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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/77

3:00 p.m., June 19, 1989

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
Dai Q.	Zhang Z.
	C. S. Warner
J. de Groote	J. Prader
E. T. El Kogali	
	S.-W. Kwon
E. V. Feldman	
L. Filardo	
	N. Kyriazidis
M. Finaish	
	O. Kabbaj
	B. Goos
J. E. Ismael	E. Kiriwat
B. Jalan	L. E. N. Fernando
	G. Bindley-Taylor, Temporary
M. Massé	
	J. K. Orleans-Lindsay, Temporary
Y. A. Nimatallah	
	M. Fogelholm
H. Ploix	
G. A. Posthumus	
	S. Yoshikuni

L. Van Houtven, Secretary and Counsellor
D. J. de Vos, Assistant

Also Present

IBRD: F. Jasperson, Country Economics Department. African Department: M. Touré, Counsellor and Director; N. Abu-zobaa, R. C. Williams. Asian Department: M. J. Fetherston. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; E. Brau, H. M. Flickenschild, C. Puckahtikom, M. H. Rodlauer, B. C. Stuart, P. J. P. Szymczak, J.-P. Wang. External Relations Department: P. E. Gleason. Legal Department: A. O. Liuksila. Research Department: M. Goldstein, Deputy Director; B. B. Aghevli, R. C. Baban, M. S. Khan, P. J. Montiel, P. Wickham. Western Hemisphere Department: M. Caiola, Deputy Director. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. Al-Jasser, M. B. Chatah, J. M. Jones, J. L. Menda, M. Pétursson, P. Péterfalvy, R. Wenzel. Assistants to Executive Directors: H. S. Binay, E. C. Demaestri, S. K. Fayyad, J. Gold, M. E. Hansen, K. Ichikawa, C. J. Jarvis, J. E. M. Jones, P. Kapetanovic, V. K. Malhotra, R. Marino, G. Montiel, N. Morshed, A. Napky, M. J. Shaffrey, Shao Z., Yang J.

1. CONDITIONALITY IN FUND-SUPPORTED ADJUSTMENT PROGRAMS - ISSUES AND REVIEW OF EXPERIENCE; AND POLICIES TO PROMOTE PRIVATE CAPITAL INFLOWS

The Executive Directors resumed from the previous meeting their consideration of a staff paper on issues in conditionality in relation to selected aspects of experience with programs supported by stand-by and extended arrangements (EBS/89/17, 2/13/89; and Sup. 1, 2/23/89; and Sup. 2, 2/24/89), together with a paper on policies to promote private capital inflows in Fund-supported adjustment programs (EBS/89/117, 6/8/89). They also had before them a staff paper on savings issues in such programs in developing countries (EBS/89/116, 6/6/89).

Mr. Orleans-Lindsay made the following statement:

> We commend the staff for providing a comprehensive main paper and extensive background information on the adjustment experience of the nine countries selected for the case studies.
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> On the choice of the case study approach, we welcome the change from the cross-country analysis approach, which relied on the adjustment experiences of countries that had had arrangements for at least a year. Indeed, the use of the cross-country approach, involving a large number of countries, seemed to lead to broad conclusions that gave inadequate attention to country-specific aspects of adjustment. However, while we agree that the case study approach is meant to focus on and delineate the particular adjustment experiences of selected countries, it appears that the sample is not broadly representative of the diverse number of developing countries that have undertaken programs supported by stand-by and extended arrangements over the 1982-87 period. Again, while we acknowledge that a high degree of judgment was involved in the selection of countries to represent different regions and economic structures, it is not quite clear why one criterion should be preferred over others. Like Mr. Enoch, we believe that the representativeness of the sample would have been enhanced and the broadness of the review's results would have been increased if, for example, the criterion relating to regional balance had included countries with different economic and institutional structures, such as a member country from the CFA monetary arrangement, like Niger, Senegal, Gabon, or the Central African Republic. The economic policies and performance of such countries are more likely to be affected by their monetary arrangements, since these raise different issues from those cited in the studies. While this omission from the sample of countries is regrettable, we nevertheless consider the case study approach as useful for helping Directors to draw lessons from the specific adjustment experiences of individual countries. We would, however, like to caution against an attempt to apply such specific conclusions in a general manner to all member countries undertaking Fund-supported adjustment programs. On the occasion of the next

review, the case study approach might focus on a few country cases to allow for in-depth analysis of selected issues. Furthermore, we would need to gain more experience from its application for our review of the Fund's conditionality guidelines, and not immediately--in other words, soon after this review--revert to the previous cross-country approach.

The case studies have made it clear that the varying degrees of success of adjustment in the selected countries reflect the differing approaches of these countries to the adjustment process. More importantly, and as Mr. Jalan has stated, the studies indicate that policies that are easily adopted and implemented in one country might not or cannot be adopted and implemented fully in another country. The studies also indicate that despite the successes achieved and the Fund's continued involvement in most of these countries' adjustment efforts, the countries concerned remain far from achieving external viability. Many countries, including several in Africa, are facing severe balance of payments difficulties, and their progress toward medium-term external viability is proving elusive. In recent years, they have been striving, with Fund support under stand-by, structural adjustment, enhanced structural adjustment, and extended arrangements, to overcome these difficulties by implementing measures designed to remove deep-seated structural obstacles to sustainable growth and reasonable price stability. The pace at which these policies can be carried out in a sustained manner varies between the selected countries and also with the choice of specific policy reforms. The studies have shown in addition that some of the reforms have had to be undertaken in an uncertain economic environment, characterized by external shocks or unanticipated unfavorable developments that either slowed down program implementation, or resulted in difficulties in meeting program targets, as evidenced by the cases of Bangladesh and Ghana. However, in cases in which policies were adapted to adverse circumstances, program implementation proved generally more successful.

The staff's analysis of the difficulties associated with the implementation of programs indicates that there is a need not only to improve the design of programs, but also to design those programs to reflect economic, social, and institutional realities in member countries. For African countries, in particular, these programs must be framed to mirror the peculiar experience of each country, taking into account broad characteristics, such as the small productive base--including single commodity export crops--low factor productivity, weak infrastructure, and administrative constraints that hamper implementation of a wide range of structural reforms. It is against this background that the general framework for program design should be focused; and, as several speakers have suggested already, where circumstances dictate that short-term stabilization policies are required to restrain domestic absorption, the scope of the program could be designed narrowly with this in mind. However, for Africa, where the structural rigidities referred to above need to be reduced significantly, the adjustment process goes beyond the medium term. Therefore, in designing growth-oriented adjustment programs, the growth targets should be set at realistic levels, having the long-term growth potential in perspective; and, as Mr. Goos and Mr. Enoch have indicated, overoptimistic assumptions in program design must be avoided.

It is acknowledged widely that a weak administrative capacity in most African countries is one of the factors constraining the successful implementation of necessary structural reforms. In this connection, technical assistance from the Fund has been helpful in lessening some of these constraints. The continued provision of such assistance to members would contribute substantially to strengthening their macroeconomic policies and thereby to enhancing general economic conditions. The continued close collaboration between the Fund and the Bank in providing technical assistance in areas such as pricing policy and investment strategy is crucial for members undertaking structural reforms.

With respect to a member's commitment to implementing a program, it is evident that a well-designed program is more likely to elicit the authorities' commitment to sustained execution, especially when the benefits that will accrue are clearly foreseen. In assessing the strength of a member's commitment to a program, the staff may consider the authorities' policy formulation record. When member countries have, on their own, initiated substantial policy reforms in the past and have put in place adequate measures to correct economic and financial imbalances, such actions should constitute a clear indication that a member is strongly committed to further adjustment. Commitment to adjustment could also be reflected by the speed with which politically sensitive measures, such as the correction of misaligned prices, are taken.

As regards program monitoring, we continue to believe that precise and objective monitoring is necessary to assure members about the conditions under which disbursements can be made. However, quantitative performance criteria should cover a few important macroeconomic variables, and these should be specified in terms of ranges, rather than fixed points. It is worth pointing out that recent experience with the operations of stand-by, structural adjustment, and enhanced structural adjustment arrangements have led to a perception that benchmarks are being used more intensively and prior actions more extensively with the intention of ensuring the success of programs. This tendency, coupled with the practice of setting detailed timetables for structural benchmarks, would appear to call for greater staff involvement in the economic management of member countries. The Fund should not be perceived as doing so, given the social and political tensions that are likely to erupt as a result of a perception of that sort. In that connection, program reviews should be limited to cases in which structural uncertainties exist, and in cases in which it is important to focus--at the inception of the program--on the structural changes that are crucial to maintaining the adjustment process. Such reviews, which are meant to introduce some flexibility into program monitoring, should nevertheless be based on understandings reached at the inception of programs.

On the possibility of a more drawn out process of external adjustment and its implications for the prolonged use of Fund resources and their revolving character, it is evident that since a number of countries have not moved in any significant manner toward the objective of achieving a viable balance of payments position, they will continue to seek Fund financial support, especially in the context of the new Fund facilities. Repeated or prolonged use of Fund resources is not inappropriate, so long as such use is accompanied by substantial progress toward a viable balance of payments position within a reasonable time, and that such progress enables the member to make repurchases as scheduled. As all Directors know, a situation of that sort is not inconsistent with the revolving character of the Fund's resources.

As for the periodicity of reviews of conditionality required under Guideline 12, we support a review based on a 12-16 month cycle.

Mr. Massé made the following statement:

As my chair has noted in the past, a strong degree of conditionality must be present when Fund resources are used if the Fund's objectives are to be met, including that of maintaining the revolving nature of its resources. Like other Directors, we commend the staff for the high quality of the papers before the Board, and their frankness. I also wish to express my chair's appreciation for Directors' opening statements, as they have made an invaluable contribution to the continued evolution of the Board's views on this issue.

In the limited sample of countries chosen by staff, a number of members that have sought the Fund's assistance in the recent past remain some distance away from solving their problems. In one case, arrears to the Fund have emerged. While recognizing that unanticipated adverse external developments, as well as a somewhat weak program design, might have hindered members' efforts, there have been too many instances of inadequate implementation of adjustment programs. This points to the fundamental importance of a strong political commitment to the program, but can also suggest that the degree of conditionality associated with programs may, at times, have been insufficient.

The staff's approach of restricting analysis to the programs of a small number of members is useful in that it has led to a more focused discussion. Like a number of other Directors, including Mr. Finaish and Mr. Posthumus, it would be useful in future papers to consider further restricting the analysis to selected policy questions. For example, emphasis may be placed on those members that have had a considerable degree of adjustment success, or that have accumulated sustained arrears to the Fund, or that have brought under control a very high rate of inflation. If the practice of considering programs of a selected group of members persists, the criteria for selection should be sufficiently flexible so that the group of countries under consideration can change from time to time. Moreover, I would add that we prefer to maintain the current frequency of reviews.

The staff indicates that program implementation in a number of cases has been affected negatively by adverse external developments, with programs sometimes going off track. The staff raises the question of whether the policy margins built into programs were adequate, or whether additional financing from the Fund and other sources would have been appropriate. To some extent, these issues could now be addressed by use of the compensatory and contingency financing facility. However, given the complexity of this facility, few countries have chosen to have recourse to it. In view of this reticence, we urge the Board to give priority to simplifying the compensatory and contingency financing facility in the near future, as suggested also by Mr. de Groote. In general, we would caution against being too liberal with program parameters, particularly as a system of waivers and modifications is in place already. Where serious problems have developed with programs, the only feasible response might be to renegotiate them.

We would agree with Mr. Enoch and Mr. Goos that staff should guard against being overly optimistic in designing programs. As has been demonstrated, such optimism only increases the risk that the program will go off track.

Too little emphasis is placed on the role of exchange rate policy. The staff indicates that with primary producers, in particular, a flexible exchange rate policy can often result in excessive exchange rate volatility, threatening overall financial stability. However, we wonder how financial stability can be maintained in an environment in which there is a clear indication that the exchange rate is inappropriate. The staff also indicates that "in a number of cases, a flexible exchange rate policy without adequate support of fiscal and monetary policy led to accelerating inflation." In our view, the primary cause of the acceleration in inflation in such cases was not the exchange rate policy per se, but probably inappropriate domestic policies. A fixed exchange rate will not prevent inflation if monetary and fiscal policy remain out of line, and it may perpetuate serious distortions in the economy. Although these questions have been discussed in the past, in view of the continued differing approaches expressed by Directors during the current discussion, a more detailed examination in a future paper on conditionality--or separately--of how to determine optimal exchange rate policy in Fund arrangements would be useful. Mr. Posthumus seems to have made a similar suggestion.

We welcome the increased emphasis on structural adjustment policies in Fund programs and the shift toward a longer-term planning horizon. Although this shift will inevitably lead to a considerably longer-term Fund financial involvement, we must also recognize that the durability of adjustment depends on appropriate institutional and economic structures, and that the Fund must have a role in fostering such structures. However, the increased emphasis on structural adjustment should not lead to an easing of conditionality for the Fund's general resources, but, instead, to changes in the manner in which conditionality is applied. As noted by a number of Directors, increased emphasis on structural policies should not obscure the fact that macro policies remain central to Fund-supported adjustment programs.

The staff paper raises the key question of how one can know to what degree structural adjustment should be a component of Fund programs, and whether drawings under an arrangement should be interrupted in the face of inadequate implementation of structural measures. These assessments can only be made on a case-by-case basis, based on the perceived degree of importance of structural measures to the overall program. We would urge caution in relating Fund drawings directly to structural measures, given the relative difficulty of developing clear performance criteria in this area. This is an area that would warrant further study by the staff.

The staff notes that, in some instances, the administrative capacity of the member was not up to the task of fully implementing the program. Increased emphasis on structural measures, whose implementation usually requires a series of complex steps involving institutional and legislative changes, would likely place further demands on members' administrative capacity. This points to the need to increase the focus on the administrative abilities of members to implement programs and to formulate schedules for program implementation that are consistent with such constraints. Additional technical assistance could also facilitate the implementation of structural reforms.

The importance of structural measures highlights the need to collaborate and coordinate more closely with the World Bank. We welcome the recent agreement reached by the Fund and the Bank on strengthening the procedures and mechanism for collaboration, and hope that it leads to more fruitful cooperation.

With regard to the paper on policies to promote private capital inflows, we concur entirely with the staff that sound macroeconomic policies are the essential ingredient for restoring confidence and for establishing an economic environment that is conducive to flight capital repatriation. We support the staff's recommendation to monitor private capital flows in the broad context of net international reserves. The underlying assumptions on private capital flows incorporated in the reserve targets should be specified clearly, and the Board should be prepared to provide waivers in cases in which the authorities have taken the specific actions recommended, without the objective in terms of capital inflows having yet materialized. It is not realistic to assume a significant return of flight capital in the short run, as confidence will likely be restored only gradually. We are attracted by Mr. Goos's idea that more explicit consideration of these issues should become standard in the discussion of all programs, rather than in just the relatively few cases that will involve debt reduction.

Mr. Kwon made the following statement:

The current topic for discussion is important and complex. I fully agree with Mr. El Kogali that conditionality must remain a fundamental precept of Fund lending.

When evaluating the Fund's approach to conditionality, Directors should keep two points in mind. First, the adjustment programs formulated in a cooperative process between the Fund and its members should be pragmatic, flexible, and compatible with both the particular member's interests and those of the Fund membership as a whole. Second, there is no single approach to the design and implementation of adjustment programs, and the Fund must take into account that the circumstances of each country differ.

The staff paper recognizes this in stating that programs should pay due regard to "domestic, social, and political objectives, the economic priorities, and the circumstances of members." However, due regard must be paid also to the interests of the other members of the Fund, by ensuring that Fund resources are not jeopardized; in this connection, I agree with Mr. Enoch that this review is in some ways a review of the first element of the Fund's arrears strategy. The care and attention put into the preparation of an adjustment program will be well rewarded if it forestalls the emergence of arrears.

Mr. Jalan places great emphasis on the need to consider each country's individual circumstances when designing a reform package, particularly its level of development. And while I fully agree with his plea that programs must take these factors into account, such considerations should not be allowed to override the primary goals of adjustment programs. In most cases, adjustment programs must therefore strike a delicate balance between what is feasible for a member country to undertake, and what is necessary to restore a viable balance of payments situation without severely compromising the prospects for growth and reasonable price stability.

The case studies approach has provided a very useful review of the Fund's experience with adjustment programs in a diverse group of member countries. This approach allows a more in-depth analysis of the experience of individual countries with their adjustment programs than before. It is unfortunate, but perhaps indicative of the largely unfavorable external environment in the 1980s, that only one country whose progress toward viability could be described as substantial was included in the country sample.

The staff paper suggests that Directors may wish to consider more narrowly focused case studies to illustrate selected issues in depth. I agree with Mr Jalan's suggestion that it may well be instructive to narrow the focus of the review of adjustment programs to compare the experience of, say, two countries in the same region where the program outcomes for each differed substantially. Also, it might be of considerable value if, for example, the analysis were to concentrate on the comparative experience in particularly critical policy areas. Such areas might well include fiscal policy and fiscal reforms, monetary and interest rate policies, and external policies. The analysis might serve to highlight the role of each of these critical policy areas in achieving the objectives of an adjustment program, or the consequences for the overall program of less than successful implementation in any one of the critical areas.

It is difficult to disagree with the staff's conclusion that programs need to be broad in scope and have a well balanced policy mix, especially given that the Fund's adjustment programs are now concentrated on low- and middle-income countries whose economic systems are usually rudimentary compared with those of developed countries. Mr. Jalan contends that programs with a broad scope are "not necessarily more successful than programs with narrower and more pinpointed objectives," especially in the context of short-term stand-by arrangements. However, for most countries undertaking Fund-supported adjustment programs, reasonably broad-based policy measures are essential if any real progress is to be made. Concentrating on narrower objectives will, in all probability, not achieve the desired results, due to impediments in other areas that have not been addressed.

The sequencing of adjustment policies is an important topic, and one that could have received more attention in the staff paper. I am in complete agreement with Mr. El Kogali that it merits further study. The current staff paper mentions the appropriate sequencing of structural reforms only, and does not appear to recognize that there are concerns relating to the *sequencing of both macro initiatives and structural reforms*. Getting the macroeconomic setting right is a prerequisite for allowing a number of different types of structural reforms to work in the desired direction.

I welcome the staff's recognition of the need for attention to be paid to both the revenue and expenditure aspects of fiscal adjustment, and that it has been difficult to sustain fiscal adjustment through ad hoc revenue measures and cuts in investment. Recently, my chair commented on the undesirability of achieving a reduction in public expenditure by curtailing investment, viewing it as a short-term expedient creating problems in the future in terms of reduced growth potential.

I share most of Mr. Jalan's concerns over a rigid insistence on positive real interest rates in all circumstances. Circumstances in most developing countries, with their unsophisticated financial systems, may well mean that the Fund will not get the response it expects from interest rate liberalization. It should therefore be approached cautiously. The focus should be on how best to mobilize private sector domestic savings, which may include a wide range of policies aimed at improving small savers' access to the "formal" financial sector.

The assessment of problems in a country is a crucial area of program design, and it is heartening that it improved over time in the course of countries' programs. Here, it does appear important that there be reasonable continuity with the staff involved in a particular program. The staff paper comments that a lack of such continuity has been a weakness for countries with especially complex economies, and that this should be a consideration in the management of staff resources. The paper could have stated this point more forcefully: it is imperative that there be continuity of staff that are fully familiar with all aspects of a member country's adjustment program. Only then can the Fund expect to maximize its chances for detecting problems in program design and implementation before they have an unduly adverse effect.

A related issue is the role of resident representatives. The staff suggests that some thought might be given to strengthening their role. This may be well worth considering for those cases in which the program is particularly broad and/or complex and would facilitate monitoring of progress, but obviously the disposition of these scarce resources warrants careful consideration and justification.

My Australian authorities consider that priority should be given to improving the assessment of problems in a country, and to this I would add, the staff paper's suggestion that more emphasis be given to analyzing key structural aspects in collaboration with the World Bank, in its areas of expertise, in the initial stages of design program. Another important point in this respect, especially in the context of ensuring that a program is appropriate to a country's stage of development, is that in some cases the assessment of a country's administrative capacity has been optimistic, and implementation has thereby suffered. My chair recently expressed some concerns on this point in respect of the discussion on Sao Tome and Principe's request for a structural adjustment arrangement (EBM/89/69, 6/2/89). In that case, it was clear that an extensive program was warranted, but it was equally clear that the country's administrative capacity was suspect.

The staff paper refers to some programs that might best be described as second best, in that they are circumscribed by essentially political constraints in some key structural areas. In circumstances where the macroeconomic program is agreed between the two parties, but the country is less forthcoming on agreeing to implement crucial structural reforms, the Fund should carefully consider whether the resulting package is likely to result in significant progress toward external viability. If the answer is no, the Fund should insist on acceptable structural reforms to the fullest extent possible, even if this might result in no arrangement being provided.

The importance of sustained program implementation as a necessary condition for achieving program objectives cannot be overestimated. In the case of Chile, the authorities' commitment to achieving the objectives of the adjustment plan played a major role in that country's success, while Yugoslavia's stop-go approach, coupled with actual reversals in policies, appears to have greatly undermined the adjustment program in that country. In this respect, I agree with Mr. Jalan that realistic program objectives--which fully reflect, for example, the social and political conditions in a country--can be implemented more easily, although it scarcely needs to be added that the objectives of the program should entail adequate progress toward the goals of adjustment programs.

The staff paper asks how current monitoring practices might be adapted to ensure more rapid progress in structural adjustment. Timetables are suggested for clearly specified policy steps on benchmarks, or performance criteria for quantified policy measures. Of course, this would place greater demands on staff resources and increase the likelihood that the Fund could be accused of dictating to its members. This appears to be a matter of judgment; in some cases, a member's authorities may welcome closer involvement by the Fund in specifying and monitoring the progress of structural reform. However, the evidence does seem to indicate that there is no conclusive correlation between the number of performance criteria and the prospects for a successful program, which brings one back again to the overriding importance of program design.

There is no doubt that the current situation requires longer adjustment periods for dealing with the problems facing some Fund members. I agree with Mr. Goos that access to successive stand-by arrangements should be considered only when the necessary degree of commitment, accompanied by tangible progress, has been demonstrated. The suggestion in the staff paper of encouraging greater use of extended arrangements is worth considering, but there must be more than just "adequate" commitment to the longer adjustment period.

The current interval between reviews of conditionality is about 16 months; I cannot see any compelling reason to alter it.

I have no major difficulty in agreeing with the staff's analysis and conclusion that a reflow of flight capital on a substantial scale would require sustained policy adjustment and improved economic performance over an extended period. However, after hearing the extremely interesting debate between Mr. Goos and Mr. Jalan at EBM/89/76, I am more inclined to the view that further case studies are needed before Directors reach any hasty conclusions. I therefore support Mr. Yamazaki's proposal on this point.

Mr. Kyriazidis made the following statement:

The review of practical experience in designing Fund-supported adjustment programs and conditionality is a matter of crucial importance to this institution. These are the major instruments through which the Fund ensures that its resources are used effectively in promoting its major objective, namely, the achievement and maintenance of stability and growth in an open trade and payments system. These are also the instruments that the Fund has to use to protect its financial integrity, while putting its expertise at the service of those members that need its support. It is thus a priority that the quality and effectiveness of the programs supported by the Fund, and the appropriateness and efficacy of the conditionality attached to them, be maintained continuously at the highest level and, if possible, be enhanced.

I am grateful to the staff for its detailed and candid case studies. The criteria used have led to a selection of countries that have relied on Fund resources for a prolonged period with results that--judged in the light of progress toward the achievement of medium-term balance of payments viability--range from the mixed, in the majority of the cases, to the insufficient. It is this characteristic precisely that makes these case studies instructive. The Fund has more to learn from marginally successful or even failed cases than vice versa. Although I would agree with Mr. Enoch, Mr. Jalan, and Mr. Goos that comparative or cross-country studies would be extremely useful from an analytical point of view--and might perhaps be conducted in connection with the next review of conditionality--the conclusions that the staff draws are weighty and significant, and point to a number of means for improving Fund performance.

We concur with the staff that comprehensive programs need to be designed to cover a consistent set of macroeconomic policies, combined with structural reforms, where underlying structural imbalances or institutional weaknesses can affect the sustainability of macroeconomic policy and the effectiveness of the relevant policy instruments.

Experience in the 1980s has proved that adjustment in the current world environment cannot be achieved only by using macroeconomic policies. Adjustment requires an appropriate degree of support from structural reforms over the medium term. This is especially true of developing countries where structural imbalances are in many cases severe, and the instruments of macroeconomic policy are weak. The success of Fund intervention will therefore depend to a large extent on expanding, where necessary, the scope of Fund programs and strengthening conditionality through carefully selected structural reform measures.

This chair believes that it is not always practical or effective to concentrate on demand-management policies with a view to obtaining rapid results. Conditionality conceived in this narrow frame, particularly in the case of developing countries, has been neither strong nor effective. This chair does not adhere to the view that there is a positive correlation between the strength of conditionality and the time frame within which it is conceived. The strength of conditionality depends on the consistency and comprehensiveness of the measures envisaged and their sequence in light of the targets sought, including the structural reforms essential to their achievement. The time frame, if adjusted appropriately to a realistic assessment of objective conditions in each case, can add to the strength and effectiveness of the programs.

The evidence in the case studies shows that the introduction of structural reform in the fiscal sector is especially important. In the majority of cases, a sustained effort on both the revenue and expenditure sides is required over a period of years. Mere concentration on fiscal aggregates is not necessarily helpful or appropriate, since targets can be attained by a variety of means that can adversely affect long-term growth prospects without correcting the underlying causes of fiscal imbalance. It would therefore be appropriate that the essential elements of tax reform programs form a part of a strengthened approach to conditionality and, in appropriate cases, be introduced as performance criteria. This approach should also be applicable to actions required for the qualitative improvement of expenditure composition.

Particular attention should also be paid to the development of adequate policy instruments. In principle, where financial systems are weak or undeveloped and economies are largely nonmonetized, it is not helpful or practical to give priority to positive real interest rates, however correct that policy may be. In those cases, the countries concerned should be assisted in developing the instruments that can make interest rate policy more effective. Similar considerations apply in the case of weak public administrative infrastructures, which may well undermine the prospects for the success of appropriate fiscal policies. Important and desirable in this connection are an in-depth study of the relevant structural problems, the expanded technical assistance envisaged by the staff, and the involvement at an early stage of other institutions, particularly the World Bank, which has the expertise in these matters.

In the area of program design, the staff also raises the question of mitigating the effects of unexpected exogenous shocks on program implementation. These contingencies should be faced principally through building adequate policy margins into the programs, with eventual additional support being provided through the compensatory and contingency financing facility. In addition, in the special case of single commodity exporters, the buildup of a stabilization fund in times of favorable developments, to help cushion the economy against future adverse shocks, appears to be particularly appropriate. At any rate, an explicit presentation of downside risks in the medium-term projections connected with a program would be especially useful to the Board in assessing the proposed arrangement. A similar presentation of downside risks with respect to external financing would also be useful.

My chair's general approach to program design, which is broadly in line with the staff's suggestions, may well lengthen the program period and involve the risk of prolonged use of Fund resources. This risk, however, is not likely to increase in comparison with current practice, as the case studies indicate. A program appropriately conceived within a proper time frame is more likely to enhance the effectiveness of Fund intervention, strengthen its catalytic role, provide greater incentives for sustained implementation, and reduce the risks of future arrears.

Furthermore, through the structural adjustment, enhanced structural adjustment, and revived extended Fund facilities, this institution is better equipped than recently to lengthen its involvement in support of adjustment programs. These facilities are better adapted to the current situation and are less likely to undermine the monetary character of the Fund than successive stand-by arrangements, which carry with them the risks mentioned by Mr. Goos. However, whatever instrument is adopted, the essential prerequisite for the approval of a program should be a reasonable degree of certainty that the borrowing country is fully committed to sustained implementation of the program. Of course, this is bound to be a judgmental matter based on the authorities' track record and the actions taken before the arrangement is in place, as well as the political context in which the program is to be introduced. But it would be of great assistance to the Board if the staff were to provide an assessment of the risks involved in each case.

As for monitoring, we agree with the staff's recommendations on the structural reforms that are crucial to the success of programs. Especially useful would be prior actions or policy measures that involve discrete steps, or timetables for clearly specified actions, combined with benchmarks or appropriate performance criteria, provided that they are kept to the minimum required for programs' successful implementation.

The structural aspects of programs uncover an important issue, arising from the fact that the far-reaching structural measures required for redressing present imbalances may interfere with members' social and political objectives. There is no doubt that deeper involvement by the Fund in determining the quality of the adjustment process may give rise to such an interference. It is up to the member, on the one hand, to decide what its social and political priorities are. It is the Fund's responsibility, on the other hand, to ascertain whether the instruments and measures chosen by the member are compatible with the objectives of adjustment and growth. In case of incompatibility, the Fund has to advise the member how to solve the inconsistency, and only if consistency is established ex ante should the Fund agree to an arrangement.

We attach great importance to the periodic reviews of conditionality and would wish them to be at least as frequent as they have been in the past.

I must admit that I have serious doubts about the effectiveness or the usefulness of special measures to promote capital inflows, whose result is more likely than not to be distortionary. Indeed, as a matter of principle, all special measures tend to be ineffective in a weak macroeconomic climate, while, in a strong macroeconomic situation, they are unnecessary. In the view of this general position, I would tend to be wary about introducing specific policies focusing on capital inflows in Fund programs, except perhaps for measures of a structural nature designed to eliminate rigidities that impede capital inflows independent of the macroeconomic climate.

Mr. Fogelholm made the following statement:

The case studies are a welcome supplement to the more traditional approach of reviewing conditionality. The opening statements were most useful, and it is noteworthy that they again reveal that all Directors embrace the concept of conditionality--and thus appear to agree with Mr. Enoch and Mr. Goos that the application of conditionality also serves the interest of the users of Fund resources. Conditionality is obviously a necessity for the Fund, as it is the one and only means of providing at least some sort of safeguard for the repayment of Fund resources.

Of course, there are clear nuances between the views expressed on the appropriate conditionality to be applied to specific cases. It should come as no surprise that the views of this chair, which could be labeled a "Fund conservative," are by and large fairly close to those expressed in the opening statements of Mr. Enoch and Mr. Goos. However, I do acknowledge that political and social consideration sometimes make the full application of stringent conditionality difficult. It is also quite clear that a Fund program that on paper seems to be quite strong is not particularly effective if it goes off track immediately after the first drawing.

Conditionality should thus be designed to achieve maximum adjustment within the constraints imposed by society. At a minimum, however, the Fund should require that external viability be attained over the medium term. However, what is the Fund supposed to do if external viability in the medium term does not seem achievable, or is highly unlikely to be attained because imbalances are so substantial that the political and social fabric could probably not cope with the necessary adjustment? Should the Board approve the program, even at the risk of endangering the revolving character of Fund resources, or should it opt to stay out and wait for a more opportune moment to develop?

This is indeed a difficult judgment to make, particularly as there would always appear to be good reasons to support the momentum of economic adjustment and reform. Nonetheless, the Fund has made some costly mistakes in some instances, and the experience of the country cases illustrates that political commitment to adjustment and the ability to carry it out are the best guarantees for securing external viability and growth in a medium-term perspective.

With the current arrears situation already at hand, the Fund should on balance be cautious indeed, and its analysis should err on the conservative side, with its conditionality being designed accordingly. In this connection, I support Mr. Enoch's comments on the importance of avoiding over-optimistic assumptions and projections.

We generally believe that balanced and properly coordinated economic policies in adjustment programs are crucial. For example, a sudden liberalization of foreign exchange policies might have unwanted effects if the price structure of an economy is distorted. In parallel with traditional macroeconomic adjustment policies, there is often a need for structural reforms. However, as structural reforms are mostly a medium-term process, such reforms should normally not be included as regular performance criteria in Fund programs. Nevertheless, experience has shown that prior actions in the structural area have often been invaluable. We support the notion that the Fund, in cooperation with the World Bank and the member country, develop a timetable for the implementation of structural measures in parallel with macroeconomic measures. If structural reforms are indeed regarded as essential for sustaining an adjustment program, my authorities would support Fund requests for such measures as prior actions. Moreover, such prior actions should be given equal weight to traditional macroeconomic measures when the Fund considers a member's request to use Fund resources. In addition, prior actions and front-loaded execution of policy measures may often prove to be decisive for the program's catalytic effect.

The staff paper points out that an incorrect and often overoptimistic evaluation of external developments has been an important explanation for the derailing of Fund programs. To some extent, the compensatory and contingency financing facility can and should alleviate this problem. However, overreliance on that facility should be avoided, and greater emphasis should be placed on achieving more accurate forecasts. In this connection, it is important that the Fund's forecasting techniques be improved, not the least to enhance the basis for discussion with the users of Fund resources. I support the research proposals in the area of program design suggested by Mr. Jalan and Mr. Enoch. I also support the so-called focused approach, as proposed by Mr. Finaish.

It is obvious that a strong program remains strong only if it is implemented decisively. Accordingly, a firm political commitment is no doubt a precondition for the program's success. Second-best solutions in Fund programs in specific cases cannot be ruled out altogether, but should be avoided whenever possible. However, as mentioned earlier, a program should not be allowed to be so weak, whether in design or implementation, that its external viability is at risk. The need for strong programs is especially important in arrangements that include debt and debt service reductions. The strength of the program--including prior actions and front-loading--should be even more pronounced in cases where the approval of additional resources leads to access above normal limits.

In certain instances, there would seem to be a need for the Fund to embark on a pedagogical exercise and convince the authorities that the envisaged adjustment efforts are compatible with, and necessary to achieve, reasonable growth, even in the short run. The Fund should also be responsive to members' requests for analyses of the effects of the program under discussion and, if requested, present alternative program formulations without relaxing the overall objectives.

If adjustment measures are not accomplished as prior actions, which would certainly be preferable, monitoring should generally be conducted in the form of reviews. Only when the "key areas of relevance" can be specified clearly is it appropriate to use structural performance criteria. Moreover, the practice of granting waivers, which has the effect of weakening reviews, should be applied only sparingly. Over time, the existence of the compensatory and contingency financing facility should reduce the need for waivers.

The Nordic countries agree with the staff that there is justification in some cases for a longer period of Fund involvement than under a stand-by arrangement.

The structural adjustment and enhanced structural adjustment facilities respond to the needs of the poorest countries. For countries not eligible for such resources, but that have adjustment problems of a longer-term nature, an extended arrangement or successive stand-by arrangements could be considered. However, this should be preceded by clear progress in implementing structural adjustment and by the establishment of a good track record. Normally, an extension of Fund involvement should be avoided.

For relations with other creditors, the Fund's catalytic role--based on strong programs--should be emphasized above its financial involvement. It is therefore important to avoid the negative impact caused by a continuation of unsatisfactory programs. In this context, approval in principle of not too strong programs does not seem to have been effective for the countries concerned.

This chair believes that regular reviews of Fund conditionality are warranted. We would support flexibility in the timing of these reviews, however, but believe a comprehensive review should be performed at least once every second year.

The staff's paper on private capital flows is lucid about the main factors determining capital flows. I agree with the staff that the policies in Fund programs affecting capital repatriation merit close attention, and I can thus support Mr. Goos's proposal to include a chapter on this issue in each staff paper on requests for stand-by or extended arrangements.

My authorities broadly agree with the staff that sound macroeconomic adjustment policies, namely, appropriate interest and exchange rate policies, coupled with dismantling of institutional constraints, are essential preconditions for the inflow of private capital. Efforts should indeed be directed to preventing capital outflows as, generally speaking, it is easier to prevent capital flight than to repatriate resources that have been invested abroad.

Special measures, as described by the staff, may have a beneficial impact on capital movements. However, we agree with the staff that the distorting effects of such measures should be considered carefully, and the general rule should be to eliminate regulation of quantities and prices, which by necessity distort resource allocation over time. In this connection, while we endorse the staff's view that debt conversion is an instrument that cannot be used indefinitely, we have difficulty in understanding how this instrument can be compared to export subsidies in its distortionary effects. It is even harder to comprehend the inclusion of liberalization of investment regulations in this category without major reservations. The liberalization of investment regulations should lessen distortions, and thus have a positive effect in the long run.

Mr. Bindley-Taylor made the following statement:

Before commenting on the topics for discussion raised by the staff, we wish to review quickly the theoretical framework in which we believe programs must be designed, and the main objectives that Fund programs are supposed to achieve.

Fund programs must aim at re-establishing balance of payments viability with satisfactory growth and due regard for poorer sectors of the population. The achievement of these main objectives has been complicated in the recent past by the existence of a large stock of official and private foreign debt, which has also contributed to the Fund's arrears problem.

The Fund is often accused of neglecting objectives other than adjustment in formulating its programs. This is obviously untrue at present. It is the case also that the unfavorable environment created by the debt crisis makes the achievement of even the traditional objectives of adjustment and monetary stabilization particularly difficult. The need to create large trade surpluses and to transfer large sums of money--predominantly from the private export sector--to governments for the payment of debt service requires large devaluations and large fiscal adjustments, which in turn tend to lead to large corrective price and interest rate increases, even where there are no other distortions. In the past, it has also been true that Fund programs have not taken into account the extent of monopolistic and oligopolistic private sector structures that exist in some member countries. These structures contribute to difficulties in stabilization and in making market-oriented policies effective. However, just as the Fund has increasingly accepted income policies as an important, albeit, auxiliary, measure in stabilization programs, so it has accepted temporary price controls, to control oligopolistic and monopolistic pricing, in cases in which the opening of an economy to foreign competition cannot be undertaken with dispatch.

The speed with which Fund programs obtain their objectives often reflects the absence of available financing for stretching out the corrective process. Adequate financing in this context means both the provision of so-called new money and debt relief in various forms. Despite new initiatives, the Fund is still only at the beginning of the process that might lead to adequate debt relief. At the same time, the financing available at the beginning of the debt crisis from commercial banks has practically disappeared for the problem debtors. An important aspect of the lack of financing and of the limitations on the Fund in catalyzing other financial contributions of diverse kind is the delay in increasing Fund quotas.

We would certainly agree with respect to program design that programs must focus on structural measures to complement strong macroeconomic policies, but we are not convinced that this focus should necessarily be expressed in specific performance criteria. However, we would agree that, where structural problems loom large, there is no reason why they should not be part of the review process, which, currently, is itself in most cases a performance clause. We are opposed to the multiplication of specific performance clauses, because we are convinced that governments need all the flexibility possible to react to unforeseen events. Even if waivers and modifications of programs are available, the interruption of drawings when a specific--often minor--criterion is violated can be extremely damaging to the progress of a Fund program. The staff paper raises the question of the role of technical assistance in areas of Fund expertise, and a strengthened role for resident representatives. Whenever a country wishes to obtain the technical assistance of the Fund in its areas of expertise, we certainly feel that it should be offered. The question of whether to attempt to give resident representatives a strengthened role depends very much on the quality of staff that can be made available and the particular circumstances of each country. Resident representatives too often have no or little experience outside universities or as staff. Even though such technicians can be helpful in countries where there is a major shortage of well trained economists, it is doubtful whether they can be useful as policy advisors. If they are expected to be advisors, they must be sensitive, and avoid being seen as Fund comptrollers, for this can undermine the authorities' legitimacy, which is critical to the success of any adjustment program. In each case also, political considerations will be decisive, and no country should be obliged to accept a resident representative as a condition for obtaining Fund assistance.

There is no question that policy implementation has often been unsatisfactory. An unbiased examination would probably show that program design was sometimes too weak and sometimes too exacting. My chair has suggested repeatedly that the latter will very often be due, or perhaps has always been due, to the lack of adequate financing. Care must be taken that the legitimate desire to ensure implementation does not lead to excessive demands for the front-loading of performance. Even the best program, from the technical point of view, may be politically unviable if the public does not see a connection between measures that may hurt sectors of the population in the short run, and financial assistance that brings relief at least in the longer run. The fact that front-loading of performance can replace monitoring cannot be a reason for increasing front-loading, given the problem it may cause to the viability of a program.

In the current circumstances, we would favor a more drawn-out process of external adjustment for most countries. This does not necessarily imply a more prolonged use of Fund resources than at present. In this context, it would be helpful if multiyear rescheduling arrangements with banks were supplemented by multiyear new money disbursements.

We would not have any problem with extending the periodicity of conditionality reviews to about 18 months, or even longer, depending on the particular circumstances.

Obviously, sound macroeconomic policies are likely to stimulate net capital inflows, other things being equal. Whether operationally useful results will emerge from studies on the elasticity of net capital inflows with respect to various policies, including structural reforms, may be doubtful. It is a little surprising that the staff paper places no emphasis on the effect on capital inflows of removing the debt overhang. Incorporating assumptions regarding capital flows into overall balance of payments targets is certainly more sensible than monitoring private capital flows separately; but, as the paper correctly states, great prudence will be needed to avoid complicating the authorities' implementation of their program. The positive effect of measures to attract capital should not be overestimated, and neither should the negative effects of political factors, the debt overhang, and other circumstances be underestimated. Care will have to be taken to avoid excessively demanding reserve accumulation targets that could result from such mistaken assumptions.

We firmly agree with the case-by-case approach and we see it as a step in the right direction for the review of past experience with adjustment. The Fund can but benefit if Directors let the failures or mistakes and successes of the past provide the guidelines for the design of future adjustment programs.

Mr. Dai made the following statement:

I am generally in favor of the case studies approach, which helps Directors to look at the issues more perceptively than before. The selection of countries sampled is broadly balanced, as the problems revealed by the individual case studies in the areas of program design, implementation, and monitoring appear to be representative of those encountered in many Fund-supported programs over recent years. While I can see the merits of continuing the case studies approach to illustrate selected issues in greater depth, I still believe that some of the general issues, such as the appropriateness of conditionality guidelines in relation to an ever evolving environment, should be reviewed in a regular and more comprehensive manner.

It is indeed disappointing that almost all the countries covered by the case studies have yet to achieve the full objectives of their programs, namely, balance of payments viability with reasonable growth and improved inflation performance. Chile is the only country out of the nine assessed to have come anywhere close to achieving external viability. Meanwhile, Fund involvement has generally been lengthy, ranging from six to nine years.

This experience has proved to us that economic adjustment and structural reform in most developing countries are currently time-consuming and complex processes. It is unrealistic to expect that a sustained turnaround in a country's deteriorating balance of payments position can be achieved in a relatively short period of time. The question may arise as to how the financial needs of member countries can be met in the context of their protracted adjustment efforts, while simultaneously maintaining the revolving character of the Fund's resources. While the Fund has created the structural adjustment and enhanced structural adjustment facilities to serve the needs of the low-income countries, there are still other countries not eligible to use the resources of the structural adjustment facility that are experiencing difficulties which need to be corrected with prolonged adjustment efforts, such as the cases described in the case studies. In this regard, one should note that the history of the Fund since its inception fully indicates that the role of the institution has developed and been modified significantly to adapt to the changing world. When circumstances change, the Fund must make proper adjustments to its functioning and role in accordance with the general purposes of the institution. The Fund's old, conventional concepts regarding its own nature should also be reconsidered and understood in light of changing reality and the Fund's evolving responsibilities.

A review of the experience with conditionality has proved also that the success of Fund-supported programs lies in whether they are tailored to the particular circumstances of the specific countries in question, taking into full account not only domestic economic realities--including the levels of development, economic structures, institutional setups, histories of economic development, economic priorities, and so on--but also the social and political backgrounds. Emphasizing this point does not imply the relaxation of conditionality; on the contrary, only if programs are realistic can the success of conditionality be ensured. It is my chair's belief that programs can be effectively realized only if they fit the reality of a particular country. The practicality and thus the correctness of Fund programs are subject to the conditions in specific countries at the time they apply for an arrangement. This is why adjustment performance differs in countries implementing the same policies. Furthermore, simplistic, theoretical conclusions or concepts do not always apply universally in the current complex international political and economic environment. No one in the international arena has ever denied the correctness and importance of the theory of comparative advantage. Given that protectionism still prevails in many well developed countries, how can one expect developing countries to liberalize completely their trade systems overnight? Moreover, if intervention in foreign exchange markets by major currency countries is still considered to be inevitable from time to time--in order to meet the different policy objectives of major industrial countries--how can one expect developing countries to liberalize completely their exchange rate arrangements or devaluations based entirely on market forces, even despite the well recognized fact that devaluation promotes exports and facilitates balance of payments adjustment?

Another observation of mine is related to the importance of unanticipated exogenous factors on the adjustment outcome. As indicated in the case studies, slower than expected progress in most cases can be attributed by one means or another to a less favorable external environment than anticipated, and to uneven policy implementation. Even where policy slippages occurred, they have often been the result of certain unexpected domestic or external events. In fact, and particularly at present, when many developing countries are coping with a more difficult and uncertain external environment since the emergence of the debt crisis in 1982, it has not been uncommon to see cases in which conditionality turned out to be inappropriate when applied with increasing rigidity in the context of a volatile external environment. To address the problem of rigidity, one feasible solution, as strongly urged by the Ministers of the Group of Twenty-Four, is for the Fund "to adopt a more flexible approach toward conditionality."

I can see the staff's reasons for suggesting the need for programs to be designed with a broad scope and with emphasis on structural measures to promote effective and sustained implementation. With the Fund's monetary character in mind, however, it is difficult to imagine that broader objectives, especially those aimed at deep-seated structural weaknesses--for which a lengthier adjustment process is normally required--could be encompassed by the relatively short time frame under the Fund's regular arrangements.

Certainly, in view of the deep-seated problems in many member countries, Fund-supported programs should emphasize measures to address major structural weaknesses. However, to make program implementation more flexible and therefore more effective, it would be advisable to confine program targets to those variables in the external and other major macroeconomic policy areas whose improvement within a shorter time frame is feasible.

I welcome the suggestion made on the role of Fund technical assistance in improving program design. In fact, such assistance is a two-way street, because the Fund staff might come to better comprehend specific problems in member countries, thus increasing the accuracy of its assessments.

It is apparent that better program design would facilitate effective and sustained implementation. I agree with the notions that adequate policy margins should be built into the programs and that contingency policy packages should be developed at the time of program design. I do not, however, see the point that effective program implementation would benefit from increased specification of program measures and targets. Detailed specification would likely result in rigid program implementation, which is definitely undesirable when accommodating the impact of unanticipated external shocks.

It is apparent that without a realistically designed program in the first place, monitoring in an effective and precise manner is impossible. Experience suggests that it would be better to have a greater degree of flexibility in programs that encompass complex structural reforms and that require a longer adjustment process. In this context, it is best to concentrate the performance criteria on a limited number of key variables in the form of a range instead of precise points. The Fund should also be cautious in incorporating targeted structural measures and detailed timetables as performance criteria. In any event, it is important for the Fund to avoid direct interference in daily economic management in a member country.

From last year's discussion reviewing structural adjustment, I would stress that an invaluable lesson from past experience is that the success of a program depends on whether the government "owns" the program. This undoubtedly holds true for the current topics under discussion. Without the authorities' full understanding and support, and those of the people, no program can work smoothly and be successful, no matter how good the prescribed measures are. It goes without saying that strong commitment on the part of authorities is a necessary condition for successful implementation and monitoring.

I reiterate the necessity of regular reviews of the conditionality guidelines, and favor a yearly review cycle. At the least, the review cycle should be the same as in the past.

Mr. Enoch said that he wished to associate himself with Mr. Jalan in disavowing a comment that he had, in effect, advocated second-best programs in cautioning against inappropriate use of structural measures. In situations of external macro disturbances, macroeconomic measures might be sufficient to secure the adjustment required.

In any event, the notion of second-best policies should perhaps be a technical focus of future staff work on program design, Mr. Enoch suggested. The literature on second-best policies examined the issues involved in the pursuit of secondary targets after primary ones had been missed, and dealt with questions such as the degree to which the burden of adjustment should be shifted to the exchange rate in cases in which, for example, constraints with individual policy instruments or authorities' unwillingness had led to missed monetary or fiscal targets. With a limited number of instruments, there was a risk that such shifts would discredit policy instruments. In that connection, some increases in inflation after devaluation might have been more the result of the absence of concomitant measures than devaluation per se.

The Chairman commented that he was uneasy with the notion of second-best programs, given that all Fund programs were in reality second-best ones, compared with an ideal standard. He asked Mr. Enoch for further clarity what he meant by second-best policies and the possible targets under nonoptimal programs.

Mr. Enoch replied that there were constraints on the use of individual policy instruments in most cases, although some countries might find themselves less constrained with respect to using some instruments than others. For instance, some countries had little difficulty in establishing positive real interest rates, or in cutting fiscal deficits, or in devaluing their currencies, and would be amenable to moving further in those directions at the Fund's suggestion, whereas they might be rigidly unwilling to adjust in other areas. A technical question then arose--to which there were no easy answers--of whether authorities' adjustments in some areas should be softened in the absence of accompanying measures. If a government opposed fiscal and monetary retrenchment, yet inquired about how much it should devalue the currency, should the Fund then recommend a large devaluation of 150-200 percent, for instance? Without accompanying measures in place, Directors' concerns about aspects of exchange rate adjustment would indeed come to the fore. The Fund should bear in mind that the use of available instruments should not necessarily be intensified in an effort to achieve full adjustment in the absence of other instruments being available. Comprehensive, balanced programs were needed.

The second point that he wished to make dealt with the comment that the Fund be flexible in applying its conditionality, depending on the circumstances in which countries came to the Fund for use of its resources, Mr. Enoch continued. Clearly, purchases in the first tranche had different conditionality than purchases in other tranches; but one would have to be careful to avoid conditionality beyond the first tranche that was too flexible. Favoring less conditionality for countries that had not used Fund resources previously, or even more, for countries that had accumulated or were near to accumulating arrears, would not serve to safeguard Fund resources. Otherwise, the most rigorous conditionality would be applied to countries that had consistently followed Fund programs successfully. While conditionality clearly had to be applied on a case-by-case basis, it should not be so flexible that it would serve neither the purposes of the Fund nor the member.

He agreed with the staff that the prime requirement for fostering private capital inflows was the achievement of a sound macroeconomic framework, Mr. Enoch remarked. Also, he agreed with a Director that measures were needed to encourage inward investment, and with another's skepticism that gradual adjustment would promote capital reflows. The example of Mexico in 1986-87 was a good illustration of the rapidly accruing benefits of sound policies and, in fact, of possible overshooting of those policies. His point was not necessarily inconsistent with the reservations expressed by some Directors about rapid adjustment, including the point made that the history of mismanagement in the case of Guyana was such that one could not expect sudden capital reflows. Staff papers should regularly examine the scope for possible reflows, which would give Directors a useful indication of the policy courses that would be appropriate in each case.

The Chairman inquired whether Mr. Enoch would favor capital reflows being targeted in Fund-supported adjustment programs.

Mr. Enoch considered that targeting reflows would be appropriate in a number of cases, namely, those characterized by good track records, by authorities that were committed to adjustment, and ones in which there had been substantial capital flight--in other words, those that had good prospects for attaining external viability in the short to medium term. However, there might be cases in which the history of mismanagement, the degree of disequilibrium, and the prospects for attaining external viability were so negative that targeting reflows would be unrealistic.

The Chairman inquired further whether Mr. Enoch would err on the conservative side in evaluating the potential for reflows.

Mr. Enoch replied that caution was required in projecting reflows.

Mr. Nimatallah made the following statement:

Conditionality should not insinuate or imply that the Fund and a borrowing member stand in opposition to each other. Instead, conditionality should be construed as securing proper use of resources to help a country repay its debt and to help the Fund secure the return of its resources. After all, a part of Fund resources belongs to the member itself. Therefore, the issue under consideration is not a question of whether or not conditionality is necessary, but only of looking for the best structure of conditionality that can be fitted to the programs of reform that countries come forward with.

It is unfortunate that, despite Fund efforts and its extensive involvement, many of its members "have yet to achieve full external viability," as the staff puts it. It is for the Board to ask why this has been the case. Was the reason that the design of Fund-supported programs did not adequately take all relevant domestic and other factors into consideration? Was it that authorities waited too long to start adjustment, and, when they did, resorted to interruptions and stop-and-go policies? In other words, was the reason for failure to achieve full adjustment that the heads of state did not really show enough commitment and resolve, especially in certain countries making prolonged use of Fund resources? Or, was it not the fault of program design but of the authorities' unnecessary burdening of their countries with heavy debt, which was often not used productively? Or, was it because of some or all of the above?

Depending on each case, all of these factors have contributed in various degrees to the failure to achieve full external viability. The Board should be more candid each time it reviews conditionality, because the purpose of conditionality is a mutual one between the Fund and the member--namely, successful adjustment and reform, and thereby the eventual realization of both external viability and sustained noninflationary growth. It is not a matter of the Fund versus the member.

There is no question that sustained implementation is the key to success in achieving a program's objectives. It can be attained only by a strong commitment by the heads of state. Commitment by a head of state can be demonstrated through reasonable degrees of prior action, and through obtaining a mandate from the people. A committed leader should start a wide range of prior actions and should face his people bravely, telling them about the difficulties that they will have to confront, and asking them for their support as he adopts the appropriate program his country needs for adjustment and reform.

Throughout my many years of association with the Fund, I have noticed that the commitment of a head of state to a program has been the most important factor for ensuring its success. Some time in the future, it might be useful for the Fund to require in advance that a mandate be in place behind the authorities of certain countries, particularly in those countries that have been prolonged users of Fund resources and those that have had severe structural problems. I am sure the Fund would be gratified to continue its involvement with those countries, but only if they demonstrate more commitment and seriousness. That is why, during the recent discussion on Zaïre (EBM/89/72, 6/9/89), I stated that it is about time that the President of Zaïre showed more commitment to sustained implementation of reform.

Monitoring and follow-up are also good for the member and the Fund. Given that bureaucracies never fail to delay progress and reform, it should be particularly useful to authorities that the Fund helps in tracking performance or lack of it. With lack of adequate prior actions in certain cases, and the need for a blending of the structural reforms that are critical to the success of a program, careful, and, if possible, continuous monitoring of progress is essential. Continuous monitoring may, in certain difficult cases, require that a resident representative be in place, or that more frequent visits be made by staff.

Mr. Orleans-Lindsay noted that as Mr. Nimatallah had again commented that Zaïre's head of state was insufficiently committed to adjustment, he therefore wondered whether Mr. Nimatallah had any suggestions to make on how the head of state could demonstrate his commitment.

Mr. Nimatallah replied that commitment could be demonstrated by an acceleration of prior actions and, more importantly, by heads of state explaining to populations that they needed their support in view of the serious difficulties facing their countries. Given the oft made claim--including by heads of state--that harsh programs could not be implemented, it was especially important that those leaders be honest with their populations about the severity of a program and explain to them openly that the leadership needed their patience and help. In those circumstances, a leader would likely obtain a mandate for adjustment and a population that would be willing to endure sustained adjustment. If aspects of a program needed to be tightened or relaxed, the Fund and the member could always look flexibly at the program during its implementation. In general, however, a head of state's strong commitment to a program was essential for its successful implementation.

Mr. Feldman, referring to Mr. Enoch's comments on setting targets for private capital reflows and the staff's comment that appreciable reflows in the case of Chile had emerged only after two years of appropriate policies, said that he was skeptical about what one could realistically expect from such capital reflows. They might take considerably longer to emerge than anticipated, even under the most favorable conditions.

Mr. Kyriazidis commented further that, while in the case of Greece, the correction of macroeconomic variables had led to substantial private reflows in the short run, it would seem that Chile's experience had been different. Even so, he supported Mr. Feldman's skepticism about targeting such reflows, as the program was then more likely to go off track or seem to be doing so, or would appear to be too optimistic or pessimistic in some cases. To the extent possible, a realistic assessment by the staff, in the light of macroeconomic conditions, of expected capital inflows in the balance of payments projections would be appropriate, but he would be most wary about targeting capital flows. External flows were subject to a number of factors, including some that had nothing to do with domestic macroeconomic policy; in those cases, capital flight could probably not be reversed or even halted.

The Chairman remarked that as the Fund had every reason to be prudent in projecting private capital inflows, it would err on the conservative side in making estimates in that area, which was an important one to all Directors. While there were cases in which governments might appreciate the Fund setting some form of benchmarks for private reflows--as a means of demonstrating their commitment to restoring inflows--the Fund would need to gain experience and learn much before setting targets for such inflows.

Mr. Kyriazidis suggested that the staff consult on an unofficial basis with the authorities of member countries that had adopted special programs and measures to encourage capital reflows. If those authorities were candid, interesting points would arise about new distortions and rigidities that had emerged as a result, such as, in one case, the difficulties that a special program of deposits had caused for monetary control.

Mr. Massé observed that his chair had also hesitated about setting targets for capital reflows, which were extremely difficult to measure. Specific actions to foster capital repatriation could be integrated into a program in terms of changing the net international reserves target, on the understanding that if the target were missed, the Board would grant relevant waivers more easily than would otherwise be the case.

The Chairman responded that, while he was obviously in favor of any policies that would reattract capital, he did not like the implication from Mr. Massé's suggestion that countries could expect easy granting of waivers, or that the Board would discuss such waivers on a regular basis. Before setting precise targets for reflows, the Fund would first have to know with sufficient precision that a specific set of policies would result in a certain amount of reflows, which would require the staff to conduct studies in the area. Not only would the Fund have to know better the effects of, for instance, overshooting exchange and interest rate policies on reflows, it would also have to know the different forms in which capital had fled, whether it had been invested in short- or long-term assets, and the answer to the difficult question of where the capital had been invested. Some capital had fled to offshore locations that had high degrees of banking secrecy, and the owners would hesitate to repatriate the capital, even when the home country was pursuing good exchange and interest rate policies. He was familiar with the experiences of Mexico and Chile, but he would leave it to the Board's discretion whether general lessons could be drawn from those cases. Moreover, countries that had experienced capital flight were often in the midst of such great political strains that their adjustment efforts were not always conducive to flight capital repatriation.

Mr. Yoshikuni said that he recognized the Chairman's concerns about the difficulties of setting targets for capital inflows. Nevertheless, without a specific target, either implicit or explicit, further disputes would emerge to that between, for instance, Venezuela and the commercial banks over estimates for capital inflows. In that connection, the incorporation of private capital flows into program assumptions in the staff paper on Venezuela's request for an extended arrangement (EBS/89/107, 5/26/89; and Sup. 1, 6/7/89) had been most interesting.

Mr. Kyriazidis questioned whether capital inflows should be targeted; otherwise, there would have to be two reserves targets, namely, the performance criterion and another higher target. If the projections of capital inflows proved to be incorrect, then one would have to run the danger of effectively granting waivers in advance.

Mr. Nimatallah noted that the issue was a sensitive one. He could understand why some Directors favored targeting capital inflows, given that such targeting might encourage or force the adjusting country to take the necessary measures with greater commitment; but capital inflows were also difficult to measure and could not be guaranteed, because of the many different factors involved. A compromise might be to formulate targets as a range for the second or even third year of a program, as capital holders might want to wait until economic and political developments had moved sufficiently in the right direction before repatriating their capital. Targeting capital inflows at the beginning of a program would not make much sense and would not help to achieve the objective that Mr. Massé had had in mind. Credibility factors were also involved.

Mrs. Filardo remarked that Directors would have an opportunity to consider the issue of targeting capital inflows during the coming discussions on saving in developing and industrial countries, and that consideration of the issue should be an aspect of the study that her chair had requested on program design. In Mexico's case, there had been a tremendous reflow of capital in 1986, but subsequently, there had been an equally substantial outflow despite the high real interest rates of about 25-30 percent. There were different reasons for capital flows, for instance, the Mexican private sector's desire at the time to buy debt and thereby to benefit from debt reduction; and capital flows per se were not all in the form of flight capital. As the Chairman had observed, capital could flee anywhere and would not necessarily be reattracted by sound macroeconomic policies. Capital inflows had been factored into the program for Venezuela (EBM/89/80 and EBM/89/81, 6/23/89) as covering part of the financing gap, a program that would provide an opportunity to evaluate the appropriateness of such projections. Without capital reflows, there would be a financing gap and the program in Venezuela would be jeopardized.

Mr. Massé said that he basically agreed with the Chairman's comments on the state of knowledge with respect to targeting capital reflows. Even so, two imperfect but possible methodological choices were available. An observer might decide that the instruments for measuring capital reflows were undeveloped and, therefore, without targeting such reflows, just aim at the implementation of general measures. If large capital reflows resulted, the measures would be judged a success without the flows having been targeted. Alternatively, an observer might decide to target capital flows in full awareness that the instruments for measurement were imperfect, and wait to see the results with obvious readiness to change the targets in view of the difficulties enumerated by the Chairman, and which he fully accepted.

The Chairman replied that the problem at present was not primarily one of measuring capital flows--which was difficult enough--but of having the experience to target those flows. The Fund did not currently have the econometric evidence for linking certain policies and certain results in the area of reflows.

Mr. Goos commented that the discussion had perhaps become more complicated than it need be in view of the variety of expressions that were being used to describe capital flows. In all Fund programs, the staff developed an idea about trends in the capital account and informed Directors of its projections for capital inflows in the public and private sectors. As suggested, those projections could be formulated in terms of performance criteria or as benchmarks; nonetheless, that would probably be premature because the Fund did not know the exact quantitative relationships between certain policy measures and outcomes. The Fund should, however, develop certain ideas on how and in what direction the capital account should move, and should assess the adequacy of the program against its expectations about developments in the capital account. As the important factors that influenced capital flows were basically known, the Fund should concentrate on those known variables in dealing with the problem of capital flight and that of retaining capital. In particular, it should especially work to stabilize the macroeconomic framework, concentrating on reducing the inflation rate as fast as possible, and on re-establishing competitive, risk-adjusted returns on domestic assets. With those measures in place and resulting good prospects, the capital account would improve.

The Director of the Exchange and Trade Relations Department said that, irrespective of the whole issue of targeting capital inflows, the staff would certainly consider the suggestion that member countries report regularly to the Fund on such flows, and the staff to the Board, in the event that developments in that regard deviated from those expected. In that connection, one should keep in mind that capital flows did not just affect the balance of payments accounts but also the monetary figures, so that if outcomes arose that were markedly different from the underlying assumptions of the member country and the Fund, adjustments would have to be made to both of those accounts.

Reference had been made in the staff paper to an unfavorable world economic climate in the 1980s owing, for one, to the recession in industrial countries in the early part of the decade, the Director continued. Reference had also been made to the distinctly unfavorable movement in the terms of trade for a number of commodities that, unfortunately, ranked very high in the exports of many countries in Africa with Fund-supported programs. A further relevant variable in the 1980s for most borrowing countries had been the continued high real interest rates, whether measured in terms of export prices or some other world price deflator. Moreover, the staff's assumption in the early part of the decade that protectionism would decline had not been confirmed by subsequent events.

Social, cultural, and political constraints--perhaps aggravated partly by the balance adopted between adjustment and growth since 1985--surely explained the difficulty at times of the Fund and member countries reaching agreement on programs, despite both parties having the same basic aim, the Director remarked. As he understood it, equal emphasis had been put on adjustment and growth at the Annual Meetings in 1985, but many countries had apparently interpreted those meetings as having put greater emphasis on growth than adjustment, making it more difficult for governments to undertake programs that might constrain growth in early years of programs. That interpretation had effectively constrained program results in the sense that governments of debtor countries were asking for more time to adjust and thus for more external financing. In any event, governments had to consider social, cultural, and political difficulties just as they, and the Fund, had to consider the adequacy of external financing and the time frame of the adjustment process.

The staff agreed fully that sequencing of measures was a basic albeit complex problem, embracing not only the sequencing of structural measures, but also how those measures should fit into the macroeconomic framework, the Director commented.

The staff was indeed working on how to simplify the compensatory and contingency financing facility, the Director went on. Work on the staff paper on program design had been postponed, but would be continued and in due course be submitted to the Board.

The staff papers under consideration represented the first attempt at a case study approach to reviewing conditionality, the Director noted. Not only did the approach involve a great deal more work than had been expected, but it was still not the best possible approach in the sense of having too much of a "shotgun" aspect to it, which the staff had realized on completing the studies. The staff agreed with Directors that it would have been better advised to target a smaller number of countries and probably some specific questions, which it would do in the next review. As the process of reviewing conditionality was a lengthy one, the staff had to choose the questions that it would consider some nine months in advance, and there was always the risk that one would later wish to have chosen other questions. The staff had wondered whether it would be criticized for its frankness about particular countries in the current papers, but given that it had not, it would proceed with the even more difficult task of making cross-country comparisons.

However much the staff tried to refine the process of reviewing conditionality, it would remain difficult to draw definitive conclusions, and a large judgmental element would remain in evaluating programs, the Director cautioned. For instance, the staff had been surprised during a recent discussion with World Bank staff on the effects of agricultural pricing that even in that area, hard and fast conclusions could not be drawn, according to the experts. When dealing with wider concepts than agricultural pricing, it was often much more difficult to come to precise conclusions.

Several Directors had mentioned a need for the Fund to establish an independent evaluation unit for judging program results, the Director of the Exchange and Trade Relations Department observed. In the case of the Bank, an independent unit evaluated reports by the relevant lending department within about six months of the last disbursement of a loan. With its current work load, that unit had audited about 40 percent of the reports required on project cases, and had sought to audit the reports on all program lending cases. As project disbursements were made over a long period, evaluation of a project often took place some 5-7 years after the initial agreement, although that was not the case for program loans, disbursed normally over 12-18 months. The evaluation unit in the Bank reported directly to the Bank Board, which, in an effort to ensure the unit's independence, appointed its head, determined his tenure, and stipulated that he could not return to work on the staff of the Bank. While opinions varied, the unit was generally regarded as following reasonably effective procedures. Moreover, while the number of financial transactions of the Bank had by definition to far exceed those of the Fund, the number of staff in the Bank's evaluation unit was proportionately much greater than those involved in a similar function in the Fund; the Bank had been devoting some 60 staff to the unit, 40 of whom were professionals, compared with the Fund's assignment of between one and two staff in terms of man-years to the function. The staff of the independent unit visited the countries concerned, asked the authorities for their full opinion, and then reported back to the Executive Board of the Bank. The Bank clearly took the evaluation function seriously.

Mrs. Ploix remarked that the evaluation unit in the Bank, the Operations Evaluation Department, had conducted invaluable work in terms of giving a broad picture of the reasons behind positive and negative performance under Bank loans. Its ability to draw on experience from many cases with project loans and to make cross-country comparisons had been most useful. Reports had been made, inter alia, on topics such as adjustment lending and agricultural programs. The dissemination of the Operations Evaluation Department's conclusions was important, as the unit had to explain its findings to other Bank departments to ensure that subsequent operations took into account the conclusions reached.

The Director of the Exchange and Trade Relations Department agreed with the view expressed, while adding that it would be fair to say that it was easier in the case of project lending to assess results with a reasonable degree of certainty than it was with macroeconomic programs. For instance, engineers could be sent directly to evaluate a hydroelectric project and could thereby present technically accurate findings.

Mrs. Filardo noted that the Operations Evaluation Department had produced a report on structural and sectoral adjustment lending, which she had found invaluable during her tenure as an Executive Director at the World Bank.

Mr. Kabbaj stated that the basic notion behind the desire for an independent evaluation unit in the Fund was to have some kind of neutral examination of program results. Given that the staff was heavily involved in program design and implementation, it was not surprising that the staff had not assumed responsibility for the failure or success of programs. The current staff papers were more balanced than before, and had clearly highlighted the impact of exogenous factors on the "failure" of programs, which had been ascribed inevitably in the recent past to the countries themselves. Directors had made more numerous complaints in the past about the staff's evaluation of program results, and he noted that various reports had been issued by the Bank in the context of its lending operations. Progress was thus being made. Even so, he hoped that the Chairman would continue to consider the possible establishment of an internal evaluation unit not dependent on existing staff that could review program results independently and be headed by someone who could report frankly to the Board, and, indeed, to management as well.

Mr. Warner stated that his chair had not as yet expressed a view on establishing an evaluation unit for a number of reasons, including its desire to avoid a further expansion of staff. The Director of the Exchange and Trade Relations Department was correct in noting that such a unit would require a really substantial increase in staff; it would also take time to develop a specialized unit of that sort. Nonetheless, he himself had never known, much less been associated with, a large and efficiently operating financial organization that had not had some form of internal auditing and/or program evaluation function. While he would not want to generate an excessive number of studies or unnecessarily novel ideas, enough Directors had raised the point to make it a matter of interest. In the context of increasing Bank/Fund collaboration, Directors should seriously consider the possibility that the work of the Bank's Operations Evaluation Department might become increasingly relevant to the Fund. An evaluation unit was at least worth brief investigation and further discussion in the Board, to see whether it could be effective and, if so, what it would cost in terms of staff resources. In the right circumstances, his authorities might take a positive view of such a unit.

The Director of the Exchange and Trade Relations Department responded that the staff would certainly examine the question of establishing an evaluation unit, as several Directors had raised the issue. Given that the Exchange and Trade Relations Department was unavoidably involved in program work with area departments, it would, from an internal Fund point of view, look better if some unit other than that department evaluated program results. However, from an external point of view, he was not sure that outside critics would be content with an auditing procedure that, as far as they could see, was staffed by a further branch of the Fund staff and thus apparently subject to the same constraints. The Fund, in any event, was a leaner institution than the Bank and had gained immeasurably from the fact that the staff involved in reviewing conditionality had dealt practically on a daily basis with the mass of issues relating to the topic. In fact, while the equivalent of two man-years had been spent reviewing conditionality, six people in total had participated in the studies, several of them working for six to eight months of the year on closely related items. Such a context for reviewing conditionality would be lost with the establishment of a separate evaluation unit. All of the factors mentioned would have to be borne in mind, needless to say, in considering the appropriateness of establishing a unit.

The Chairman said that he had been considering the pros and cons of establishing an independent evaluation unit for the past 18 months, as a decision either for or against such a unit would indeed have to be made. He had been impressed by Directors' points, took the matter seriously, and after discussing it further with the staff would report to the Board at about the time of, or subsequent to, the Annual Meetings. If an independent evaluation unit were created, it would certainly be smaller than that of the Bank.

Numerous other suggestions had been made in the Board during the discussion, the Chairman noted. Directors had suggested, for instance, the provision of technical assistance through the Institute and additional technical assistance missions, more mission travel within a country, increased monitoring of capital flows, further studies on structural adjustment and country cases, and increased expertise in general. However, in seeking to improve the Fund's work, the Board should not overburden the staff any further than it already was; Directors should instead concentrate on more central questions. It was indeed difficult to keep the Fund a lean institution!

Mrs. Filardo said that she was greatly concerned about the appropriate method for evaluating programs and thereby with the follow-up to the current discussion. At the request of the Board, the Exchange and Trade Relations Department had been changing its method of program evaluation to that of case studies and cross-country analyses, but, at the same time, the Research Department had been writing different papers, in methodological terms, on adjustment programs that were also useful. As Directors were not experts in the matter, she inquired how they should reconcile the differing work of the staff with their own understanding of how to evaluate adjustment programs.

The Director of the Exchange and Trade Relations Department responded that it would be incorrect to view particular studies as the products of departments acting in isolation, as the relationship between staff, while necessarily divided by department, was close and continuous. The staff exchanged studies among departments for comment, and there was considerable cross-fertilization of ideas. The occasional papers and working papers referred to by Mrs. Filardo were written more in the authors' own capacities than in the Fund's, to give greater latitude to the staff to express personal opinions. The staff reports or papers submitted to the Board reflected fundamental agreement between departments.

Mr. Massé commented that his chair obviously favored stringency in the Fund budget but had also indicated on previous occasions that the Fund was an international organization that had to grow, albeit in a carefully defined manner. The staff was overworked, and it should not be. Spending public money on increased technical assistance and other similar programs was worthwhile. In that connection, he inquired whether the suggestion that his chair had made about a special study on exchange rate policy would be a useful one on which to concentrate some staff resources, given the topic's fundamental importance.

The Chairman made the following summing up:

This discussion has provided us with an opportunity to examine issues in conditionality that have emerged from the recent experience with a number of programs supported by stand-by and extended arrangements.

Before addressing the specific issues, I would wish first to note that Executive Directors in general welcomed the case studies approach and found the background material to be comprehensive and useful in helping to draw lessons for the application of conditionality. In addition, most Directors thought that the criteria that were used in selecting the countries were broadly appropriate. Most Directors saw an advantage in focusing the next review more narrowly, in order to illustrate selected issues in greater depth, and in making more use of cross-country comparisons. It was also felt that there is a need for further research and empirical work in key policy areas. A number of Directors also suggested that this approach should alternate with the more traditional approach of examining the broad result of a wider range of programs. The objective of these reviews and research is to seek conditionality that works.

Directors emphasized that programs that meet high standards are the best means of assuring confidence, international as well as domestic, in a member's adjustment process, and assuring a timely pace of adjustment toward external viability. It was recalled that in recent discussions of Fund support for debt and debt service reduction operations, the central importance of sustained implementation of policy reforms in debtor countries had again been emphasized. In considering ways in which the Fund might better support the adjustment efforts of its members, Directors focused their attention on five areas.

1. Program design

We are indebted to Mr. Jalan for his pertinent remarks on program design, which a number of other Directors have noted in their statements. We should keep in mind his call for caution wherever the Fund suggests major changes in policies that are now perceived to be incorrect, but that for many years in the past commanded political, academic, and multilateral support. In a similar vein, while all Directors subscribe to the search for increased efficiency in the use of national resources, some Directors cautioned that past distrust in the functioning of markets should not now give way to excessive confidence in the effective working of these markets.

Directors stressed the need for programs with strong financial and exchange rate policies to ensure macroeconomic stability. It was also noted that program design must incorporate the impact of exchange rate policy on the fiscal position and on domestic inflation. There were differing views, however, on the appropriate scope of structural reforms in Fund-supported programs. Most Directors felt that where major structural weaknesses impeded the effectiveness of macroeconomic policies, there was a need for carefully targeted structural measures to be implemented at an early stage in a complementary manner. In this type of situation, it was noted that programs need to be bold, and reliance should not be placed on a "band-aid" type of solution of temporary stabilization measures. Other Directors, however, believed that macroeconomic policies should remain the core of Fund programs; they clearly felt that care should be taken to ensure that the recent emphasis on structural reforms should be limited to a degree that is consistent with the Fund's mandate and functions, and that closer cooperation with the World Bank should be sought, where appropriate. In any case, Directors agreed that if a second-best adjustment path were chosen, explicit references should be made in staff appraisals to the risks involved.

In considering the scope for improving the design of policies to encourage sustained implementation, Directors emphasized that greater attention be paid to the measures underlying fiscal adjustment, to ways of liberalizing interest rates or otherwise securing positive real interest rates in the financial system, and to more detailed specification in most structural areas. In this context, some Directors questioned the appropriateness of major import liberalization in cases where financial imbalances are very large and international reserves are critically low. In connection with programs in a high inflation rate environment, a heterodox approach and incomes policy might play a role. In special cases of single commodity exporters, the need was emphasized for strong policies to promote export diversification and contingency policy packages that were developed at the outset. Moreover, a buildup of a stabilization fund in times of favorable developments would help cushion the economy against adverse shocks. Mr. de Groote referred to several ways in which other creditors could contribute to the contingency element of programs, and we have noted his suggestions.

In a few cases, programs might not have offered sufficient assurances that external viability would be achieved in a reasonable time frame, reflecting, inter alia, an underestimation of the adjustment problem facing the country and/or overoptimistic expectations concerning financing prospects. Directors observed that weaknesses in the assessment of the adjustment problems could be reduced in the future with a sharper focus on background economic studies, and strong efforts, where called for, to improve the data base. Equally, ways should be considered to lessen the constraints that administrative capacity in member countries might impose on the design and implementation of structural reforms. At the same time, however, Directors stressed that the need for a careful and thorough study of economic problems should not lead to an undue postponement of needed corrective actions.

In all these aspects, Directors saw a useful role for Fund technical assistance in areas of Fund expertise, as well as closer collaboration with the World Bank in its areas of expertise, and with other development institutions. More specifically, where complex and deep-seated structural problems are involved, Bank assistance in the design of structural policies may be crucial, and should be sought at an early stage. Several Directors also supported a strengthened role for the IMF Institute. Furthermore, it might be helpful to secure greater continuity of staff involved in operations with particularly complex cases; some Directors also felt that a strengthened role for resident representatives might be considered on a case-by-case basis.

2. Program implementation

Directors stressed again the critical importance of sustained implementation in the achievement of program objectives and underlined the role that contingency policy planning, as well as an appropriate accumulation of international reserves and use of the new contingency and compensatory financing facility (CCFF), could play to help to keep programs on track in the face of adverse external shocks. The CCFF should indeed become as useful as possible to the membership as a whole. I have noted the call from a number of Directors for simplification of this instrument, and these issues will be addressed in the coming review of the facility. Also, since the success of adjustment depends in part on early adoption of corrective policies, it was suggested that the staff examine why members appeared reluctant to take early policy actions with Fund support. Many Directors emphasized that strengthened program design could facilitate sustained implementation. Also, to avoid premature relaxation of the adjustment effort, Directors stressed the importance of realistic expectations by all parties involved regarding the timing of program results.

The record demonstrated that persistence in program implementation requires a strong commitment on the part of the authorities. Where difficult policy measures were involved, many Directors emphasized the need for careful staff assessment of the commitment to adjustment. At the same time, a number of Directors cautioned that the Fund must continue to pay due regard to members' domestic, social, and political objectives. Greater attention might also be paid in programs to the social consequences and the distributional impact of policies. A number of Directors stressed that increasing emphasis on the sociopolitical implications of programs should not, however, be allowed to weaken conditionality.

3. Monitoring the programs

There was broad agreement that monitoring of programs in accordance with current practices had generally been effective, both in helping to safeguard the revolving nature of Fund resources as well as in assisting members in identifying at an early stage corrective measures that may be needed to keep a program on track. Directors emphasized the importance of prior actions, when needed, for giving a strong start to programs, and of clearly specified performance criteria and reviews of appropriate scope in ensuring an adequate tracking of progress.

Further to these current practices, Directors generally viewed it as essential to monitor carefully those structural reforms when they were key to the success of the programs. Most Directors agreed that progress in such structural areas could be an appropriate prerequisite for approving an arrangement, or as the basis for interrupting purchases. I have already noted that Directors' views differed on the extent to which the Fund's conditionality should be extended to cover structural reforms. There were also technical questions concerning the appropriate timing and sequencing of structural reforms.

Monitoring of needed structural reforms could take the form of prior actions for policy measures that involved discrete steps. Monitoring could also be enhanced by setting out timetables for clearly specified policy steps as part of the review process, and, to the extent possible, through the use of benchmarks or performance criteria for quantified policy measures. Such advance specification would help to reduce the burden of monitoring at the time of reviews. I have noted, of course, the preference of some Directors for the use of ranges as a monitoring device.

4. Time frame for the use of Fund resources

Directors observed that large balance of payments difficulties facing several members, particularly those with large external debt burdens, had required increasing attention to the correction of impediments to growth and--in part because of often slower results on the supply side--longer periods of implementation. Against this background, Directors noted that the structural adjustment and enhanced structural adjustment facilities had been developed in response to the needs of low-income countries. For countries not eligible for the structural adjustment facility, extended arrangements may remain appropriate, provided that there was an adequate commitment to the longer adjustment period; of course, the nature of the problems confronting these countries would require strong policy actions at an early stage.

5. Policies to promote private capital inflows

Directors attached considerable importance to this matter. They agreed that in Fund-supported adjustment programs, especially in those cases where Fund support of debt and debt service reduction was seen as essential, particular importance should be attached to policies aimed at reversing capital flight and attracting private capital inflows. Here, a focus on the fundamentals of macroeconomic and exchange rate adjustment was seen as critical. Adjustment programs should also emphasize structural reforms that improve the savings climate and enhance returns on domestic investment, through the removal of economic distortions. In this context, a number of Directors saw a useful role that could be played by debt-equity conversion mechanisms, provided that they are compatible with the country's macroeconomic framework. It was suggested that a further study be undertaken on the subject of debt-equity conversion; this could be done in the context of our work on international capital markets.

A number of Directors stressed that closer monitoring in the context of Fund arrangements could help to focus policy attention on these issues. This could be achieved by incorporating the assumptions regarding such flows into the overall balance of payments objectives of the program, and supplemented by a careful review of policies and analysis of such flows. Directors cautioned, however, that uncertainties about the size and timing of capital reflows would suggest the need for judgment and prudence in projecting capital inflows to avoid complicating the authorities' implementation of their programs. A number of Directors suggested that staff papers provide more analysis of private capital flows. The determinants of capital flows will be examined again in the forthcoming staff papers on savings and program design.

Finally, I would note that this review is conducted under conditionality Guideline 12, which calls for such a review to be prepared from time to time; in practice, this review has taken place on average every 16 months. Directors have considered that it would be appropriate to continue to have reviews with about this frequency. Several Directors suggested that such studies might be conducted by an independent unit, a matter on which we need to reflect further. In the context of our next work program after the Annual Meetings, we should also reflect further on the empirical studies you wish to give priority to, and on the nature and scope of the 1990 review of the application of conditionality.

You will also recall that when we last examined the 1979 Guidelines on conditionality, in April 1988, it was generally agreed that the guidelines had served us well. We had decided at that time to continue with the present guidelines but to keep them under examination as further experience is gained. In our discussion today, I note that there continued to be widespread agreement that the guidelines remain broadly appropriate.

Mr. Kabbaj asked, in the context of the Chairman's reference to prior actions in the structural area and to possible interruption of purchases owing to insufficient structural progress, how structural measures could be successful if they were taken as prior actions, except perhaps in the area of the exchange system. Given the existing experience of the Fund--and that of his own country, Morocco, as one of the test cases for the World Bank in structural reform--how could a value-added tax be introduced or fiscal progress be made in the framework of negotiations for a stand-by or extended arrangement?

The Chairman replied that Directors had not suggested that all structural measures be taken as prior actions, but that in some cases, certain measures of that sort be taken on a prior basis, as indeed was the current practice of the Fund. Macroeconomic policies by themselves would often not generate growth and therefore required the implementation of structural measures at the outset of programs, to remove impediments to economic expansion. In any event, one should be careful to distinguish macroeconomic and structural policies.

Mr. Kabbaj added that structural measures, including in the fiscal field, took years to bear fruit. Moreover, legislative processes in developing countries should not somehow be regarded as invariably amenable to the adoption of prior actions.

The Chairman observed that certain measures, such as trade liberalization, could profitably be taken in some cases as prior actions. As prior actions, those measures would help to foster growth over the course of a program. The adoption of such measures should not imply that undue pressure was being put on the authorities, who, in any event, often took prior actions at their own initiative. More generally, one should not regard conditionality as necessarily being negative for a country.

Mr. Kabbaj commented that prior structural actions might be counterproductive or a hurdle to the authorities in the face of a public that was unprepared for such measures, and given other pending legislative action. Directors should respect the legislative and legal processes of member countries. Trade liberalization measures could be justified as prior actions if the country concerned was highly protectionist, but would be difficult to implement given the many industries involved, which would have to be informed of the measures being adopted. Programs that had been negotiated took three to six months to come to the Board, a period that was too short for structural reforms to be formulated as prior actions.

The Chairman reiterated that the issue depended on exactly which structural measures one was considering; Directors had not advocated that all structural measures be formulated as prior actions. But there were cases in which structural measures as prior actions were indispensable. He agreed entirely with Mr. Kabbaj's cautionary note that effective programs with structural measures did require authorities to inform the relevant sectors and the public; but once an educational process about coming measures was under way, the sooner a government implemented the structural measures the better the chances for a program to produce the growth required. The Fund would never press a government to take measures before the authorities had first had a chance to inform the public.

Mrs. Filardo said that it was her understanding that a majority of speakers--even when emphasizing the importance of structural adjustment--had not stressed the need for countries to take structural measures as prior actions, given that the current discussion dealt with conditionality. Structural measures or conditionality in that regard should be monitored by the World Bank.

The Chairman remarked that Directors of course recognized that the design and monitoring of structural measures should be in collaboration with the Bank, but not at the expense of neglecting such measures in Fund-supported programs, when those measures--generally few in number--were essential to the program's success. In those cases, the Fund would have to take structural measures into account in its conditionality.

Mrs. Filardo responded that she certainly agreed that structural measures should not be neglected in Fund-supported programs, but that there was a danger that conditionality in the structural area between the Fund and the Bank would overlap substantially when a country had a program with both institutions.

The Chairman noted the reference in the summing up that, in certain cases, "...Bank assistance in the design of structural policies may be crucial and should be sought at an early stage." In other words, close cooperation between the two institutions in the structural area had been viewed as necessary.

In response to some discussion on where to integrate the further consideration of private capital inflows in the work program, the Chairman remarked that it was surprising that Directors had not mentioned the need for further work on capital flows in balance of payments accounting more generally. The Fund was implementing the recommendations of the recent report on the global current account discrepancy, but the obverse of the phenomenon would obviously remain a substantial discrepancy in the capital account as well. Substantial uncertainties would therefore remain with any conclusions that were reached in the area of capital flows, however zealously one studied the topic. He supported Directors' recommendations for continued work on private capital inflows in the context of the coming papers on savings and program design. It was an area in which major efforts in general were indeed being made.

Mr. Nimatallah made the point that during future discussions of capital reflows, Directors should distinguish between the need to encourage foreign investment and flight capital repatriation. Causally speaking, the items were different, in that encouraging foreign investment was a widespread concern of all countries, requiring that countries adopt accommodative foreign investment laws and join the Multilateral Investment Guarantee Agency, among other actions, while the need to repatriate flight capital was a concern of only a number of countries. The topics should be addressed separately in the future.

The Chairman said that he agreed entirely with the distinction between foreign investment, capital flows in general, and flight capital repatriation, although Directors had not made the distinction during the current discussion.

The Executive Board then took the following decision:

1. Pursuant to Decision No. 8583-(87/72), adopted May 8, 1987, the Fund has reviewed the experience with recent programs supported by stand-by and extended arrangements, and decides that the guidelines on conditionality will remain in force in the present circumstances.

2. In view of the comprehensive reconsideration of the extended Fund facility undertaken in 1988, the Fund decides to postpone the review of the provisions of the extended Fund facility envisaged in Section 2 of Decision No. 8583-(87/72).

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

Decision No. 9189-(89/77), adopted
June 19, 1989

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/89/76 (6/19/89) and EBM/89/77 (6/19/89).

2. TRINIDAD AND TOBAGO - STAND-BY ARRANGEMENT - WAIVER OF PERFORMANCE CRITERION

1. Trinidad and Tobago has consulted with the Fund pursuant to paragraph 4 of the stand-by arrangement for Trinidad and Tobago (EBS/88/262, Sup. 2) concerning the nonobservance as of March 31, 1989 of the performance criterion on gross disbursements of external debt of the public sector which has an original maturity range of between 1 to 12 years, referred to in paragraph 4(a)(v) of the stand-by arrangement.

2. The Fund finds that, in view of the intention of the authorities of Trinidad and Tobago and the circumstances that resulted in the nonobservance of this performance criterion as described in the letter from the Minister of Finance and the Governor of the Central Bank of Trinidad and Tobago dated June 13, 1989, no additional understandings are necessary regarding the circumstances in which purchases can be resumed under the stand-by arrangement, and that Trinidad and Tobago may proceed to make purchases under the stand-by arrangement.

Decision No. 9190-(89/77), adopted
June 19, 1989

APPROVED: February 8, 1990

LEO VAN HOUTVEN
Secretary