the medium term. In these circumstances, Directors were of the opinion that a fundamental improvement in the external payments position required the adoption of comprehensive adjustment policies. Syria was well endowed with natural and human resources, Directors observed. In these circumstances the adoption and pursuit of comprehensive economic reforms and a clear delineation of the tasks of the public sector, giving greater scope to private initiative, could yield important benefits over the medium term.

The next Article IV consultation with the Syrian Arab Republic will be held on the standard 12-month cycle.

4. SURVEILLANCE OVER EXCHANGE RATE POLICIES - REVIEW

The Executive Directors continued from EBM/90/108 (7/9/90) their consideration of the staff paper on the biennial review of the implementation of the Fund's surveillance over members' exchange rate policies and of the 1977 surveillance decision (SM/90/102, 5/29/90; and Sup. 1, 5/29/90).

Mr. Ismael said that he was in broad agreement with Mr. Fogelholm's statement and could, therefore, go along with his proposed four-point surveillance procedure. As to the proposal to hold Article IV consultations on a biennial basis, he suggested that, rather than excepting the largest industrial countries, the exception be made, for example, for the 20 largest member countries ranked by quotas; in that way, Mr. Dawson's reservations could be allayed. The practice of having an interim Article IV consultation mission would be effective only if, first, the period of a staff visit was five to seven days rather than two to three days; second, the mission had a concluding session with high-level economic policy decision makers where the findings and policy recommendations were discussed; and third, the interim mission report submitted to the Board was an issue-oriented report, incorporating the findings and policy recommendations as discussed with the authorities, with a format that was not comprehensive but was, as suggested by Mr. Fogelholm, like the back-to-office report of the staff mission to management. In that way proper Board attention, which Mr. Posthumus was concerned about, would be facilitated.

On regionally oriented surveillance as a complement to Article IV consultations, Mr. Ismael remarked that he would like to see it limited to include only what Mr. Finaish defined as "groupings which involve the abdication by individual members of some of their policies to a supranational body" and "groupings where the common denominator is limited to geography or the similarity of economic structures." In that way, the new activity would not eliminate the savings in time and resources obtained from placing the majority of Fund members on a biennial basis.

Mr. Clark made the following statement:

As a number of Executive Directors noted at EBM/90/108, surveillance is at the heart of the Fund's role in the international monetary system, and we thus welcome this review. The staff argues that the need for surveillance has, if anything, increased in recent years, but also that the objectives of surveillance have not been fully realized. We do not disagree with this assessment. However, in our view there will always be a need to strive to make the surveillance exercise more effective and to ensure that it is applied in as evenhanded manner as possible. Nevertheless, we are in complete agreement with the staff that there is no reason to consider modifications to the existing decision on the principles of surveillance at this time. These principles can be interpreted

widely enough not to impose any serious limitation on the Fund's scope for surveillance.

In our view, the binding constraint on surveillance is the willingness of countries to take into account the international ramifications of their economic policies. We would agree that the basis for effective surveillance by the Fund has to be the persuasiveness of its analysis and what the staff refers to as "constructive tension." I will, therefore, focus the rest of my remarks on the staff's suggestions for ways of enhancing surveillance in this context and for possible modifications to procedures that would contribute to more efficient use of both Board time and staff resources.

As a means of strengthening the multilateral focus of surveillance, the staff has suggested clustering Article IV consultations with the Group of Seven (G-7) countries. In our view, such a clustering could have some marginal benefits. Care would need to be taken, however, to ensure that such a clustering did not result in document "indigestion" for the Board and for national capitals, given the often important but lengthy supporting appendices that are prepared by the staff. At that same time, care would also have to be taken to ensure that the timing did not conflict with other demands on the authorities. Such problems could probably be coped with. There would not, for example, seem to be any reason why appendices could not be issued as they are completed, throughout the year, with a reference to their main conclusions included in the staff report.

We find the idea of broadening the country-specific focus of the surveillance process by examining regional groupings with a high commonality of interests or institutional arrangements attractive. Clearly a move in this direction would need to be assessed in terms of the possible increase in work load for the staff. We would not see regionally based or grouped consultations taking the place of bilateral consultations with members on a regular basis. We also are doubtful of the value or practicality of an effort to give greater focus to common interests by attempting to cluster the consultations with a targeted group of countries within a short period. However, we believe that papers that explored issues of common interest could be very useful and add to our understanding of the policy issues facing countries. Such studies could well allow some cutback in the scope of consultations with individual countries and at the same time contribute to more informed discussions with authorities.

Regarding the proposals for some modification of procedures, the crucial question is how best to ensure that the Board is supplied with the information that it needs for the conduct of

surveillance but at the same time is not so overloaded that it cannot work effectively. We would agree with the suggestion that in the preparation of staff reports, beyond certain core areas of macroeconomic and related structural issues, the staff should exercise its judgment. In recent years, there has been a substantial widening of the topics covered in reports, in part resulting from demands from the Board. While much of the increased comprehensiveness of reports has been justified, it is the responsibility of the Board to make sure that it is not demanding overly comprehensive reports from the staff. We need to assess whether the reports are as sharply focused as they should be and whether the best use is being made of staff resources. In this context, we encourage the staff to produce streamlined reports covering the core areas, but otherwise to be relatively selective. Insofar as papers on recent economic developments are concerned, we agree with the staff proposals. In our view, it would be more beneficial to have the staff devote time to preparing special studies of particular relevance to a country or group of countries than to preparing reports on current developments, particularly if this information is readily available elsewhere.

On the frequency of consultations, we agree that in principle there should be annual Article IV consultations with all members and that a concise report should be prepared. With respect to Board consideration, we are concerned, like others, about the increasing demands on the Board and feel that some streamlining of procedures is needed. However, we should move cautiously in making changes in surveillance procedures. We are therefore attracted by Mr. Fogelholm's suggestion of applying the bicyclic procedure to all members and then making exceptions to allow for annual consultations where warranted, presumably at a minimum the largest industrial countries and countries with programs. This would ensure that in principle there would be a Board discussion of the situation of each member at least every two years.

In intervening years, a less than full consultation would be all that was necessary, thereby lessening the demands on the staff. This would be in line with the staff proposals that papers on recent economic developments should be less frequent. However, the extent to which interim consultations are scaled back should be left to the judgment of the staff. There may be times when the situation in a country has changed significantly and warrants fuller discussion. Also, some small countries with only limited trained manpower rely heavily on the annual staff report for an assessment of developments in their countries.

Finally, I would like to refer to two other procedural matters raised by the staff. First, we agree with the proposal to integrate reporting on significant developments in nominal and

real exchange rates into the quarterly report on exchange arrangements and dropping the information notice system. Second, we have some reservations regarding the suggestion to publish, on a selective basis, studies prepared by the staff as appendices to Article IV consultations. In principle, we are in favor of widespread dissemination of useful staff analyses and do not disagree with the arguments put forward by the staff for selective publication. Our reservations relate entirely to the importance that we attach to maintaining the open and frank nature of the exchanges between staff and members. To a large extent, this rests on the high degree of confidentiality that characterizes this relationship. As we would not like to see this put at risk, we feel that any decision to publish a staff study should be cleared first with the authorities.

Mr. Filosa made the following statement:

While I agree that the underlying principles of the surveillance decision of 1977 are still valid, I also see some scope to enhance the effectiveness of surveillance. In particular, some of the proposals contained in the staff paper appear to be steps in the right direction toward the recommendation included in the 1985 report of the Group of Ten (G-10) on the functioning of the international monetary system, which in my view is still valid.

With regard to the staff's proposal for supplemental consultations, I remain skeptical about the appropriateness of triggering such consultations if, after some time following the consultation, policy actions proposed by the Board are not implemented. On the one hand, this proposal seems too rigid in setting a precise timetable for policy actions. On the other hand, the broad nature of the Board's recommendations makes them, in a number of cases, unsuitable for the application of the double-checking procedure between the recommendations of the Board and the policy measures of the member that is implicit in the staff's proposal.

In the same vein, I am also skeptical about the possibility of triggering supplemental consultations as a result of judgments based on quantitative indicators. Despite my sympathy for the use of quantitative economic indicators, I feel that their proposed use in the context of surveillance requires further analytical work in order to make them suitable for specific policy prescriptions. In particular, in addition to the coverage of indicators, the relationship between the policy and the target indicators has to be more firmly and convincingly established. However, if sufficient progress in this field is achieved, the use of indicators would be helpful in rendering supplemental consultations more

common in the context of surveillance procedures. For these reasons, I urge the staff to make a concrete proposal to this end.

As far as follow-up consultations along the lines suggested in the 1985 G-10 Deputies Report are concerned, the staff suggestions deserve support. In this respect, while I am in broad agreement with the staff proposal, I would like to stress that follow-up consultations should focus mainly on the impact of national policies on the international economy and on the smooth functioning of the international monetary system. This would facilitate the identification of both the areas of and the reasons for possible agreement--or disagreement--and a better understanding of the international perspective of Fund recommendations. In this way, traditional bilateral surveillance could facilitate greater integration of the policy prescriptions concerning at least the major industrial economies and would constitute a step toward implementation of some embryonic form of multilateral surveillance. In this respect, I would like to note that the Houston summit meeting communiqué, in commending the cooperative process that has been put in place during the year, stated that the process has contributed importantly to the strengthening performance of the world economy and to the improved stability of exchange rates by concentrating attention on multilateral surveillance and close coordination of economic policy, including cooperation on exchange markets.

The staff suggests the possibility of undertaking a formal surveillance exercise based on specific groupings of countries. While I have an open mind, it seems to me that formal consultations with groups of countries appear premature in the light of the limited scope of institutional arrangements between some groups of countries mentioned in the paper, and more generally because of the lack of a common authority. At the moment, the clustering of consultations with the targeted group of countries and special papers for a multicountry exercise seem more promising.

The staff envisages the possibility of disseminating the Fund's views through selective publication of staff papers on recent economic developments. I support this proposal. As a matter of fact, we already have a good example--namely, the Occasional Paper on Germany--of the way in which this matter might be dealt with; moreover, I have agreed to have the 1988 Article IV consultation with Italy published, although the publication has not yet been issued. The proposal, however, requires the setting of some standards to be followed consistently.

In my view, first, papers to be published need to be thematic in nature, particularly in the case of those countries already

In my view, first, papers to be published need to be thematic in nature, particularly in the case of those countries already included in the publication series of other organizations. For example, descriptive papers concerning G-7 countries would add little to the already redundant reports available. Second, publication should cover all Fund members, even though, on an experimental basis, I support the idea proposed to start with G-7 countries. Third, it should be explored whether the World Bank would agree to publish its report too; if so, a coordination problem would arise. Fourth, I wonder whether this proposal will absorb additional staff resources, in particular given the staff's comments at EBM/90/108 on capacity constraints. My experience indicates that this is precisely the case. For Germany, the publication was very different, from an editorial point of view, from the staff paper. In the case of Italy, my contacts with the staff suggest that the same situation exists.

In view of the importance of the problems incurred by the decision to publish the Fund's views on the consultation, I would like to hear from the staff how it sees the issue and how it intends to manage the problems of both substance and form concerning such an undertaking. Also, if the staff produces a paper on recent economic developments for a member every two to four years, an additional problem arises because in some years information that is expected to be published will not be available.

Concerning exchange rate monitoring, while I believe that the present documentation is useful, I wonder whether efforts made so far to make it adequate and comprehensive have been sufficient. In this respect, the proposal concerning the preparation of the quarterly reports on exchange arrangements, which, in my view, should include comprehensive background material on current monetary and fiscal developments in the major economies, seems appropriate. In addition, a monthly update of the main charts and tables of such reports would help to give continuity to the exercise. While the Board's periodic seminars remain a useful form of discussion, a quarterly report could contribute significantly, if appropriately designed, to our discussions. As I have said on previous occasions, this report should include, in addition to the charts and tables currently presented, appropriate information on capital flows.

I find the staff proposal's on streamlining the exercise of surveillance broadly acceptable, although I have the same reservations as those expressed by many Directors. First, I agree with the idea that an annual paper for each country would constitute the main surveillance document. Second, in light of the usefulness of most of the background papers on recent economic developments, the interval between successive papers should be less than

the four years envisaged by the staff; Mr. Dawson's proposal of two years seems reasonable. Third, while I agree with the suggestion that not all annual consultation papers need to be discussed by the Board, it is not clear to me which criteria will be followed in the selection. Reports on countries with programs or in arrears need not be discussed by the Board, as major developments in those countries are examined several times within a year, but there does not seem to be sufficient grounds to exclude some countries from discussion merely because no substantial economic change has transpired from one year to the next. In many cases, little change in policies might suggest instead the need for Board discussion. I share Mr. Dawson's views on the danger of excluding important countries from Board consideration. While I understand Mr. Fogelholm's reasons, I share the concern voiced by Mr. Posthumus in this context, and clarification from the staff of the criteria for selection would, therefore, be appreciated.

Mr. Mawakani made the following statement:

The paper prepared by the staff describes clearly the challenges facing us in the exercise of our surveillance responsibilities and the increase in "spillover effects" that is accompanying the deregulation of international capital markets. Moreover, other changes are occurring in different parts of the world which have an effect on the international exchange system. Taking into account these developments, the staff has made some suggestions aimed at improving our surveillance exercise. While these suggestions appear to be in the right direction, their effectiveness will remain dependent on the countries' willingness to follow Fund advice and to implement sound and stable economic policies that take into consideration their effects on other member countries.

The staff's proposal on the clustering of G-7 consultations is quite interesting. It can certainly help to put the different policies in perspective and enable the Board to better formulate its advice in the context of policy coordination. But the proposal's feasibility will depend to a large extent on the countries involved agreeing to change the dates of their consultation and on the availability of manpower in the Fund. We can also agree with the suggestion for follow-up consultations along the lines described by the staff.

However, we have some reservations about broadening the surveillance exercise to include regional groupings. We do not, at the present time, favor grouped consultations as a replacement of or supplement to annual consultations. Consultations should continue with each country individually, as they are conducted now. We would prefer that if there is a need for a special study

of a regional group, the study should be part of the world economic outlook as is currently done for other groups, such as oil exporting countries, or as a supplement to the Article IV consultation.

Regarding exchange rate monitoring, we can support the suggestion to replace the present information notice system with a quarterly report, along the lines described by the staff. The report will be more useful and give a more comprehensive idea of the interrelated effects of the changes.

With respect to publicity concerning consultations, we believe that the present procedures for publication of Fund documents are adequate. Public statements by management on major policy issues should continue, with special focus on the policy problems of particular member countries, or groups of countries, whenever this is needed.

On the frequency of consultations, we note that the staff reports have already been significantly reduced in size, and we would prefer to continue present procedures regarding Article IV consultations. All staff reports on Article IV consultations, except those for countries under biennial consultations, should be discussed by the Board. We cannot agree with the suggestion that endorsement of the staff appraisal replace the Chairman's summing up. We would prefer to continue our present procedure of having a comprehensive paper on recent economic developments, especially in the case of countries that are using Fund resources, because frequently these papers are distributed to other international organizations and to donors and creditors who use them as a source of current information. Shortening these papers to statistical appendices will reduce their effectiveness. In the final analysis, we must remember that our primary responsibility is to ensure that the international monetary system functions as efficiently as possible; any reduction in the consultation process can only weaken this exercise. We support the proposed decision.

Mr. Lombardo made the following statement:

The staff paper states: "If the effectiveness of the Fund's surveillance over its members' exchange rate policies is to be strengthened, the basic issue is not procedure, but rather the willingness of members to be prepared to take full consideration of the views expressed by the international community in formulating and adopting their macroeconomic and structural policies." This is one of the key points developed by the staff; other main ideas focus, first, on the Fund's surveillance--often perceived as

not sufficiently evenhanded--and second, on the challenges for surveillance that emerge from the new realities in the world economy.

It is clear that so far the Fund has had a greater opportunity to exercise surveillance over deficit countries than over surplus countries, or more specifically, over debtor rather than creditor countries. This situation is related to the nature of this institution. A creditor institution is in a better position to judge and advise its debtors. This is as old as the financial markets and this is the reason for the perception that the Fund's surveillance is not evenhanded. Nevertheless, I am not too worried about this perception, because in fact international economic relations are not evenhanded, and it is not fair to put all the blame on the Fund, while certain developed countries continue with policies that are not evenhanded and fail to take full consideration of the views of the international community. The problem is not the Fund but the uneven conditions in which the international economy has developed, particularly in the 1980s.

The concern expressed by the staff is, nevertheless, very healthy. It is particularly so if one looks at the challenges that the international monetary system is going to present to the Fund's surveillance in the short term. In a recent seminar on the international monetary system, the staff suggested that a new global equilibrium is being framed on the basis of a three-nominal-anchor system, responding to the three major economies in the world, namely, Germany, Japan, and the United States. This new equilibrium seems to be building rapidly, as the changes in Europe and the recent Enterprise for the Americas launched by President Bush suggest. Therefore, if the staff's foresight is confirmed, the consequences for the international economy will be unpredictable scope. The main flows of commerce and capital within and among the three economic units will affect the main features of the system, and the Fund's surveillance will perhaps have to change its nature and scope.

The paper prepared by the staff is valuable in describing the problems of Fund surveillance thus far. But we are at a moment when a breakthrough can occur, while changes will continue to be significant. The next biennial review of the implementation of the Fund's surveillance over members' exchange rate policies will take place in a new environment, and perhaps the challenges at that time will be so formidable that we should try to deal with the changes taking place now. For this reason, the suggestions made by the staff are valuable in enhancing the effectiveness of surveillance, particularly those suggestions related to the multilateral focus of surveillance. It is clear that one of the main features of the new reality is that countries cannot be seen

as isolated or in the abstract, but should be seen as integrated in groups of countries or economic regions; not doing so could lead to serious mistakes in economic policies and in the assessment of exchange rate management.

In this sense, it is important to identify not only those regional institutions that play a key role, but also the roles that are played by regional institutions. I am not sure if this new kind of surveillance would increase the work load of the staff. There would be a change in the nature of the work, because while integration is in progress, exchange rate policies will have less flexibility and monetary and fiscal policies will be more predictable and disciplined. I look forward to the paper to be prepared by the staff on the implications of the new international monetary system for developing countries; but with the material prepared so far, which is focused on developed countries, one can conclude that conventional surveillance would be easier with these new realities, and that in most cases Article IV consultations could be made on a biennial basis, as proposed.

Mr. Ghasimi made the following statement:

Since the last review of the Fund's role in the surveillance process in March 1988, we have witnessed an easing of many political and regional tensions, as well as a consolidation of the concept of regional economic integration. These developments, which will certainly have a noticeable impact on the Fund's activities and resources, are reflected in the increase in membership and in the attention devoted by the Fund to the move by countries in Eastern Europe to market economies. It has also resulted in the resumption of relations between the Fund and some of its members, including two countries in our own constituency, namely, the Islamic Republic of Iran and Afghanistan. In this connection, some of the information presented in Table 5 of Supplement 1 to the staff paper is rather out of date.

In analyzing the Fund's surveillance responsibilities, the staff indicated that "the world economy is still some distance from achieving the objectives of orderly economic and financial conditions and a stable system of exchange rates." We share these concerns and would like to take the opportunity provided by this review to re-emphasize the central role of this institution in promoting the orderly adjustment necessary for global financial stability and in encouraging the adoption of macroeconomic policies to sustain noninflationary growth for the world economy. In this connection, we believe that this role would be enhanced if the Fund's surveillance were more effective and more evenhanded.

We generally agree with the staff's main proposals to improve the current procedures for surveillance. First, we have no difficulties with clustering G-7 consultations in connection with the Board consideration of the world economic outlook exercise. We would like to add that the staff's attention to the Chairman's summing up at the conclusion of each G-7 Article IV consultation would be very useful in preparing the world economic outlook, particularly the section on policy issues in individual countries. We can support, on a tentative basis, some broadening of the coverage of surveillance and particularly further interest on the part of Fund in conducting studies on regional economic entities in some developing countries, either separately or, if not feasible, in the context of the world economic outlook exercise. We can also go along with the proposal to integrate into the existing quarterly report on exchange arrangements the information notices on real effective exchange rate changes.

Second, we support the staff's approach to the scope and focus of surveillance. Flexibility should guide the staff in preparing for and conducting the surveillance discussions with each member country. We can also go along with the recommendation that a comprehensive but concise annual report form the basis of the surveillance document. We consider that the Board's work load will be greatly reduced if we exercise flexibility in including these reports on the Board's agenda, and in this connection, we can support, on a tentative basis, the proposal set out in the staff paper.

Finally, the Board should also be flexible and consider the conclusion of some program reviews on a lapse of time basis. The Board could develop some guidelines to be followed by the staff to this end. For example, we could include in this way, on a case-by-case basis, reviews not combined with Article IV consultations for countries under extended or enhanced structural adjustment arrangements that have good track records of program implementation and have successfully satisfied the performance criteria. If this proposal is not agreeable to the Board, an alternative procedure would be for Directors to circulate their statements without calling for a formal Board meeting.

Mr. Dai said that, on the effectiveness of surveillance, he agreed with the staff's conclusion that the basic issue was not procedure, but rather the willingness of members to take full consideration of the views expressed by the international community in formulating and adopting their macroeconomic and structural policies. That view was particularly true for those largest industrial member countries that were mainly responsible for an orderly and stable system of exchange rates--the major objective of Fund

surveillance. Without their strong commitment, the stability of the international monetary system was not possible.

It was also true that the Fund's surveillance was generally more effective when it applied to member countries in deficit, especially those using Fund resources, Mr. Dai continued. For those members in surplus or not using Fund resources, the Fund was merely in a position to apply persuasion, and its influence on them was limited. Notwithstanding the constraints under the present rules of the game, the Fund should continue its efforts to enhance the effectiveness of surveillance; for example, the Managing Director's participation in meetings of the Group of Seven strengthened the exercise of multilateral surveillance.

With regard to the proposed modifications of procedures affecting the multilateral focus of surveillance and exchange rate monitoring, he could go along with the staff's proposals, Mr. Dai stated. On the issue of broadening the coverage of surveillance by examining regional groups, Mr. Finaish's idea was worth studying.

As to work load considerations, he agreed that efforts should be made toward more streamlined reports and greater selectivity of topics beyond the core areas, Mr. Dai commented. Doing so would not only reduce the work load of both the staff and the Board but would help to achieve a better focus on the key issues and, thus, more efficient surveillance. There was certainly a tendency to widen the coverage of consultation reports. For instance, issues related to the environment and government organization and restructuring had been included in staff reports; while Fund staff members might be good economists, he was not sure they were also experts on the environment and in political science.

He could endorse the staff's proposals regarding the frequency of consultations and reporting requirements, Mr. Dai said. He also found merit in Mr. Fogelholm's proposal, and he agreed with the thrust of his idea. The scope for broadening the bicyclic group could be discussed further if the Board first agreed in principle.

Finally, the fact that the pressure on Fund staff resources had been growing in recent years and would continue to grow in view of the increases in Fund membership, Fund-supported programs, and the provision of technical assistance should be acknowledged, Mr. Dai remarked. And another new task would be added to the Fund's agenda, namely, the study on the needs of the Soviet economy. He agreed that the issue of the constraint on staff resources should be given due consideration and addressed appropriately at the next budget review.

Mr. Kwon made the following statement:

Like previous speakers, we believe that surveillance remains a primary responsibility of the Fund and should be accorded the

highest priority. It is an area in which the Fund has a comparative advantage, and notwithstanding the other important issues on the agenda, attention to surveillance responsibilities must remain uncompromised.

The experience to date with surveillance has provided many lessons. Perhaps the most useful of these has been that the nature of surveillance changes as it responds to the evolving environment in which member countries operate and that, essentially, there are no hard and fast rules. In our opinion, discretion and flexibility on the Fund's part are more conducive to effective surveillance than any rule.

We continue to view Article IV consultations as the primary vehicle for fulfillment of the Fund's obligation to exercise firm surveillance over the exchange rate policies of its members. The primary focus of surveillance should be macroeconomic policies and those structural policies directly linked to the international economy. There can be no question that in the present world economic environment, increasing emphasis is being placed on a multilateral focus, and this aspect of Fund surveillance must continue to be enhanced. We believe, however, that efforts in this area should be supplementary to the more traditional single country surveillance.

We note that discussions on undertaking surveillance take place against the background of an unrelenting increase in the pressure on staff resources. In the absence of any fundamental review of the disposition of the Fund's resources, the central issue remains how to use existing resources better. This leads us to favor a more focused approach to the whole issue of surveillance.

We can also support the staff's proposal for a more focused quarterly report on significant exchange rate developments that incorporates movements in real effective exchange rates. However, modifications to exchange systems, especially in types of arrangements, currency pegs, and intervention procedures, should be notified to the Board as promptly as possible.

A reasonable frequency of consultations remains essential to effective surveillance. However, we can go along with increasing staff flexibility in exercising judgment on the scope and depth of the surveillance discussions, and we agree with the staff suggestion that reliance can be placed on less formal but ongoing contacts with national authorities.

We can also support more streamlined procedures for reporting to the Board. In this regard, we favor countries currently on the

bicyclic consultation cycle remaining so--subject to no fundamental change in their circumstances--and a move to a more concise and focused annual report for those countries on a 12-month cycle, with more comprehensive staff reports only where significant changes in policy or external circumstances have occurred. However, there could be merit in going even further than this, and Mr. Fogelholm's suggestions for a less intense surveillance procedure, incorporating biennial Article IV consultations for the majority of countries with smaller-scale interim missions, seem worthy of further consideration.

While we can support fewer country-specific Board discussions, we would include for discussion, apart from G-7 countries and those using Fund resources, any country where there have been basic economic changes or a fundamental deterioration in the balance of payments. We can also agree to papers on recent economic developments being prepared less frequently, say every two years, subject to the important qualification that fundamental economic changes and reforms be documented when they occur.

On the methods for enhancing multilateral surveillance, we note the success of Fund participation in the G-7 process and the benefits of the world economic outlook exercise. While we can see some merit in clustering G-7 consultations, we are skeptical that the benefits that derive from this clustering would outweigh the risk of less in-depth discussion on each country that would inevitably occur as a result of such an intensified program of papers being brought forward for Board discussion, not to mention the strain on staff resources.

We also see some scope for placing increased emphasis on assessing individual countries from a regional perspective, including a broader assessment of the effects of policies common to a number of members. In this regard, one possible variant in a predominantly biennial arrangement is for biennial Article IV consultations to be complemented by grouped consultations every other year, even though I recognize some practical difficulties at the initial stage, as pointed out by Mr. Filosa.

Finally, we cannot support suggestions to publish Fund documents. The open and frank discussion that is central to the surveillance process would be compromised by the need to appease countries' fears of the possible publication of material.

Mr. Fernando made the following statement:

At the outset, we would observe that Fund surveillance is too narrowly linked with exchange rates and the exchange system. Even

though in the practical application of surveillance procedures we may have attempted to broaden the scope so as to cover those critical areas of policy that significantly effect the exchange rate, the perception persists that the procedures lag behind developments in the international monetary system. The credibility of the Fund, and the policy advice it gives to members, is at stake on account of the lack of symmetry in the ability of the Fund to persuade its membership to follow its advice. We should not pretend that our advice is always right or is necessarily the best. But the luxury that some have to weigh the advice and act according to domestic imperatives and the pressure on others to accept that advice set the parameters for surveillance. Indeed, the staff must be complimented on the manner in which it has stuck to its task in negotiating programs--arguing for elimination of fiscal subsidies when major creditors year after year maintain and sometimes expand them; or arguing for trade liberalization very early in the adjustment process when many major countries have a record of development behind high tariff walls.

The closer integration and interaction within capital markets, and extensive intervention in the exchange markets by monetary authorities--both being areas where the Fund lacks the capability to monitor developments--have further circumscribed the effectiveness of surveillance. In this context, the clustering of consultations with the major industrial countries just prior to the world economic outlook exercise is desirable in the way it has already been achieved. But we are apt to wonder whether, in view of the spring and autumn meetings of the Interim Committee, such consultations should not yield material for a more focused discussion and conclusions by the Interim Committee on specific matters of relevance to the international adjustment process and the monetary system. Macroeconomic policy adjustments have been known to reach limits in reducing imbalances, and attention has been focused on structural impediments in order to revive the momentum. Such a focus will be a necessary and logical development in the evolution of our surveillance responsibility.

We have to expend every effort to make surveillance more symmetrical--not in terms of arithmetical equivalence of the number of consultations or staff time spent, but rather in terms of and in relation to the economic impact of countries' economic policies on the rest of the world.

More generally, the world economic outlook exercise contains increasing potential for more and better surveillance. There is in fact a case for more frequent world economic outlook discussions, say every quarter, focused mainly on the policies of countries that have a large international impact. These policies should be assessed in a coordinated manner, to ensure more

effective international adjustment. International policy coordination should be undertaken within the purview of Fund surveillance. In this context, we welcome and encourage the participation of the Managing Director in the consultations among the Group of Seven on matters pertaining to the international economy.

With regard to surveillance over regional groupings with institutional arrangements, particularly in respect of exchange rate determination, there is a clear case for including them in the focus of surveillance. This would allow a more balanced approach to adjustment. A beginning could be made, however, by making the activities of the regional groupings and their effect on international adjustment a special subject of inquiry in the world economic outlook just as newly industrializing economies are being treated separately in the world economic outlook documents. It is necessary for the Fund to persuade the members who are associated with the regional groupings to use their influence with these groupings to ensure that they act in a manner that is compatible with the healthy development of the international economy.

Work load considerations have already resulted in shorter reports for Article IV consultations and the adoption of the bicyclic procedure. We recognize that, even within arrangements that further reduce the frequency of Article IV consultations, generally along the lines advanced by Mr. Fogelholm, not all consultation reports require a Board discussion. Similarly, in the case of program countries, we are prepared to take note of a review, on a lapse of time basis, provided performance is broadly in line with targets and balance of payments viability is not seriously at risk. However, in the case of major industrial countries, apart from the annual review of performance and policy, selected topics should continue to be probed in depth through special supplements to the papers on recent economic developments.

On exchange rate monitoring, we can go along with the staff proposal that, in view of the limited impact of information notices on real effective exchange rate changes, significant developments in nominal and real exchange rates during a quarter may be integrated with the existing quarterly report on exchange arrangements.

As regards frequency of consultations, going by past experience, I feel that consultations with more countries can be held on a 24-month cycle. If this is agreed, I suggest that selection of such countries be made strictly according to an objective set of criteria. Alternatively, I may not be adverse to some lengthening of the period between consultations. I am also willing to go

along with the staff proposals regarding more streamlined reporting procedures and procedures for Executive Board treatment of such reports. This will provide Executive Directors with a greater latitude to concentrate on policy matters.

Like the staff, we are concerned about the addition of new topics in the consultation report coverage, as we see a clear risk of diluting the focus of surveillance. We conveyed our views on this matter during the discussion for the Article IV consultation with Thailand (EBM/90/40, 3/19/90). Briefly, the poverty focus should be relevant only to program countries, and only on the basis that social features prevailing in such countries can impede adjustment and reform. The Board should be aware of the risks, and as far as possible, attention to this subject should be within a framework where the program design permits the alleviation of hardships arising from policy reform. Issues related to the environment are best left to the World Bank, which has a comparative advantage in dealing with the subject; in addition, the Bank can exercise leverage through its lending policies, which can directly cover environmental issues.

Finally, as pointed out by Mr. Enoch, the next review of surveillance could take place before July 1, rather than April 1 as suggested in the proposed decision.

The Director of the Exchange and Trade Relations Department stated that the staff's basic responsibility, subject to the direction of management, was to provide material to Executive Directors that allowed the Board to conduct its statutory obligations in regard to surveillance. Over time, Executive Directors tended to suggest that additional subjects should be included in future reports but seldom suggested that subjects should be deleted. Therefore, the staff paper presented an opportunity to revisit ideas that had been put forward by the Group of Ten, the Group of Twenty-Four, and other bodies to streamline a process that was running up against constraints throughout the Fund.

The savings obtained from the bicyclic procedure had been rather limited for two reasons, the Director noted. One was perhaps the staff's fault: the number of people sent on the intermediate year's mission on average was only slightly less than the number sent on the full Article IV consultation mission, and the time spent in those countries was also only slightly reduced, because the staff had undertaken to produce a fairly full report to the Board in the intermediate years whether the document was considered in a Board session or not. The other and more obvious reason was that many countries were not on the bicyclic procedure: countries not included were those having a substantial impact on third countries, or those with approximately the 20 highest quotas; those with Fund arrangements, or

about 64 at present; those without medium-term viability; and those that had requested not to be on a bi-cycle--a total of about 108 members.

Two approaches could be used to remedy the situation, the Director continued; first, the suggestion had been put forward by Mr. Fogelholm and supported by several other Directors to look at the frequency guidelines and implement changes. The other, as put forward in the paper, was that more discretion should be exercised by the staff with the help of Executive Directors' comments. The staff had also noted the reservation expressed by some chairs about having somewhat shorter and less frequent papers.

On the publication of Fund documents, the reactions suggested that the present procedure, whereby appendices would not be published without the agreement of the country concerned, should continue, the Director said. As indicated by Mr. Filosa, the publication process took time, thereby helping ensure that it was somewhat sparsely used.

It had been noted that there had been a rather long gestation period for the staff paper, as a result of the other matters dealt with by the Board before the Interim Committee, the Director noted. For those reasons, some data were not current, and the date in the decision should be changed.

Replying to a question by Mr. Goos, the Director of the Exchange and Trade Relations Department confirmed that changes in exchange rate systems and arrangements would be reported promptly so as to keep national authorities informed.

The Deputy Director of the Research Department observed that a few Directors had commented on the method used to measure real effective exchange rates. Over the past year or so, the staff had conducted an appraisal of the indices used for industrial countries to measure normalized unit labor costs. International Financial Statistics (IFS) in fact published five series, including normalized unit labor costs for industrial countries, and on the basis of the staff's review, it was decided to alter the method used to calculate normalized unit labor costs. The purpose of that series was to correct actual unit labor costs for cyclical movements in productivity. However, a problem had developed in that sustained drifts were found between normalized and actual unit labor costs, most dramatically in the case of the United Kingdom, but also for some other countries. As that made little sense, it was found that a simple moving average of actual unit labor costs would give many of the advantages sought earlier, and the present plan was to introduce the new index in August 1990 and to publish the revised data in IFS in September. The revision would apply only to the industrial countries, although large differences, at least in short-run changes in competitiveness, were not expected; for the developing countries, the same series would be used.

Over the next few weeks, the staff would endeavor to determine how to provide a more standardized and economical way of presenting exchange rate

statistics in the various regular reports that were distributed, the Deputy Director remarked. On the one hand, the staff had been requested to eliminate any duplication and to find any economies that existed, and on the other hand, it had been asked to provide more comprehensive material. The staff hoped to find a satisfactory compromise.

Mr. Posthumus inquired what criteria would be used to select the annual reports to be discussed by the Board, apart from the general criterion proposed by the staff that all G-7 and program countries would be on the agenda. One method could be to have the staff decide which of the annual country reports the Board should discuss. It was unlikely that an Executive Director would ask that a country in his constituency be placed on the agenda because of imminent or actual problems, nor would another Executive Director easily take the initiative.

Another method would be to have the document--along with the staff's suggestion as to whether it should be discussed by the Board, and the staff's reasons--placed on the agenda, and have the Board then decide whether or not to discuss the document, Mr. Posthumus said. In that way, the important principle that every annual consultation report was on the agenda of the Board would be upheld. His concern was not that every report should be discussed, but that the Board should decide which annual reports should be discussed.

The Director of the Exchange and Trade Relations Department noted that the Managing Director proposed, and the Board adopted, the agenda without the staff's participation. Under existing procedures, 108 members were on the standard 12-month cycle; 33 members were on the bi-cycle, following the Board's decision to that effect in each case; and 9 members were on special cycles of 18 or 24 months or with no stipulated cycle. While the staff had suggested greater flexibility regarding the first group of 108 members, a number of Directors had proposed that reports on all members should be on the agenda, with the Board deciding which report should be discussed. That formal procedure seemed to be appropriate and would not pose difficulties for the staff.

Mr. Fogelholm added that a lapse of time procedure could be considered. On the frequency of Board consideration, a number of program countries were included in the first group of 108 members, and they could be dropped fairly easily from an annual Article IV consultation cycle because they were reviewed two or three times a year. They would, in effect, need a full Article IV consultation only every 24 months. In that way, the number of members on a bicyclic procedure would be increased although the work load would not necessarily be reduced much.

The staff produced a monthly paper on gold prices in world markets, and he wondered whether a monthly document was necessary, Mr. Fogelholm said. Information was available on a daily basis, and a report on a

quarterly or semiannual basis would seem sufficient. It was important to ascertain that unnecessary papers were not distributed.

The Director of the Exchange and Trade Relations Department agreed that the staff would look more carefully into the various documents on gold prices and foreign exchange that were provided. As to the program countries, in 1989 only two had had a separate Article IV consultation discussion, as the staff's practice, with the Board's encouragement, was to combine it with a review. On some occasions, Executive Directors had expressed the view that for the review, they should concentrate on particular issues, although they would welcome the opportunity to speak on other aspects of the economy. But, in fact, that had not been done in the past calendar year.

The Board had given the staff some flexibility with respect to the papers on recent economic developments, which, perhaps, the staff had not used as much as it should, the Director noted. But some departments--for instance, the African Department--issued those papers for certain countries only every other year, alternating with statistical tables; on the whole, Executive Directors had not found any difficulty with that practice, and perhaps it could be carried somewhat further without loss. Regarding the savings of staff time, it needed to be remembered that the staff found it essential that a small number of staff members, not necessarily from the same department, took the time to prepare a document--a "background paper"--compiling in a somewhat unedited form all the tables, data, and institutional changes so as to provide the basis for analysis and discussion with the member country. That document was later corrected, refined, and circulated to Executive Directors as the paper on recent economic developments.

The Acting Chairman made the following summing up: 1/

Let me note first that the Executive Board has been conducting two closely related reviews. One is that of the implementation of surveillance following the 1988 Executive Board Decision requiring reviews at intervals of two years rather than annually. The second is the biennial review of the principles contained in the 1977 document, "Surveillance over Exchange Rate Policies." This is a particularly important review given that a number of the subjects addressed have been discussed in different contexts over the recent past.

Quite a few specific suggestions for improving the implementation of surveillance have been made, and some of these will need to be given further study in the context of the coming work program discussions. At the same time, the text of the 1977

1/ The summing up was subsequently circulated (SM/90/103, Sup. 3, 8/23/90) for discussion by Executive Directors at an informal meeting on September 17, 1990.

document on the surveillance over exchange rate policies was confirmed.

One theme stressed during the discussion was that the effectiveness of surveillance depended significantly on the quality of the staff analysis along with the force of Board statements and views on the policies of member countries; in addition, the importance of dialogue with the authorities, particularly at a policymaking level, was highlighted.

I have also observed that, while views were clear in some areas, differences of views among Directors remained in others, underscoring the importance of giving the staff flexibility in using different approaches to determine the most effective method of implementing surveillance.

1. The Fund's surveillance responsibilities

There was a reaffirmation of the central role of Fund surveillance in promoting the objectives of orderly underlying economic and financial conditions and a stable exchange rate system referred to in Article IV and in the 1977 surveillance document. Many Directors commented that despite a long period of economic expansion and relatively low inflation in the industrial countries as well as efforts to improve policy coordination, developments in recent years still pointed to the need to make surveillance more effective. The general movement toward greater liberalization and integration of markets in trade as well as capital and toward economic integration of member countries within specific regions also posed greater challenges for both Fund surveillance and the evolving policy coordination process.

Directors were of the view that if the effectiveness of the Fund's surveillance over members' exchange rate policies is to be strengthened significantly, the basic issue was not the surveillance principles in themselves, but rather the willingness of members to be prepared to give full consideration to the views expressed by the international community in formulating and adopting their own macroeconomic and structural policies.

2. Enhancing the effectiveness of surveillance

We had an extensive discussion of various proposals to strengthen the effectiveness of surveillance. Directors noted that most of these proposals have been discussed before in seeking to overcome the constraints on the effectiveness of surveillance. They include supplemental and special consultations; follow-ups to consultations, involving the Managing Director, the national authorities, and/or meetings of different country groupings such

as the Group of Seven; a broadening of the country-specific focus of the surveillance process; the use of exchange rate indicators; recourse to greater publicity; and a strengthened linkage between technical assistance and surveillance.

With respect to special, supplemental, and follow-up consultations, a number of Directors again endorsed their usefulness where warranted, but they considered that a pragmatic and flexible approach should be used and that automatic procedures to trigger such consultations should be avoided.

Directors expressed the desire to strengthen the Fund's role in the international policy coordination process and thus emphasized the importance of multilateral surveillance. The World Economic Outlook was seen as playing a crucial role in that effort. In this framework, the increased emphasis on the systemic implications of country developments in both bilateral and multilateral surveillance was welcome. A number of Directors indicated that it would be useful if bilateral consultations were framed more explicitly against this multilateral setting, especially where alternative scenarios could result in substantially different individual country prospects. Another procedural change to strengthen this process was the concept of clustering G-7 consultations, but most Directors were skeptical and pointed to the practical difficulties that could arise--the availability of staff, the time constraints of the authorities, and possible overload of Board discussions. More generally, Directors observed that the world economic outlook exercise provided the basis for an integrated analysis of economic policies of the seven major industrial countries in a larger multilateral context.

There was general support for a more regional and cross-country perspective for surveillance, especially in those circumstances where macroeconomic policy is centralized institutionally. But the circumstances of different countries would have to be taken into account, and emphasis was placed on the need for consultations with the national authorities of the countries within the group. It was suggested that more could be done in the context of the world economic outlook exercise to integrate analyses of groups of countries in order to address regional or cross-country issues.

While some Directors expressed a willingness to see special studies, and perhaps selected papers on recent economic developments, published--of course with the full concurrence of national authorities--many Directors again stressed the importance of not jeopardizing the depth and breadth of discussions with members and of maintaining the confidentiality of those discussions. The

question of publication could be addressed as individual papers are presented to the Board for discussion.

Directors agreed that the present procedures for separate information notices on exchange rate developments could be discontinued, and that information on significant changes in real and nominal effective exchange rates would be communicated to the Board in a quarterly report. Moreover, the Executive Board would be notified promptly of significant changes in exchange arrangements of members. The staff will review the array of documents now provided on exchange rate and other market developments in order to minimize duplication.

3. Scope and focus of surveillance

There was general recognition that the scope of surveillance in recent years has broadened in response to changes in the domestic and external environment of members and to concerns over structural and other issues. Directors agreed that this tendency for surveillance to become more comprehensive should not come at the cost of the coverage and the quality of treatment of core issues that have substantial implications for economic growth and efficiency, employment, and the external policies of members, as viewed from both their individual standpoints and their linkages with the international community. Some Directors commented that the Fund's focus should be on macroeconomic policies, cautioning that the Fund may not have the expertise to address some structural issues, for example, the environment.

Directors encouraged a more flexible approach and greater selectivity in the choice of issues to be covered in staff reports. Several Directors remarked that in consultations where considerable divergence of views between the staff and authorities arose, the authorities' views should be presented consistently in the staff reports. Directors also encouraged the staff to draw, as appropriate, on the knowledge and expertise of other organizations when addressing relevant noncore issues.

4. Frequency of consultations and reporting

Directors were strongly of the view that continuing close contacts between the staff and the authorities of members played a key role in ensuring the effectiveness of surveillance. In this regard, Directors stressed the crucial importance for surveillance activities of an adequate flow of information and analysis concerning developments in the world economy and those of individual members. They also stressed that the quality of the staff's analysis influenced the Fund's work with individual countries.

On balance, support was broad for conducting the Article IV consultations with all members on an annual basis, which would encompass Article VIII and Article XIV considerations as appropriate. A number of Directors either supported or indicated an interest in further exploring Mr. Fogelholm's suggestion to hold consultations with most members on a biennial basis, but with a small interim consultation. A way to bridge these two approaches is to extend the bicyclic reporting procedure to cover more countries. In addition, for those countries not on the bicyclic procedure, the staff could use its judgment to streamline a staff report if the circumstances of the country had not changed significantly from the previous year. A number of Directors encouraged the staff to provide more concise and focused interim reports.

Directors agreed that the form and content of the reports would be determined to a large extent by the staff's judgment as to what was relevant for the Board to exercise surveillance, and this reflected a desire on the part of many Directors to keep the reports concise, focusing in each case on those areas of direct relevance to an understanding of overall economic performance, notably macroeconomic and related structural policies, as well as the external context. More comprehensive staff reports would be prepared where significant changes in policy or external circumstances have occurred since the time of the previous Board review of the country's situation, or in cases where it is judged that a wider range of policy issues needs to be covered, as well as generally in cases of countries with systemic influence and for those using, or likely to use, Fund resources. In any case, a comprehensive staff report would be expected for each member at least once every two years.

A paper on recent economic developments--going beyond the statistical appendices necessary to conduct annual surveillance--should be issued usually every other year. However, annual papers on recent economic developments could be issued in those cases where the paper was helpful to the country in formulating its own policies or in obtaining financial support.

A number of Directors were concerned that the demands on the staff would increase despite our endeavors to streamline and make more effective the surveillance process. The implications for the work load of the staff will have to be considered, as many of you indicated, in the context of the next medium-term budget review.

The Executive Board then took the following decision:

1. The Executive Board has reviewed the general implementation of the Fund's surveillance over members' exchange rate policies, as required by paragraph VI of Procedures for Surveillance contained in the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, including the procedures for the conduct of consultations under Article IV, which in principle shall comprehend the regular consultations under Article VIII and Article XIV, and approves the modifications of the procedures as described in SM/90/103, in the light of the Managing Director's summing up, until the next review, which shall be conducted not later than July 11, 1992.

2. The Executive Board also has reviewed the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, as required by paragraph 2 of that decision. The next review of the document shall be conducted not later than July 11, 1992.

Decision No. 9499-(90/111), adopted
July 11, 1990

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/110 (7/9/90) and EBM/90/111 (7/11/90).

5. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/90/180 (7/6/90) is approved.

APPROVED: June 25, 1991

LEO VAN HOUTVEN
Secretary