

MASTER FILES
ROOM C-130

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/140

3:00 p.m., September 16, 1987

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

Executive Directors

Alternate Executive Directors

A. Abdallah

J. de Groot

J. E. Ismael
A. Kafka
T. P. Lankester
M. Massé
Mawakani Samba

G. Ortiz

C. R. Rye
G. Salehkhov
A. K. Sengupta

S. Zecchini

E. T. El Kogali
Song G., Temporary
M. K. Bush
 A. Rieffel, Temporary

E. Feldman
M. B. Chatah, Temporary
B. Goos
J. Reddy
J. Hospedales
M. Foot

I. A. Al-Assaf

M. Fogelholm
G. P. J. Hogeweg

O. Kabbaj
L. E. N. Fernando
M. Sugita

L. Van Houtven, Secretary and Counsellor
R. S. Franklin, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director; J. G. Keyes, R. C. Williams. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; S. J. Anjaria, E. Brau, D. Burton, G. G. Johnson, H. B. Junz, S. Kanesa-Thanan, M. R. Kelly, G. Oliveros, C. Puckahtikom. External Relations Department: D. D. Driscoll. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: O. B. Makalou. Legal Department: R. H. Munzberg. Middle Eastern Department: J. G. Borpujari, M. D. Knight. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; N. U. Haque, M. S. Khan, P. R. Menon, P. J. Montiel, I. Otani, D. Villanueva, P. Wickham. Treasurer's Department: M. A. Lumsden. Western Hemisphere Department: S. T. Beza, Director. Personal Assistants to the Managing Director: R. M. G. Brown, H. G. O. Simpson. Advisors to Executive Directors: A. Bertuch-Samuels, L. P. Ebrill, H. S. Hassan, J.-C. Obame, G. Pineau, I. Sliper, J. E. Zeas, A. Vasudevan. Assistants to Executive Directors: A. R. Al-Abdullatif, J. R. N. Almeida, O. S.-M. Bethel, H. S. Binay, E. C. Demaestri, F. Di Mauro, W. N. Engert, V. J. Fernandez, S. Guribye, C. Noriega, S. Rouai, G. Schurr.

1. ROLE OF THE FUND - ISSUES RAISED IN THE GROUP OF TEN AND GROUP OF TWENTY-FOUR REPORTS

The Executive Directors continued from the previous meeting (EBM/87/139, 9/16/87) their consideration of proposals regarding the role of the Fund, as presented in a report of the Deputies of the Group of Ten (EBD/85/154, Sup. 1, 6/21/85) and reports of the Deputies of the Group of Twenty-Four (EBD/85/228, 8/30/85; and EBD/87/196, 7/22/87), and as summarized in a staff paper on issues raised in those reports (SM/87/189, 7/31/87; and Cor. 1, 9/14/87).

Mr. Feldman made the following statement:

My authorities fully support the recommendations in the second report of the Deputies of the Group of Twenty-Four on the role of the Fund in adjustment with growth, and regret that it has not been possible to have it included in the agenda of the forthcoming Interim Committee meeting.

Although we think this is not the right time to discuss in full the document prepared by the staff, we would like to stress that the two central issues contained in the G-10 and G-24 reports--and which we understand would require priority in the staff's consideration--are, broadly speaking, the design and implementation of Fund-supported adjustment programs and the financial requirements of supporting these programs through the use of Fund resources.

On the design and implementation of adjustment programs, we endorse the following points in the G-24 report. First, an excessive burden has been placed on demand restraint in indebted countries, leading to a substantial loss of output and severe cuts in investment, a process strongly associated with the transfer of real resources derived from the service of debt; second, the proliferation of prior actions, performance criteria, and monetary techniques has led to a tightening of conditionality. The G-24 proposals seek a more flexible application of conditionality and, especially, the adaptation of performance criteria to the fulfillment of the objective of growth; in the achievement of this aim, the number of quantitative performance criteria should be limited and set as ranges. Third, contingency mechanisms should be formally included in Fund-supported programs as a way to make available additional financing to cope with the adverse external environment that affects the debtors' capacity to repay their obligations.

On the financing side, we would like also to stress three points. First, it is necessary to strengthen the Fund's ability to promote adjustment with growth; consequently, the availability of resources should be enhanced through a significant increase in quotas. In addition, the allocation of SDRs is important as

a way of providing liquidity that could neutralize the need to further compress the level of imports and, hence, of economic activity in heavily indebted countries. Simultaneously with the increase in the availability of financial resources, access policy--including the question of phasing--should be made more flexible to expand access.

Second, in relation to the catalytic role of the Fund, we consider of utmost importance the idea of debt reconstruction, which would include an evaluation of the level of debt service that a debtor country could bear as well as the consideration of appropriate treatment of the debt problem through different kinds of instruments and financial schemes.

Third, a special and rapid redefinition of the compensatory financing facility is crucial to secure appropriate financing to cope with unexpected exogenous shocks. The redefinition should include the question of conditionality and the interpretation of the test of cooperation.

It is our feeling that the paper prepared by the staff provides a useful description of the different and complex proposals raised in the G-24 report as well as a clear comparison between the approaches and suggestions made in both the G-10 and the G-24 reports. However, like other Directors, we feel that the time has come to take new steps in the debt strategy and to redefine the role of the Fund. In that respect, we are in agreement with the suggestions of Mr. Sengupta and Mr. Ortiz and we would strongly encourage the staff to make its own appraisal of the G-10 and G-24 reports, taking a position on the proposals contained therein, stressing the pros and cons they may find in the analysis, and to provide, if possible, the elements of an overall proposal and, perhaps more important, a set of guidelines for its implementation.

We understand that both reports embody a set of complex and interrelated issues, which have a precise meaning and rationale when viewed as a whole and in an integrated manner. As such, it is important for the Board to consider the different subjects in a combined and integrated fashion. If considered in a fragmented way, the proposals lose their rationale, and this should be avoided.

As other Directors have mentioned, the staff analysis of the proposals should be concentrated in no more than two staff papers: one referring to the design and implementation of Fund-supported adjustment programs and the other on the financial aspects of these programs, with particular emphasis on the use of Fund facilities. In that connection, we think that the enhancement of the structural adjustment facility for low-income countries

is being carried out with great success; but the time has now come to produce satisfactory answers to the urgent problems of other countries facing financial difficulties, especially the heavily indebted middle-income countries.

We look forward to discussing the above-mentioned papers in the Board after the Annual Meetings. Once these papers become available, the discussions should not take long, as most of the issues have already been covered, or are planned to be covered, in various other staff documents. Once the two proposed papers have been discussed, it is to be hoped that these issues will be included in the agenda for the spring 1988 Interim Committee meeting.

Mr. Abdallah made the following statement:

As other Executive Directors have stated, today's consideration of the issues raised in the G-10 and G-24 reports on the role of the Fund is a preliminary one, mainly concerned with determining priorities for further work by the staff. My comments will, therefore, be general and fairly brief.

The growing awareness of the need for growth-oriented adjustment is welcome and will, we hope, lead to a reorientation in the design of Fund programs. We also welcome the three forthcoming papers on program design and ask that they make a thorough examination of the specific issues raised in the G-24 report about the design of growth-oriented adjustment programs, including the integration of growth exercises and more reliance on supply-oriented structural adjustment measures. The countries represented by this chair that have been under Fund-supported programs for several years, consider it particularly important that the design of growth-oriented adjustment programs take into consideration the specific situations and circumstances of the low-income countries. These countries have narrow production bases, usually relying on single commodity exports, and thus have limited capacity to adjust, which has implications for the scope of adjustment, the time horizon of adjustment programs, and the magnitude and timing of external financing. All these structural weaknesses need to be addressed squarely in the forthcoming papers.

On conditionality and program implementation, the G-24 report contains a number of specific proposals on how to improve formulation and implementation of performance criteria. These proposals--in particular, those related to the choice of monitoring variables and the formulation of performance criteria and how they can be adjusted to stress the growth aspect and accommodate its requirements--should receive serious consideration.

Integration of contingency mechanisms into Fund-supported programs is another important issue which needs careful study. Staff consideration of this subject should not be limited to the three types of contingency mechanisms proposed in the G-24 report, but should explore additional mechanisms that would help to introduce in Fund-supported programs the internal flexibility that is needed to sustain growth-oriented adjustment under rapidly changing circumstances and an adverse external environment. Contingency mechanisms related to exogenous developments proposed in the G-24 report are much broader than contingent commodity financing and are meant to address a variety of exogenous developments that influence and constrain domestic adjustment efforts. They should, therefore, be evaluated in this light.

Fund policies on access limits in recent years have been deeply influenced by considerations that low-income countries of Africa find very difficult to accept. As private investment and credit flows from commercial sources have been declining, actual access to Fund resources has been reduced considerably on the argument that such reduction is needed to maintain the revolving character of Fund resources or discourage their prolonged use. Surely, access to resources should be related to members' actual needs, with due regard, of course, paid to the strength of the adjustment process. Some further thinking is needed on this aspect of Fund policies as recommended in the latest G-24 report.

The report calls on the Fund to make extraordinary efforts to mobilize additional resources to support low-income countries, both directly and through its catalytic role. I feel somewhat encouraged by recent developments and by pending action on the debt front for the low-income countries insofar as the Paris Club is concerned. A second encouraging development arises from the discussion we had yesterday on the enhancement of the structural adjustment facility. The thrust of that discussion, though revealing that a number of important issues still remain to be negotiated, was definitely positive. Let me urge the participants to speed up the negotiations on the enhancement of the facility at the fastest possible speed. The third encouraging development is the World Bank's special program to enhance assistance for debt-distressed, low-income countries. I feel all these developments will improve the atmosphere in which the two reports will be considered by the Ministers.

Let me conclude by endorsing the statement of Mr. Sengupta that the proposals made in the two reports should be analyzed and evaluated "in an integrated manner." Their consideration should be placed on the agenda of the Interim Committee for the 1988 spring session and all concerned should adopt "a constructive and pragmatic approach" as urged by Mrs. Ploix in the concluding sentence of her incisive statement.

Mr. Massé said that, at first glance, it appeared that the staff had examined in only a preliminary way the proposals raised in, and the overlaps between, the G-10 and G-24 reports. It was certain in his view that a number of the proposals made in the G-24 reports represented substantial departures from what had so far been the accepted practice of the Fund; as such, those proposals would require in-depth discussion. One opportunity to examine the issues could come in the course of regular reviews by the Board of, for example, the design of Fund programs. In that regard, he took the point that a number of the proposals were interconnected and that it would be important to make clear those interconnections in any papers brought forward for the Board's discussion.

The timing for discussion of the issues by the Interim Committee was a matter for the Committee itself, Mr. Massé continued. It was his understanding of the process of agenda creation that Executive Directors proposed to their various constituent authorities points that might be on the agenda of the Interim Committee. Once a draft provisional agenda was produced, the Executive Board took up the draft in formal discussion. And, with the Board's recommendations, the text was then approved by the Committee itself. He had no objection to the matter in question being considered as an item for the agenda of the Interim Committee, so long as the normal process was followed.

An interesting point had been raised by Mr. Abdallah about the need for devising special programs or procedures to deal with the low-income countries in particular, Mr. Massé said. He tended to agree with Mr. Abdallah that the Board should focus its efforts on an enhanced structural adjustment facility with a view toward its implementation, so that the Fund could contribute to resolving the problems of the low-income countries.

With regard to the work program of the Fund, Mr. Massé considered it important to be careful about giving work directives to the staff that took into account the priorities facing the institution and the manpower resources available to work on those priority issues. In sum, while he accepted that the issues in the G-10 and G-24 reports must be looked at in an integrated way and that the Interim Committee would in due course no doubt want to consider those issues, it was the responsibility of the Executive Board to make certain that the various proposals were looked at in an efficient way that was consistent with Fund practice and took account of the needs of all members.

Mr. Mawakani stated that he could endorse the views in the G-24 reports, the key issues of which had been clearly summarized in the staff paper. He would only re-emphasize the position of his chair on surveillance and the design of Fund-supported programs. As he had noted on other occasions, the exercise of Fund surveillance should be symmetrical, covering the policies of all members and not only those using Fund resources. In that context, he welcomed the use of indicators to enhance the surveillance exercise.

On the design of Fund-supported programs, it was important to incorporate the growth objective and to make the programs sufficiently flexible to take exogenous factors into account, Mr. Mwakani continued. He looked forward to further work by the staff on the different issues raised in the two reports, together with an overall evaluation. In that context, he could support the constructive suggestions made earlier by Mr. Sengupta and Mr. Ortiz. In the work program of the Fund, his own feeling was that priority should be given to an evaluation of the various proposals on the design of Fund-supported programs and the role of the Fund with a view to finding a solution to the debt problem.

Mr. Kafka said that, like others, he regretted that it had not been possible to discuss the substance of the proposals in the G-10 and G-24 reports in time for the matter of the role of the Fund to be placed on the agenda of the September meeting of the Interim Committee. Those proposals were in his view important, and preparatory work on them should be completed before the spring 1988 Interim Committee meeting. He felt certain that there would be support in the Interim Committee at that time for placing the matter of the role of the Fund on the Committee's agenda. Finally, while he agreed with those who felt the staff must not be overloaded with work, he believed that the issues in question were sufficiently important to deserve priority treatment.

Mr. Foot said that he agreed with those who felt that it was not appropriate for the Board to be attempting to establish the Interim Committee's agenda some seven months in advance. He had certainly taken note of the importance attached by some of his colleagues to discussing the issues raised in the G-24 reports. However, the link between the timing of discussions and the quantity of work requested as a basis for those discussions must be recognized. Certainly, producing a number of papers that covered individual proposals while emphasizing the ways in which they must be integrated with other proposals was bound to take longer and create a heavier work load for the staff than the sort of piecemeal approach that the staff had suggested in SM/87/189. As he saw it, those who felt most strongly that the issues needed to be addressed urgently must be the ones to determine the trade-off between an integrated approach and a rapid completion of discussions. On a related point, he would caution against expecting too much from such discussions. His own authorities had already given serious thought to many of the issues raised in the reports and had arrived at views on some of them that might not be easily reshaped.

Finally, Mr. Foot remarked, while he accepted that there should be no substantive discussion of the various issues in the G-10 and G-24 reports at the present meeting, there were two areas in which he would urge his colleagues to think carefully about the way in which certain proposals were presented and the priorities that should be attached to them. The remarks in paragraphs 160 and 180 of the G-24 report concerning the possibility of tying repayments to the Fund to members' ability to repay made it difficult for him to sell his authorities on the idea of an enhanced structural adjustment facility or a quota increase. He had similar difficulties with remarks about conditionality in respect of the extended Fund facility and the enhanced structural adjustment facility.

Mr. Goos made the following statement:

I agree with previous speakers that today is not the time to enter into a substantive discussion of the various issues addressed in the two reports; we will have ample opportunity to do so after the Annual Meetings on the basis of further staff papers. Nevertheless, having listened to the previous speakers, and in view of the far-reaching nature of the innovative ideas presented in the G-24 report, a few general remarks regarding the principles that guide our views on the appropriate role of the Fund in the adjustment process would not be out of place, even if they serve only to indicate that those principles have not changed materially since the issuance of the G-10 report. On certain questions raised in the recent G-24 report but not covered in the G-10 report--such as the matter of contingency clauses--I believe our position has been made clear in previous Board discussions.

The main concern underlying the G-24 report is apparently the adequacy of the transfer of resources from industrial countries to developing countries, and the general conclusion drawn is that multilateral institutions have a particularly important role to play in augmenting such transfers to developing countries. We certainly appreciate this concern; indeed, Mr. Grosche made it quite clear in a meeting only last week that we too recognize the importance of the issue. However, we firmly believe that this transfer of resources has to be effected in a manner that is consistent with the stability of the international monetary and financial system. To be sure, the Fund, under its Articles of Agreement, is held to foster international trade, employment, and development; but this mandate and its execution have to be seen in the context of the Fund's overriding monetary function--which is clearly reflected in Article I and elsewhere--as well as in the way we fund our activities. The basic idea is that in fulfilling its monetary functions, the Fund makes a contribution to trade, development, and so on.

It follows that the division of work between the Bank and the Fund is not merely a pragmatic, organizational matter; the demarcation line is clearly between longer-term development financing and shorter-term bridging finance for temporary balance of payments problems, and it is only this latter financing that normally is related to the monetary sphere. While balance of payments difficulties are frequently caused by structural impediments, it does not necessarily follow that it should be up to the Fund to provide the necessary resources to finance structural reform. Often the underlying problems reflect longer-term development issues that have to be tackled with appropriate nonmonetary instruments. Accordingly, in the context of growth-oriented structural adjustment, a clear distinction has to be made between the necessary longer-term transfers of resources

and the contributions that legitimately can be made out of monetary means. I therefore believe that the criticism of the Fund's adjustment policies as insensitive and inappropriate to the developing countries' situation is largely off the mark, as are calls for a new approach to Fund-supported adjustment programs. This criticism seems to imply that the Fund should close any remaining financing gaps that cannot be filled from other sources and that arise from a country's predetermined course of growth and adjustment policies. In the final analysis, such an approach would involve the provision of monetary financing to compensate for shortfalls in development assistance and, hence, an approach that would threaten to undermine the stability of the international monetary system, which of course has to remain the primary concern of the Fund. I think my remarks should make it clear that, in general, we have great difficulties with many if not most of the proposals in the G-24 report.

Turning briefly to the question of how to organize the future work on the G-10 and G-24 reports, I would agree that we should address the issues neither in individual, separate papers, nor on the basis of a single comprehensive analysis of all the problems involved. Rather, the issues should be taken up in the normal course of discussions, as outlined in the staff paper. In this way, for example, most of the issues could be integrated into the comprehensive review of Fund conditionality and our future consideration of the debt strategy. Such a presentation should meet the concern expressed by previous speakers that we should approach these issues in an integrated manner. However, rather than establishing a firm plan today on how this should be effected in detail, I propose that we return to this issue in the context of our consideration of the next work program, perhaps on the basis of more specific ideas which the staff might have at that time.

Finally, taking account of the concern expressed by a previous speaker on our limited Board and staff resources, I think that the forthcoming papers should draw as much as possible on previous work, including the results of previous Board discussions, so as to avoid unnecessary repetition. This could perhaps be achieved by extensive references to previous papers. In general, I think the aim should be the presentation, within the relevant overall context, of concise and brief analyses focused on aspects that have not yet been addressed by the Board.

Mr. Sugita said that his authorities continued to share the views expressed in the G-10 report and had difficulty associating themselves with several important points made in the G-24 reports, particularly those which would mark significant departures from the current debt strategy or those which would involve a fundamental change in the role of the Fund. However, at the present stage their views were preliminary,

to those occasions when each issue would be taken up at the Board. His inclination was therefore to deal with the issues separately, but he was also interested in Mr. Goos's idea of dealing with them as a part of the review of conditionality.

As to the work program after the Annual Meetings, Mr. Sugita noted that of the subjects referred to in the staff paper, he attached particular importance to a review of growth-oriented adjustment programs, the Ninth General Review of Quotas, problems of low-income countries, overdue obligations to the Fund, and the review of the compensatory financing facility. He understood, of course, that the Board must await the guidance of the Interim Committee for a definite work program.

Mr. Salehkhon made the following statement:

The G-24 report (EBD/87/196, 7/22/87) represents a consensus on the part of the Group's membership. As a member of the Working Group who had the privilege of taking part in the preparation of this report, I feel I should avoid addressing the variety of specific issues covered in detail and confine my remarks to some general observations.

The staff paper provides a fair summation of the G-10 and G-24 positions on issues related to the role of the Fund in adjustment with growth. Expectedly, however, the staff avoids any assessment of its own, instead confining itself in this concise report to summarizing, in a parallel fashion where possible, the views of the two groups. Although this may be a satisfactory approach at this stage, it is to be hoped that any follow-up report or reports will elaborate, in a comprehensive manner, on the staff's analysis and appraisal of the issues under consideration.

In this connection, I would like to associate myself with the remarks made earlier by Mr. Sengupta and Mr. Ortiz--and echoed by some others--regarding the integrated manner in which the positions of the two groups on the issues at hand should be addressed. While I can be flexible on the question of the modalities to be used in preparing the variety of the issues in the two reports for Board deliberations and eventual presentation to the Interim Committee, I believe that the issues should be addressed collectively. Clearly, all the components which are considered essential ingredients in the design of the Fund-supported adjustment programs, and the objectives which are to be achieved as a result of their implementation, are interrelated. It is also clear that many of these issues have been and will continue to be individually addressed by the Board. I feel that it is not so much the individual components in each program per se that need to be addressed; rather it is their interrelationship, which directly affects the outcome of program implementation. This is best demonstrated by the undeniable and widely

recognized relationship between growth and debt-servicing capacity of debtors. I feel that the approach suggested by Mr. Sengupta--of preparing two comprehensive staff papers to focus on the design and implementation of programs as well as the financial aspects of program implementation--is feasible. Should the staff not share this view, or if staff work load makes such an approach difficult, I would then suggest that forthcoming (and past) staff reports on critical and related issues such as debt, access, conditionality, and the like, be made background papers for the discussions of the reports prior to presentation to the Interim Committee.

Given the mandate by the Interim Committee, members of the Group of Twenty-Four had expected that the topic under consideration would be included as a main item in the agenda of the forthcoming meeting of that Committee. Now that, due to time constraints, the discussion of the item is to be postponed until the next spring meeting of the Interim Committee--one hopes no later than that--it would seem only fair that the Managing Director, in his report to the Interim Committee later this month, should make elaborate references to the subject. In this way, the stage would be appropriately set for the full discussion of the issues in the April 1988 meeting of the Interim Committee. It is to be hoped that the Executive Board will by then have comprehensively considered the views in the G-10 and G-24 reports and will be in a position to make recommendations to their Ministers with a view to reaching a consensus on the important, and at times controversial, issue of the role of the Fund in the design and implementation of growth-oriented adjustment programs.

As far as I remember, the preparation of the agenda of the Interim Committee is initiated by the Managing Director in consultation with the Chairman, and is then discussed by the Board. I recall that not long ago the Managing Director indicated his regret that, due to time constraints, it was impossible to have this item included in the forthcoming meeting of the Interim Committee, and that he did commit himself to suggesting that the matter be placed on the agenda of the 1988 spring meeting. I think the time is ripe for discussion of this issue, and I hope that my colleagues will pay due regard to the spirit in which this report has been prepared and the time devoted to it and will do justice to the report by agreeing to its discussion at the earliest possible opportunity.

In the past, and especially since the outbreak of the so-called debt crisis, Fund-supported programs have increasingly been criticized for promoting "protracted recessionary adjustment" in borrowing members. Such adjustment involves unnecessarily high social and political costs that are not conducive to the structural changes required for achieving growth and viable payments balances in these countries. This chair, along with most of my

other colleagues from the LDCs, has often questioned the validity of certain assumptions underlying the design of Fund-supported adjustment programs and measures adopted in their implementation. On occasion we have asked for the appointment of an outside and independent unit of experts to evaluate the effectiveness of these programs in bringing about the required structural changes and growth for which the programs were originally designed. Clearly, this proposal has not met with the approval of the majority of creditor members. The concerns which were expressed on these occasions on behalf of the national authorities so affected by Fund-supported adjustment programs were in part responsible for the preparation of the G-24 report.

The industrial country creditor members have come to realize the vital role the growth element can and should play in all Fund-supported adjustment programs. It is, however, regrettable that such realization has come about only after several years of severe hardship and sacrifice on the part of debtor members, with inadequate progress in their efforts to correct their imbalances and to achieve a viable balance of payments position. Furthermore, the debt crisis still looms large in the international financial community, and any major breakthrough appears as far-fetched as ever.

I am heartened by the favorable initial, and informal, reactions to the G-24 report by management and staff. I am confident that the same spirit will prevail in future work and discussions on the subject. The report is regarded as one of high quality and comprehensiveness, and the recommendations made therein are believed to be feasible and constructive. It is hoped that our proposals, together with those of the Group of Ten, will be given serious consideration by the industrial countries in a positive spirit so that a consensus can be reached for the mutual benefit of developing and industrial countries.

Mr. Rye said that he wished to associate himself fully with the points made earlier by Mr. Foot.

Mr. Sengupta remarked that the support given to some of the points raised in Mr. Foot's intervention pointed out the importance of dealing as a whole with the issues covered in the G-24 report rather than separating them. Mr. Foot had mentioned, for example, the issue of members' repayment obligations, and he and others had spoken of the monetary character of the Fund. The G-24 report was conscious of the monetary character of the Fund; indeed, a careful reading of the report would show that its authors believed that the Fund's monetary character should be fully protected. Of course, the authors of the G-24 report had interpreted the monetary character of the Fund in a particular way, although he could assure his colleagues that the interpretation was a logical and reasonable one. The point was that that interpretation was inextricably connected

to, for example, the issue of members' repayment obligations. The idea underlying the report was that, given a scenario for expected foreign exchange earnings on the basis of which a program was worked out, if for exogenous reasons the exchange earnings should fall short of the baseline scenario, there should be some method of capitalizing the shortage. Similarly, if those earnings exceeded what was expected in the scenario, the country should accelerate repayments to the Fund. Ab initio, there was no reason to believe that performance would always fall short of baseline scenario projections. Indeed, there was a 50/50 chance that it would exceed those projections; and, as a result, the Fund might find that its money was being returned faster than expected. That example served to highlight the importance of looking at the G-24 report as a whole rather than at individual recommendations.

Mr. Rieffel made the following statement:

I would like to thank the staff for an interesting summary of the many issues raised in the G-10 and G-24 reports. This chair has spoken on most of these issues at length during the past year, so I will try to limit my comments--as did Mr. Goos--to some basic principles.

To begin, I want to acknowledge the hard work devoted to the preparation of the latest report of the Group of Twenty-Four. This contribution can help us to ensure that the Fund will continue to play a central role in addressing the problems of the global economy and the balance of payments and debt difficulties of its members. I must also note that there are a number of points in the G-10 report that we will come back to in the various discussions of these issues after the Annual Meetings.

With respect to the design of Fund-supported adjustment programs, I would like to underscore our belief that adjustment efforts must continue to be directed toward achieving a sustainable payments position over the short to medium term, consistent with the monetary character of this institution and the revolving nature of its financing. We believe the Fund's use of financial programming is basically consistent with this objective. As a practical matter, a reduction in absorption (i.e., demand restraint) is often found to be an important element of Fund-supported programs, especially when the authorities are reluctant to move boldly to remove supply constraints and address structural rigidities.

At the same time, we share the view expressed by Mrs. Ploix that greater efforts must be made to strengthen the supply-side orientation of Fund-supported programs. In particular, greater coverage of structural measures in programs is necessary to achieve this objective. There has been progress in recent years in addressing structural impediments to growth, particularly with regard to relative prices, privatization, and liberalization.

Nevertheless, we hope the papers to be discussed after the Annual Meetings will provide additional impetus in this direction. In this context, I should also reiterate our view that appropriate program design and strong conditionality must go hand in hand with the provision of Fund resources.

Issues related to the implementation of Fund-supported adjustment programs are under continuous review in our periodic discussions of program design and conditionality. To avoid repeating our detailed comments on these issues, I would simply like to point out that we feel that the Fund has the flexibility needed to play its central role in the debt strategy, but that it should continue to be receptive to new techniques that are consistent with the objective of facilitating successful adjustment. The Mexican contingency financing mechanism is an example of the kind of adaptation that can be justified in special circumstances. At the same time, we continue to believe that prior actions can help to improve the odds for successful adjustment in many cases, and that higher levels of financing will not improve the odds in all cases.

Regarding the use of the Fund's resources, my authorities firmly believe that the Fund should remain a quota-based institution, although this does not imply a need to expand quotas to replace borrowed funds. In addition, we feel that Fund financing cannot substitute for private capital and various forms of official financing in meeting countries' liquidity needs. In particular, the Fund needs to be careful not to be drawn into providing balance of payments financing over prolonged periods of time or into providing development assistance.

Since we have discussed a number of issues relating to the adequacy and use of the Fund's resources in the past two weeks, and will be discussing others tomorrow, I will not address the specific proposals of the Group of Twenty-Four in this area. I might note, however, that while the G-10 report is two years old and therefore does not take a position on the latest G-24 proposals, most of these proposals are difficult to reconcile with the thrust of the G-10 report.

On the Fund's facilities, I note that stand-by arrangements have served well as instruments for supporting the economic programs of Fund members, and our experience with them has on balance been more favorable than that with the extended Fund facility. We agree with the Group of Twenty-Four on the desirability of enlarging the structural adjustment facility. But, as we pointed out in the Board discussion of that topic yesterday, narrowly conceived and ineffective conditionality is to be avoided as much as excessive conditionality. With respect to the compensatory financing facility, our concerns are well known, and we will be coming back to this subject after the Annual Meetings.

The need to strengthen Fund-Bank collaboration has become ever more clear in recent years. We have of course made some progress. The policy frameworks and associated lending programs are leading to a greater degree of collaboration, but there continues to be scope for improvement. We agree with the Group of Twenty-Four that the distinctions between the two organizations should not be blurred. Stronger collaboration between the World Bank and the Fund should help to establish a stronger basis for sustained noninflationary growth in countries seeking financing from both institutions, while preserving their separate identities and roles.

Some point to cross-conditionality as a possible outcome of close Fund/Bank collaboration. We do not think this should happen. Rather, a more appropriately integrated economic and financial program for the member country should be agreed, wherein the economic adjustment measures contained in programs financed by each institution are mutually reinforcing and therefore lead to high levels of output and income.

Finally, on the question of procedure, we can support the idea of looking carefully at the issues raised in the G-10 and G-24 reports in the months ahead, and we are open to the idea that some of the issues may become appropriate subjects for consideration by the Ministers at next spring's Interim Committee meeting. But, as noted by Mr. Massé, prior to having considered these matters more thoroughly in the Board, it would be premature to conclude that any particular item should be on the spring Interim Committee agenda. In the meantime, we could agree that the Managing Director, in his capacity as Chairman of the Board, should make an oral report to the forthcoming Interim Committee on the status of our preliminary discussions.

Mr. Hogeweg made the following statement:

The issues raised in both reports are all essential for the functioning of this institution, and they should be given the attention they deserve. Today is not the time to comment in detail on the substance of the report; rather, today's meeting should primarily establish the way this Board is to tackle its discussion of these reports after the Annual Meetings and should give guidance to the staff for its preparation for these discussions.

I agree with both Mr. Sengupta and Mr. Ortiz that the different issues are interrelated, and it may indeed be better to plan in advance that the discussions will be structured on that basis. If we were to tackle them one by one, their inter-related nature would tend to produce a great deal of unnecessary repetition. Also, I think it is advisable that one clearly

identify that the Board is discussing these reports and that their discussion not be lost in the ongoing discussion on the Fund's operations. However, we should not overload both the Board and the staff's program in adopting such an approach.

I have been wondering whether or not to make remarks on the substance of the reports at this stage and have decided to limit myself to general comments on the issues. I am sure everyone will agree that it is of crucial importance to preserve the monetary character of the Fund and the monetary character of its resources. However, differences of view exist about where one should put the emphasis and where one judges that the borderline lies beyond which this unique character of the Fund might be in danger. I expect this issue to be an important one in the forthcoming discussions, and I note that treating the proposals in the reports in an integrated way may bring that out more clearly. Of course, we have very strong feelings on this; the world may need more development finance, but it needs the Fund more than another development institution.

Reflecting on the role of the Fund, I was struck that one area which appears to be crucial for the Fund in the future is not touched upon directly in the papers we have before us today. I have in mind the Fund's role in the discussions on the improvement of the international monetary system and the surveillance over exchange rates. Those, too, are roles of the Fund laid down in our Articles of Agreement. It seems to me that the role of the Fund as the natural center where these discussions belong has diminished, and I very much regret this development. The best way to counter this is to actively promote discussion of these issues within the Fund.

One suggestion from our side may be worth noting at this point. In many Article IV consultation reports, the staff advocates a more flexible exchange rate policy, and I think the Fund should study the international aspects of these individual recommendations. We believe there is great merit in policies of exchange rate stability, and the Louvre Agreement is evidence that this view is shared by others. In sum, I believe that in setting priorities for discussions on the role of the Fund, we should keep this role in mind as well.

Mr. de Groote made the following statement:

Like other Directors, I regret that it was not possible to devote more time before the Annual Meetings to discussing the substance of the problems raised by the G-24 and G-10 reports. Fortunately, we now seem to agree that this has to be done in the coming months, and that a global approach to the discussion should be taken. I have, however, some difficulty in following

Mr. Goos in his choice of the centralizing theme for such a global approach: conditionality is not the only topic around which all our discussions should be centered. Quite appropriately, Mr. Hogeweg has demonstrated that exchange rate issues should also be a central point. Another important question is that of the Fund's liquidity. Hence, if we have to define more specifically the role of the Fund in the envisaged exercise, I would be happy to agree with Mr. Goos on the title, "The Fund's Conditionality and Liquidity."

In any event, today's discussion is most useful because it shows the great interest of this Board in the reports before us, reports that have been analyzed and commented upon with great care by the staff. For the organization of our further work, I would like to suggest that we give priority to the written procedures in the initial stage, given the complexity of the subject and the variety of the topics to which we have to address ourselves. Allow me now to comment briefly on four topics, on which I feel some additional input can be useful at this stage.

First, it is now generally agreed that the design of Fund-supported adjustment programs should combine the goals of growth and structural adjustment. It still needs to be made clear, however, just what this implies for Fund-provided financing. Because of the emphasis placed on structural changes, often far-reaching ones, from the very outset of the program, the amounts required to support their successful implementation may well be substantially greater than we have been accustomed to in the past.

Frequently, we now also discuss a new variant of structural adjustment, namely, systemic adjustment, as required of countries moving from a fully centralized to a market economy system. The amount of Fund assistance needed to bring such a program to a successful conclusion might be of a completely different order of magnitude from what we now have available or from what is now accepted in terms of policies governing the use of Fund resources. The issue has to be examined in principle, on its own merits, and without reference to existing quota dimensions and Fund practices.

We agree with the G-24 criticism that, in the past, the implementation of Fund-supported adjustment programs has over-emphasized demand restraint as a means of correcting unsustainable payments imbalances while treating growth as an incidental by-product rather than as a goal of the program. This does not mean that growth should be promoted by relaxing the process of external adjustment. It does mean that the quality of the adjustment is a crucial element in the design of growth-oriented adjustment programs. It also means that greater efforts are

demanded, not only of the country--which will often be required to implement from the very beginning far-reaching structural changes--but also of the Fund, which must provide the resources necessary to support such an implementation.

In the same vein, the G-24 report notes that the contraction of government budget deficits, long a cornerstone of adjustment programs, sometimes has adverse effects further along the adjustment path. This occurs not only in the frequent cases where the public sector is engaged in important production activities, but also, and more generally, because the public sector is the supplier of infrastructure, education, and other important inputs to growth and structural improvement. In this respect, it is worth citing the working paper on fiscal policy, growth, and the design of stabilization programs (WP/87/1), in which it is suggested that a given current account target can be just as well or even better pursued through fiscal policies which initially allow for even higher deficits but which from the outset give greater weight to the quality of fiscal adjustment measures.

Second, as early as January 1986, during this Board's discussion of the staff paper on issues in the implementation of conditionality (EBS/85/265, 12/5/85), we defended the idea put forward in the latest G-24 report that performance criteria should be expressed as ranges, rather than as precise figures. The use of target ranges would endow programs with the flexibility required by an ever-changing external environment. Also, performance criteria should focus more on success in the implementation of the structural reforms: of course, this should be done without a proliferation of criteria, as Mrs. Ploix has pointed out. Moreover, the contingency mechanisms proposed by the Group of Twenty-Four, such as linking a country's debt-servicing obligations to growth or to important exogenous factors like fluctuations in the prices of its main exports, could be extremely useful for hedging a country's adjustment efforts against the uncertainties of the international environment, as was shown in the case of Mexico. These mechanisms deserve further study.

Third, although the issue of the quota increase will be more thoroughly discussed on other occasions in the near future, I would like to draw attention now to a few questions concerning the quota. The G-24 report suggests that it would be desirable to establish a mechanism linking quotas to the size of the world economy, or, failing such an automatic link, to reduce the normal interval between quota reviews to three years. I strongly support these suggestions. I would like to draw the Board's attention to another, related issue, namely, whether the Fund needs more conditional or more unconditional liquidity. The Fund has to be able to respond very rapidly and decisively to large, sudden imbalances. It could do so by using new mechanisms that do not involve borrowing on the markets. These mechanisms,

such as allocations for the use of conditional liquidity, have frequently been commented on by Mr. Sengupta and by my own chair. I am certain Mr. Sengupta could easily be persuaded to make further contributions on this important subject, and I would be happy to do the same.

Fourth, experience has shown that in the framework of the present debt strategy, the structural adjustment facility does not really play a catalytic role, a point stressed a few minutes ago by Mr. Hogeweg. This is not consistent with the leadership role the Fund should play in the debt strategy. More conceptual research is therefore called for concerning the role the Fund might play in bringing closer a solution to the debt problem. An important question in this connection is whether the Fund can judge a country's need for debt relief and what role the Fund should play in the process of combining this debt relief with the adjustment efforts needed to enable the country later to regain access to the international capital markets.

Mr. Zecchini made the following statement:

In recent months we have had various opportunities to discuss Fund policies and instruments in great detail. On all these occasions, we stated our conviction that the role of the Fund is to support the external adjustment efforts of members through improved orientation of their economic policies and by providing direct and catalytic financing to the countries in need while progress continues toward restoring external balance. This requires the fulfillment of the four conditions mentioned in the last G-10 report, and we will comment briefly on these conditions. In today's discussion we will not try to summarize again our positions on all the points and topics proposed in the G-24 and G-10 reports, but rather will highlight a few aspects which have been acquiring rising importance. In particular, we will briefly focus our remarks on the design of Fund-supported adjustment programs, on some aspects of Fund conditionality, and on the relationships between the Bank and the Fund. We will not pay particular attention to questions related to access, SDR allocations, the structural adjustment facility, and the compensatory financing facility as we have had or will have specific discussions on these topics.

As for the design of Fund-supported adjustment programs, we can offer a generally positive assessment of the recent orientation. The Fund has responded with sufficient flexibility to the worsening of the debt crisis by contributing substantially to identifying the causes of the crisis and to finding a viable policy approach to favor readjustment. Greater attention to structural policies, increasing collaboration with the World Bank, and a strengthening of the financial and catalytic roles

of the Fund are some of the elements of this approach, confirming that Fund intervention is indeed evolving in accordance with the changing overall economic situation. Therefore, we disagree with the claim in the G-24 report that the design of Fund-supported programs is solely based on a restricted set of accounting identities and that "the theoretical and empirical validity of the assumptions underlying the approach of the Fund...is questionable." Indeed, the Fund, by promoting growth-oriented adjustment programs, has endorsed the main contention of the G-24 report that adjustment strategies are not sustainable without a medium-term growth objective.

The increased attention of the Fund to structural aspects of adjustment should not, however, jeopardize the revolving nature of Fund resources and the monetary nature of this institution. In this respect, the limits of Fund involvement must be made clear in light of the nature and financial size of this institution. As it is stated in the G-10 report, we believe that the balance of payments requirements of the countries asking for Fund assistance should be met by the Fund in concert with other institutions and the financial community. In particular, since growth-oriented structural adjustment takes a longer time to unfold and to show its results, as it is correctly stated in the G-24 report, larger participation by official donors and other financing sources ought to be promoted. At the same time, however, the Fund should continue to be involved in a substantive way in the financing of the programs. Direct financial involvement enhances the credibility of the programs in the view of other creditors as well as of debtors. Moreover, this is part of the institutional responsibility of this cooperative institution. The two roles of the Fund, that of a catalytic institution and that of a financing one, should go hand in hand so as to maintain credibility of the programs while at the same time guaranteeing sufficient financing.

Financial involvement of the Fund is also a means of enhancing the catalytic role of the Fund. But, to this end, as it is stated in the G-10 report, the quality of the adjustment measures contained in the programs are of paramount importance. In this context, the unsatisfactory record of implementation of several recent Fund-supported programs--among the IMF programs examined in the 1987 report on conditionality, only one fourth were successfully implemented--is a cause for concern as it weakens the credibility of Fund intervention. The Fund should, therefore, ponder carefully its direct engagement by evaluating realistically the chances for success of the agreed program and the capacity of the country to repay its debt.

In this regard, we believe that it would be helpful if more attention were paid to the impact of Fund-supported programs on income distribution, as suggested by the G-24 report. Moreover,

measures aimed at structural reform have to receive more room in the programs for the adjustment of deeply rooted external imbalances.

Turning to the issue of conditionality, we do not believe that there has been recently a "tightening of conditionality," as the G-24 report states. Conversely, the flexibility in the design we have already mentioned, the more frequent approval in principle of programs, and the structural adjustment facility programs have indeed made conditionality more coherent with the peculiar characteristics of the specific adjustment problem.

As for the specific tools of conditionality, such as prior actions, performance criteria, and so on, we are on balance satisfied with their current utilization, and we do not have to add much to what we said in reviewing conditionality a few months ago. Contingency mechanisms might also prove useful in certain circumstances to spur the authorities to embark on extensive adjustment.

As to the financial nature of the institution, the Fund should continue to be a quota-based institution, and borrowing should be limited to exceptional circumstances. In this respect, we agree with those who argue that there is a need for a substantial increase in quotas under the Ninth General Review. We will have an opportunity to articulate our position tomorrow in the Board discussion on this subject.

Turning finally to Bank-Fund collaboration, I find no foundation in the fears that such collaboration could lead to a confusion of roles. Collaboration is a way to improve the quality of the programs of both institutions so as to make the adjustment effort more comprehensive and far reaching. This collaboration, for instance, can be extremely fruitful in improving the quality of policy framework papers for the enhancement of the structural adjustment facility.

Mr. Chatah, noting that he would have another opportunity to comment on the substance of the issues raised in the report in discussions scheduled after the Annual Meetings, said that he would focus his remarks on the program of work suggested by the staff and the suggestions made by other speakers. It was important, in his view, to keep the approach to the issue of the role of the Fund as manageable and as sharply focused as possible, both in terms of the staff papers produced and the Board discussions held, as well as in the manner in which the issue was brought to the agenda of the spring Interim Committee meeting. At the same time, he agreed with those who felt that the various issues and proposals in the report should be approached in as integrated a manner as possible.

An integrated approach was not in his view inconsistent with separate discussions of the issues, since their interrelatedness could still be taken into account. However, if a global approach was not considered by the Board to be the most efficient approach, then additional attention must be paid by the staff to the integrated nature of the various proposals, so that segmented discussions would not necessarily lead to a segmentation of ideas.

Mr. Al-Assaf observed that the turn the discussion had taken obviated the need for him to comment on the substance of the papers before the Board. On the procedural question of how to address the main points raised in the staff paper, he was open minded, although he agreed with those who felt the issues should be tackled in an integrated fashion. In the establishment of the Board's work program and the preparation of the papers necessary for such discussions, two considerations should be kept in mind. One was the notion that the issues should be treated thoroughly and fairly; the second was the work load of the staff. If those two considerations could be met within the required time frame, he saw no difficulty in suggesting that the relevant items be added to the agenda of the April 1988 meeting of the Interim Committee, although any decision on that matter was of course in the hands of the Ministers.

Mr. Fogelholm remarked that the issues raised in the staff paper were fundamental ones deserving of a full and serious discussion. It was obvious that the basic issues would not be discussed in substance in the present meeting, and he would therefore limit his remarks to one or two points of concern. First, it was clear even from the preliminary remarks of his colleagues that the positions of G-10 and G-24 representatives remained far apart on some major issues; and that gap created some problems. In particular, it was questionable how much time the Board could or should devote to such issues where no rapid resolution was in sight. Also, how much time and effort should the staff be asked to put into the preparation of additional papers on such issues?

Second, Mr. Fogelholm agreed with Mr. Foot that it was impossible to adopt an integrated approach to the relevant issues while simultaneously meeting the desire to conclude discussions in time to place the issues on the agenda of the Interim Committee in the spring of 1988. The integrated approach was of course appealing from an intellectual point of view, but he did not see how it was possible to avoid repetition in such an approach. In conclusion, he tended to agree with Mr. Goos that it would be important to return to the question of the appropriate approach to the topic once the Board began discussing its work program.

The Chairman then made the following concluding remarks:

We have held a useful meeting on issues that lie at the heart of the Fund's responsibilities with respect to the financing and adjustment of members' balance of payments problems. Comments of Directors have generally focused on how we should proceed from here to a comprehensive and integrated, in-depth examination of these issues.

The staff has undertaken to carry forward work on the conclusions of last summer's discussion on the design of Fund programs, on the Interim Committee's request for a thorough review of adjustment programs and their supporting arrangements, and on the Executive Board's request of this past May for a comprehensive review of conditionality. This work will cover many of the subjects addressed by the G-10 and G-24 proposals. We have thus set for ourselves several overlapping tasks. In the interest of both logic and efficiency, we should try to combine these tasks to the extent possible. We will be reflecting on the possibilities for doing so in the weeks ahead and, as suggested by some speakers, I will present some specific suggestions toward that end in my work program statement in October, when we will also have heard the views of the Interim and Development Committees.

Let me briefly outline how such a combined approach might address the concerns you have expressed today. On the issues that fall under the G-24 report headings of design and implementation of Fund-supported programs, the staff has in preparation papers for discussion by the end of 1987 that will include an examination of the G-24 proposal on growth exercises--a proposal concerned with the financial resources needed for growth--and of issues related to structural adjustment, which can contribute to the efficiency needed for growth. Other discussions will also take place that are relevant to this work, including an October 19 seminar on high inflation, heterodox stabilization, and fiscal policy. There are in addition a number of specific proposals in the area of program implementation. On one of those--contingency mechanisms--we will be having a preliminary discussion in the forthcoming Board meeting on the review of the compensatory financing facility. I would suggest that other specific proposals, such as those relating to performance criteria, be examined in a staff paper for Board discussion early in 1988, a paper that could also serve as a basis for a first discussion in respect of the comprehensive review of conditionality.

On the Fund's financial resources and their use, we will be holding discussions in a number of areas mentioned in the G-10 and G-24 reports, such as quotas, and will consider what other studies are needed when we come to our work program discussion.

Under the heading of Fund facilities, I envisage that most of the proposals relating to stand-by arrangements and the extended Fund facility will be covered in the aforementioned preliminary paper for the comprehensive review of conditionality. A staff paper on the compensatory financing facility is scheduled to be discussed in October or early November, and at that time we can consider suggestions for further study of the facility. The structural adjustment facility is undergoing continuing development and review and will be subject to special consideration when we

have advanced further in our efforts to substantially increase the resources available for structural adjustment facility lending. Finally, I regard Fund-Bank relations as an evolving and continuing process; we shall think further with the Board's help about when it might again be useful to discuss this subject.

Several Directors have stressed the need for a comprehensive and integrated approach in addressing the views in the G-10 and G-24 reports on the role of the Fund. At the same time, all Directors have noted the large number of individual issues raised in the reports including, as some have observed, issues covered in the G-10 report but not mentioned in the G-24 report, e.g., the role of the Fund in surveillance. It is very important that we make sure that we have a thorough thrashing out and understanding of the individual issues, i.e., of the component parts, to make sure that they fit logically and coherently in an integrated analysis. This is a dialectic process in which analysis and synthesis can in practice be reconciled. However, in view of the importance and multiplicity of the issues raised, we should be under no illusion that we can thoroughly thrash out all these issues by April 1988, especially given the clear desire, which I endorse, that our discussions be geared toward practical and operational conclusions and not be limited to abstract debate.

I have noted the suggestion of several Directors that we concentrate our efforts on those areas where we believe we can make genuine progress toward consensus in this Board. And we should seize every opportunity in the course of our work to implement without delay all the improvements on which the Executive Board can agree. I suggest that we return to these matters in the context of our next work program discussion in October, when we should clearly agree on an ordered approach, looking forward to the spring meeting of the Interim Committee and, perhaps, for certain elements, beyond that point. I can assure you that staff and management will work closely with the Board to see to it that by the spring 1988 meeting of the Interim Committee we will have made substantive progress on these inter-related issues and that a report on our work can be delivered to the Interim Committee for its consideration, if it so desires. In that connection, having taken note of a divergence of views about what form such report should take, I propose that we postpone any decision on this matter until the time for reporting draws nearer.

For the September 27 Interim Committee meeting, I shall report briefly on the essence of our discussion today. The approach I have outlined will establish a heavy work load for the staff as well as for the Board, and we will have to be careful to maintain the impetus behind these initiatives throughout our discussions.

APPROVED: May 3, 1988

JOSEPH W. LANG, JR.
Acting Secretary