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Minutes of Executive Board Meeting 87/136

10:00 a.m., September 14, 1987

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

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
	Song G., Temporary
C. H. Dallara	M. K. Bush
	D. C. Templeman, Temporary
J. de Groote	
A. Donoso	E. Feldman
M. Finaish	
G. Grosche	B. Goos
J. E. Ismael	J. Reddy
A. Kafka	J. Hospedales
	M. Foot
M. Massé	
Mawakani Samba	
Y. A. Nimatallah	I. A. Al-Assaf
G. Ortiz	
J. Ovi	M. Fogelholm
H. Ploix	D. Marcel
	G. P. J. Hogeweg
C. R. Rye	I. Sliper, Temporary
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
K. Yamazaki	M. Sugita
S. Zecchini	

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant
M. J. Primorac, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; M. G. Khun. Asian Department: D. A. Lipton. European Department: M. Russo, Director; R. B. Hicks. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; S. J. Anjaria, G. Begashaw, E. Brau, H. B. Junz, S. Kanesa-Thasan, M. R. Kelly, P. P. Moutot, J. M. T. Paljarvi, P. J. Quirk, S. Schubert. External Relations Department: A. F. Mohammed, Director; J. Landell-Mills, I. S. McDonald. Fiscal Affairs Department: V. Tanzi, Director; M. Katz, A. M. Mansoor. IMF Institute: O. B. Makalou. Legal Department: J. M. Ogoola, J. V. Surr. Middle Eastern Department: Z. Iqbal, K. Nashashibi, S. von Post. Research Department: J. A. Frenkel, Economic Counsellor and Director; A. D. Crockett, Deputy Director; M. Goldstein, Deputy Director; F. C. Adams, J. M. Boughton, D. A. De Rosa, M. C. Deppler, M. Dooley, R. Flood, E. Hernández-Catá, J. P. Horne, F. Larsen, P. R. Masson, M. Mecagni, S. Symansky, E. Y. P. Tung, M. A. Wattleworth. Secretary's Department: C. Brachet, Deputy Secretary. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; M. N. Bhuiyan, W. L. Coats, D. Gupta, F. J. Lin, A. F. Moustapha, A. Salehizadeh, B. Zavoico. Western Hemsiphere Department: S. T. Beza, Associate Director; J. Ferran. Bureau of Statistics: J. B. McLenaghan, Deputy Director. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, P. E. Archibong, A. Bertuch-Samuels, M. B. Chatah, L. P. Ebrill, A. G. A. Faria, G. D. Hodgson, Khong K. N., A. Ouanes, G. Pineau, D. C. Templeman, J. E. Zeas. Assistants to Executive Diectors: N. Adachi, J. R. N. Almeida, O. S.-M. Bethel, H. S. Binay, E. C. Demaestri, F. Di Mauro, W. N. Engert, S. K. Fayyad, V. J. Fernandez, M. A. Hammoudi, G. K. Hodges, L. Hubloue, S. King, K.-H. Kleine, M. A. Kyhlberg, M. Lundsager, V. K. Malhotra, T. Morita, C. Noriega, L. M. Piantini, S. Rebecchini, D. Saha, G. Schurr, G. Seyler, H. van der Burg, Yang W., I. Zaidi.

1. WORLD ECONOMIC OUTLOOK - DEVELOPMENTS, PROSPECTS, AND POLICY ISSUES

The Executive Directors continued from the previous meeting (EBM/87/135, 9/11/87) their consideration of a staff paper on prospects and policy issues related to the world economic outlook (EBS/87/182, 8/21/87). They had before them as background material a statistical appendix (SM/87/222, 8/21/87; and Cor. 1, 9/3/87) and a staff paper on medium-term scenarios (SM/87/221, 8/21/87).

Mr. Foot said that the review of past world economic outlook papers showed something that was not bad, not biased, and not a model. The staff study which he had referred to in his opening statement, was interesting in many respects; it was an authoritative and objective outside look at the track record of the world economic outlook exercises. In general, the exercises had come through with flying colors. Reasonable arguments could, of course, be made about some of the assumptions underpinning the latest exercise. He looked forward to hearing the staff's response to his question about commodity prices, and he had been somewhat surprised that Executive Directors had not posed more questions than they had about some of the assumptions that the staff had used and about the staff's approach to constructing forecasts. If further work were carried out in developing the staff's quantitative framework, the Executive Board should consider during future discussions on the work program and the budget what additional resources the Research Department might need and the staff's priorities for disaggregating the model. The progress that the staff had made in developing the model was encouraging and should continue at an appropriate pace, although the staff should not try to do too much too quickly.

His own experience had made him very skeptical of the value of highly aggregated forecasts, Mr. Foot continued. However, the financial markets might not have the same sense of caution, and the Fund should be careful not to publish market-sensitive material. Of course, it was difficult to determine precisely which material was market sensitive, and, in that connection the presentation of material could make a considerable difference. The illustrative nature of some of the data should be clearly spelled out.

He was opposed to any attempt to use medium-term scenarios to establish benchmarks against which future performance could be measured, Mr. Foot stated. The greatest value of the scenarios was that they identified areas of possible future policy tension, although it was admittedly difficult to know what caused tensions and what would cause the system to break down. Tensions were often evident, and the main difficulty was to determine how serious the tensions might become. One such tension was the portfolio constraint on capital inflows into the United States; an external U.S. deficit that was sustainable under one set of macroeconomic circumstances might not be sustainable under another set of circumstances, but it was difficult to know when the tension would reach the breaking point. There were problems in the real world that the Fund could not avoid facing up to, and the material prepared by the staff provided an objective and helpful set of ways at looking at those problems.

His authorities remained firmly committed to the Louvre Accord and strongly hoped that the underlying policies of the major countries would be sufficiently compatible to support the Accord, Mr. Foot remarked. The discussion thus far suggested that if those policies were not compatible, the coming period would be marked by considerable exchange rate instability that would be in no one's best interest.

Mr. de Groote said that the starting point in his opening statement was his feeling of uneasiness about the functioning of the adjustment process among the industrial countries and about the present approaches to the debt issue. He felt uneasy about the incentives that the industrial countries had to make needed adjustments. Underlying most Executive Directors' presentations was the vague notion that the magnitude of certain imbalances was such as to make them necessarily unsustainable. Crash scenarios shared the common assumption that the public, through speculation, or political circles, through responsible policy action, would have to react to certain imbalances. He doubted whether that outcome would necessarily occur, provided that there were no mechanical forces that would inescapably lead to another situation, or if the threat that such forces might come into play was not sufficiently real, in the perception of political circles, that they felt compelled to act.

There seemed to be no major forces that would lead in the immediate future to a readjustment away from the apparent present situation of stable imbalance, as interest rates remained sufficiently high to attract enough savings to the United States from the rest of the world, Mr. de Groote continued. Interest rates were likely to remain so, because there was no clear indication that a downturn in the business cycle was imminent. The U.S. economy would gradually have the benefits of both much higher levels of investment in relation to savings and the recent exchange rate adjustments. Hence, the incentive not to adjust fiscal policy existed, and there was an incentive to try to allow as much time as possible for supply and exchange rate effects to manifest themselves. The U.S. authorities' view that fiscal adjustment should not become more active would be reinforced by the certainty that a recession would necessarily follow if the fiscal adjustment, in the amounts to which the Government was still committing, should be rapidly implemented while the other large industrial countries continued not to expand demand toward the limit of capacity.

Therefore, it seemed reasonable to make an effort to spell out the conditions for the success of the so-called muddle-through scenario, Mr. de Groote went on. One possibility was that after all, supply effects would become a major part of the situation, as industrial restructuring would continue rapidly. If the negative J-curve effects of the exchange rate adjustments came to a halt, a unique situation might develop in which structural adjustment success would postpone, perhaps indefinitely, the danger of a recession while allowing the realization of the Administration's most ambitious forecasts. The conditions for such success should be clearly spelled out, and one might then have to think somewhat differently about the urgency of implementing budgetary correction in the United States on the scale and according to the timetable that had been announced. Another possibility was that the positive action of supply and exchange rate effects would be defeated by recessionary forces. In that event, the situation would become the mirror image of the situation that had been apparent for some years, with fiscal policy becoming more restrictive and monetary policy becoming more expansionary. However, the probability of that outcome seemed to be low, given the continuing strength of demand in the United States.

The discussion of the debt issue had been useful, Mr. de Groote commented. However, there was some risk that the emphasis that was being placed on debt transformation and similar techniques would lead to neglect of the basic preconditions of adjustment, namely, additional financing from the various sources of funds, additional adjustment in the debtor countries themselves, and an overall climate of sustained world demand. Many of the suggestions that had been made reflected a pessimistic view of the possibility that those preconditions would materialize. Mr. Sengupta's interesting proposals should be seen in a pessimistic perspective, since they assumed that intervention would have to be substituted for market forces. That approach would only become necessary if the markets were to remain sluggish in their reaction to the Baker proposal. In sum, it should not be forgotten that the main objective of the debt strategy must remain the achievement of a sufficient rate of economic growth; it was important to remember that there was a real danger that the proposals might be allowed to nourish the illusion that they were an alternative to new financing and additional internal adjustment.

He continued to feel uneasy about the format of the discussions on the world economic outlook, Mr. de Groote said. The quality of the staff's work remained high, and it was difficult for the Executive Board to hold a discussion that was at the same level. On a future occasion the Executive Board should discuss possible ways of improving the format of the discussions.

Mr. Hogeweg, speaking for Mr. Posthumus, said that the main feature of the present discussion was the consideration of the scenarios. Apparently there was a feeling that the scenarios could be used to analyze and judge the world economic situation even if the world economy was represented by only a few countries. The wish to add a number of developing countries to the analysis to make it more realistic was understandable, and while the addition might well be useful, the scenarios should remain policy-making tools. The scenarios should not include variables that were not subject to significant change in the short term. It was already difficult to guide domestic demand in the United States and Japan. It was heroic to assume that foreign assistance provided by the United States, Japan, or Germany could be increased or used as a policy tool to obtain more rapid international growth and greater stability even in the medium term.

It seemed to be agreed that economic growth in the industrial countries would continue but not at a rapid rate, Mr. Hogeweg continued. Economists tended to be pessimistic in making forecasts, and it was clear that there were risks and that the plight of low-income debtor countries and middle-income countries could be relieved through a higher rate of world economic growth. However, many countries had shown that adjustment measures could yield positive results.

While the debt problem might no longer be a threat to the financial system, it still had to be solved on a case-by-case basis, Mr. Hogeweg said. The Fund wished to continue to play a central role through the provision of its own financial resources and as a catalyst. Accordingly, the Fund might have to consider that debtor countries should be helped to increase their adjustment effort, that creditors and bankers should be helped to increase rescheduling and lending, and that debtors and creditors should be helped to consider together whether individual debtor countries faced an unsustainable debt burden or were able to achieve positive economic growth and the steps that could be taken to deal with debt burdens and encourage growth. No institution was better placed than the Fund to analyze the proper and acceptable balance between adjustment and financing.

The Director of the Research Department said that in commenting on appropriate policies the Executive Directors had underscored the existence of substantial imbalances that were thought to be unsustainable in the context of current policies. Many speakers had stressed that the external imbalances were unlikely to disappear on their own. There was some difference of opinion among Executive Directors about the policy steps that member countries should take, but there was general agreement that the world economic outlook paper should contain a somewhat more concrete statement by the staff on the policy corrections that countries should make. For example, Mr. Kafka has suggested that more precise statements on fiscal corrections would be helpful, while Mr. Sengupta had mentioned the need for more concrete analysis of appropriate exchange rate action and Mr. Ortiz had concentrated on the need for appropriate structural policies. There were several perspectives in which to consider the appropriate policies that member countries should introduce, the Director continued. In the context of the implications of the level of economic activity in the world, a decision by a deficit country to contract its economy had a different effect than a decision by a surplus country to expand activity in its economy. Such decisions were also important in the context of external balance, since, through current trade flows, a decision by one country to expand its economic activity would have a different effect on world economic balances than a decision by a deficit country to contract its economy. Obviously there was a need to balance all such considerations.

Some Executive Directors had stressed that the judgment of imbalances could change over time, the Director commented. An imbalance that was thought to be unsustainable at one time might be seen as being sustainable after some time had passed. As Mr. Massé had noted, the introduction of appropriate policies could boost confidence in an economy, thereby encouraging observers to feel that an imbalance was no longer unsustainable. Mr. Grosche had stressed that it was important which countries decided to take action to correct imbalances, because current trade flows were asymmetrical. As Mr. Yamazaki had noted, the same policy would call for different responses in different countries, depending on the track record in each country of the policy being pursued. Therefore, the staff should be somewhat more careful in interpreting quantitatively the signals sent by various elasticities. At the same time, the forthcoming study by an outside consultant showed that there had been some forecasting errors in the staff's estimates but that the bias had not been systematic.

A number of Executive Directors had noted that substantial external imbalances were forecast under Scenario III, the Director remarked. There was a menu of possible actions to take to reduce the imbalances, including monetary, fiscal, structural, and exchange rate policies individually or in combination. Mr. Zecchini had asked the difficult question whether there was not an appropriate mix of such policies that would avoid exchange rate changes. It was of course feasible for the staff to design a package of policies that, in principle, would result in a particular outcome. In that connection, an important question was whether the outcome would be thought to be desirable and, if not, what alternatives were available. A related fundamental question was whether target zones or reference zones should be taken into account. That question could not be adequately addressed in the context of a discussion on the world economic outlook, but the fact that it had been asked suggested that the staff would have to pay more attention to the operation of all the dimensions of the international monetary system, and the staff intended to do so in the coming period.

The extent to which the staff's forecasts for the world economic outlook had been optimistic over the previous five years was not great, the Director commented. It was important to consider the origin of that optimism. Mr. Kafka had noted that an increase in the flow of resources to the developing countries by about 8 percent of their GNP would stimulate investment and yield an increase in growth rates of about 3 percentage points. However, in that process there were two important links, namely, translating resources into investment, and translating investment into growth. Each of the links was potentially troublesome, but the overall approach to looking at the situation of developing countries was helpful. At the same time, Mr. Dallara had noted that the chart on page 46a showed that there was a weak correlation between increases in resources, investment, and economic growth. The increase in the rate of investment would depend on the extent to which new resources were used for that purpose, and the resultant increase in the rate of growth would depend on the extent to which the investment proved to be productive. The weakness of the links underscored the limitation on the use of rigid coefficients in the scenario exercise. There was a clear need to provide incentives that would ensure increased flows of resources and investment to encourage economic growth, and, to that end, the implementation of proper policies and the maintenance of an appropriate economic environment.

There seemed to be a widespread feeling among Executive Directors that the staff should extend its scenario analysis beyond the group of major industrial countries, the Director remarked. In fact, Executive Directors had suggested adding a fairly large number of countries to the analysis. The scenario analysis was technical and complex, and the staff would consider ways in which the analysis could be expanded to include additional countries.

In addition, the Director noted, Mr. Sengupta had stressed the need for the scenario exercise to include sensitivity analysis to check for the consistency of the various components of the scenarios. That step was of course essential, and the staff would continue to use the best available estimates for each country without trying to develop a country-by-country model, which probably would not be useful. The staff would continue to try to combine the various estimates in a manner that would ensure that the individually estimated coefficients were consistent. The procedure involved was an iterative one: if the staff found that variables were inconsistent, it re-examined the relevant country estimates that had been provided to it. The staff had already begun to allocate significant resources to enhance the modeling exercise, but a full-fledged modeling exercise was probably beyond the resources that anyone had in mind for the staff, and a sensible compromise would have to be reached on the effort that should be undertaken.

The reason for increasing the number of countries covered by the scenario analysis was the deep conviction that the world economy consisted of interdependent economies, the Director continued. The staff had not meant to say that the developing countries could shield or shelter themselves from output fluctuations in the rest of the world. The staff had meant to say that the dependence of the developing countries on the growth of output in the industrial countries depended very much on the degree to which the developing countries could maintain access to capital markets; the dependence was decreased when developing countries had relatively large access to the capital markets.

There seemed to be widespread agreement among Executive Directors that monetary policy should be used to contain inflation and very high interest rates, thereby helping to ensure that the debt problems would not worsen, the Director said. Monetary policy should not be expected to do more than that; the main goal for monetary policy should be to create a steady environment. A number of Executive Directors had concluded that emphasis should therefore typically be placed on fiscal and structural policies. In that connection, Mr. Rye had asked the critical question whether the scenario for the change in the U.S. fiscal deficit would be different if the change took place through tax increases rather than expenditure cuts. The answer to that question was not reflected in the staff's scenarios, but the difference would be considerable.

It would be useful to consider on another occasion whether the fiscal deficit was the right variable to focus on, the Director went on. Instead, more attention should perhaps be paid--for example, in the design of indicators and performance criteria--to the precise kind of spending and taxes that were involved. To that end, careful thought should be given to what was meant by a country's fiscal position. For example, should the social security system be included or excluded? How could the descriptions of fiscal positions of various member countries be made comparable? The staff did not have a mechanistic way in which to describe each member country's medium-term fiscal position for 1991. The data involved were not strictly comparable across countries. In describing the medium-term fiscal position the staff tried to use the relevant figures that were considered to be important by the authorities concerned in their decision making, and the staff recognized that while some of the data involved seemed to be estimates, others were considered to be forecasts, projections, or objectives. The staff applied common sense in using the various figures and tried to describe clearly how it interpreted each set of figures. The table concerned could be changed to include a column on the difference between the budget deficit forecast for the current period and the budget deficit forecast for 1991. The choices involved were difficult, and further discussion of the matter would be required.

In describing the position with respect to current services the staff took into account policies that were in place, the Director said. The staff did not try to make judgments on policy intentions and to adjust its description of the current services and overall fiscal position accordingly. At the same time, it was clear that the same current services deficit in the United States in 1986 should be interpreted differently at present, in the light of the significant achievement in cutting the deficit over the previous year, although there was still a long way to go in that area.

Concerning the debt situation, the Director noted that, as Mr. Posthumus had stressed, it was important to recognize that several member countries with large external debt had maintained appropriate policies and had not encountered difficulties owing to the debt itself. In other words, the presence of a large external debt did not mean that a country was necessarily in a difficult situation.

The Deputy Director of the Research Department recalled that the question had been raised whether the staff's forecasts should not be revised somewhat in light of exchange rate and commodity price developments since the forecasts were made in mid-May 1987. The U.S. dollar had appreciated in July and early August and had subsequently depreciated. The present range of exchange rates among the major currencies was not sufficiently different from the range in mid-May to warrant a significant change in the staff's projections, especially for external balances. As to commodity prices, the index published by the Economist was useful but was not the same as the index used by the staff. From the perspective of the developing countries themselves, the recent increase in commodity prices was probably somewhat less than the increase in the index published by the Economist. In addition, as Mr. Kafka had noted, the Morgan Guaranty newsletter of August 1987 suggested that the medium-term prospects for commodity prices were not significantly brighter than they had been several months previously. On the whole, while the staff might be inclined to revise upward its estimate of commodity prices somewhat, the revision would not be large.

The projected rate of growth for developing countries in the latest World Development Report was 5.9 percent, compared with the 4.9 percent projected by the Fund staff, the Deputy Director said. The World Development Report's high-growth scenario was predicated upon an assumed rate of growth in industrial countries of 4.3 percent in the medium term, a rate that, as the Executive Board's discussion had shown, seemed to be optimistic.

In the past, the world economic outlook paper prepared just prior to the Annual Meetings had been published on two occasions, the Deputy Director of the Research Department explained. If the Executive Board wished to conform to previous practice, the main world economic outlook paper now before the Board could be revised in the light of comments that had been made--for example, by eliminating projections for 1991 for individual countries in the alternative scenarios while providing an analysis of the qualitative results of those scenarios--before publication at the time of the 1987 Annual Meetings. There was no precedent for also publishing a supporting paper, such as the medium-term scenarios paper, and the staff had not intended to publish that paper in the final World Economic Outlook document. Of course, a decision could be taken to also publish the supporting paper as a part of the World Economic Outlook document; alternatively, the supporting paper could be published separately, perhaps as a staff study.

The staff representative from the Research Department said that the staff would contact some Executive Directors on a bilateral basis to answer certain questions that they had raised.

Mr. Yamazaki stated that his authorities attached great importance to the matter of publication. A distinction should be made between surveillance and publication: surveillance was the function that was to be performed by the Executive Board and the Interim Committee, while the world economic outlook was published in the name of the staff. Accordingly, one could conclude that publication of the world economic outlook paper was not a part of the surveillance exercise. On the other hand, publication had genuinely global significance, as expectations in financial markets might be influenced by the contents of the published World Economic Outlook document. Therefore, considerable self-restraint by the staff was called for with respect to publication. Another important consideration was that publication of the world economic outlook paper should not stand in the way of the free and frank exchange of views in the Executive Board that was the core of the surveillance exercise.

The full significance of the publication of the world economic outlook paper on financial markets must be taken into account, Mr. Yamazaki continued. In Japan, the World Economic Outlook document would be met with considerable interest by the press and financial markets. The reaction of institutional investors, particularly to Scenario II, was highly unpredictable. He doubted whether the Executive Board and the staff were prepared to take responsibility for the possible dire consequences of the publication of the staff scenarios. If the full deletion of the three scenarios was not acceptable to the rest of the Executive Board, he would like to see the deletion of all tables and quantitative references in the scenarios and to treat a qualitative statement as an appendix, rather than as part of the text, of the World Economic Outlook document.

The Chairman said that Mr. Yamazaki's concern about the publication of the scenarios was understandable, and management and staff had not intended to publish them. At the same time, management and staff hoped to be able to continue the established practice with respect to publication of the world economic outlook paper. After all, the markets might also be concerned about an interruption in the usual flow of information from the Fund as a result of a decision not to publish a world economic outlook paper.

Mr. Kafka commented that, in considering the issue of publication, Executive Directors should distinguish between the provision of information and the provision of forecasts. As the Chairman has suggested, the markets would probably react adversely to an interruption in the flow of information from the Fund. However, he doubted whether the markets would react negatively if the Fund's forecasting were interrupted. That was not to say that the Fund should necessarily interrupt its forecasting. There was probably a way in which to meet Mr. Yamazaki's concern. As he understood it, management and staff could meet that concern on the basis of established practice, under which firm figures would not be published, qualitative expressions would be used, and it would be unnecessary to name individual countries. Instead, the published version could speak of major surplus and deficit countries.

Mr. Grosche remarked that, as he understood it, the staff proposed to publish the midyear world economic outlook for the third time. Publication was already the established practice, and a published version of the paper should be provided. At the same time, he shared some of the concerns that Mr. Yamazaki had mentioned, and the paper must be properly edited, including in particular the elimination of data in the scenarios for 1990-91. Any danger that the forecast could be interrupted as a certain policy indication, particularly with respect to exchange rates, should be eliminated. If the paper was to be edited in a way in which such concerns would be met, he would have no difficulty in approving a publication that included the scenarios.

Mr. Dallara said that it was not clear to him whether the staff intended to publish the medium-term scenarios without precise quantitative projections for individual countries. Presumably that proposal would include the publication of aggregative, medium-term quantifications of, for example, levels of real growth. He wondered whether such a publication would include the precise assumptions underlying the scenarios.

The Deputy Director of the Research Department recalled that in the past the staff had not prepared quantified alternative scenarios; there had been only one medium-term scenario. In addition, in the past, the medium-term scenario had been presented in table form with aggregate figures for the last year under review rather than specific figures for individual countries; accordingly, the published version of the World Economic Outlook document had shown the growth rate for a group of countries but not the individual growth rates for the same countries. As the staff was suggesting that the published version of the scenarios should contain a qualitative statement of the likely outcome of each scenario, presumably the assumptions underlying the scenarios would be expressed in qualitative, rather than quantitative terms.

Mr. Dallara considered that the approach to publication that had been described by the staff would go quite far in meeting the concerns of Mr. Yamazaki and others. He himself preferred not to go as far as Mr. Kafka had suggested in fully deleting references to individual countries. That approach might well make the scenarios useless. He understood the potential sensitivity of the scenarios, but the Fund should guard against trying to hide from the implications of the scenarios. The problems that were suggested by the scenarios must be faced by policymakers, and the Fund would not do itself any service by attempting to avoid the policy implications of the scenarios. He would not object to the proposed shift from quantification to qualitative analysis at the present stage, particularly as there were three scenarios and an effort would be made to continue moving forward in the scenario exercise. He would also not object to publishing the scenarios as an appendix to, rather than a part of, the main World Economic Outlook document.

Mr. Zecchini said that he hoped that the staff intended to adjust the table on inflation in the way in which he had requested, and that the staff would include some analysis and statistical information on unemployment. In addition, he agreed with previous speakers who had expressed the concern that publication of all the quantitative information in the alternative scenarios could affect the frankness of the Executive Board's discussions on the world economic outlook and jeopardize the further development of the world economic outlook exercise beyond the present experimental stage. He preferred to maintain the established practice of publishing only one aggregative, medium-term scenario, without any quantitative references to alternative scenarios; the aggregative scenario should contain qualitative statements and should not include any specification of the underlying quantitative assumptions, particularly with respect to market-sensitive variables. However, the treatment of the debt problem in the world economic outlook should not be scaled down as some previous speakers had suggested. The debt problem was still an extremely important factor in the economic outlook for the industrial countries as well as the developing countries. The debt problem underscored how difficult the present tight financial constraint could be for growth prospects.

Mr. Ortiz considered that Mr. Yamazaki had raised an important issue in suggesting that publication of the world economic outlook paper was not a part of the Fund's surveillance. He wondered whether the staff agreed with that view.

The Chairman considered that strictly speaking the actual publication of the World Economic Outlook was not a formal part of the Fund's surveillance. Of course, publication could be helpful in surveillance, but it was not a part of the surveillance procedures.

Mr. Grosche stated that he agreed with the Chairman. In conducting surveillance the Executive Board needed to have more detailed information available on individual countries than for world economic outlook discussions. Accordingly, the Executive Board had consistently refrained from approving the publication of any staff reports for Article IV consultations. Surveillance was a comprehensive effort that was more important than the Fund's provision of information to the public. Studies published by the Fund as a part of the world economic outlook exercise should not be as comprehensive or detailed with respect to individual countries as papers prepared for surveillance.

Mr. Kafka stated that he agreed with the Chairman's most recent remarks and with Mr. Grosche.

Mr. Sengupta recalled that in a G-10 report published in 1985 it was stated that pressure through publication was one of the principal instruments of surveillance over industrial countries. He agreed with Mr. Kafka that surveillance was a function of the Executive Board, while the published World Economic Outlook document was a staff paper.

Mr. Templeman said that he agreed with the Chairman and Mr. Grosche. There were differences of opinion on the issue of publication. In his view, surveillance and the publication of the world economic outlook paper were separate, although related, matters.

Mr. Yamazaki remarked that he was interested in Mr. Dallara's proposal to include the scenarios as an appendix to, rather than as part of the main text of, the published World Economic Outlook document. The staff's proposal to present the scenarios in a qualitative way was acceptable.

Mrs. Ploix said that she favored publication of the staff paper, provided that quantitative material and very specific qualitative statements on individual countries were excluded.

Mr. Sengupta stated that his position was the same as that of Mrs. Ploix.

Mr. Kafka said that he shared Mrs. Ploix's concern that qualitative statements could cause difficulties, in terms of the reaction by the markets, akin to those of quantitative statements. In addition, he agreed with Mr. Zecchini that it was important to include in the published version of the world economic outlook the discussion in the staff paper on the debt problem.

The Chairman commented that he fully understood the concerns that had been expressed about the published version of the World Economic Outlook. Management and staff would make every effort to meet those concerns. At the same time, care should be taken to avoid significantly reducing the Fund's general distribution of information to the public. Experience showed that much of the unpublished information in the World Economic Outlook eventually found its way to the markets.

The Deputy Director of the Research Department noted that the statistical appendix included information on the consumer price indices and unit labor costs in the major industrial countries. The tables included in the main staff paper traditionally highlighted only some of the data that were available in the statistical appendix. In coming world economic outlook papers the staff would include in the table on inflation consumer price indices together with GDP price deflators for the major industrial countries. The present statistical appendix also included data on unemployment that typically had not been abbreviated in a table in the main staff paper, but the staff would include such data in future staff papers.

Mr. Zecchini said that the relevant table in the main paper probably should not include the word "inflation" in its title. It would be better to have a title that referred specifically to the variables that were covered by the table, including GNP deflators and consumer price indices.

Mr. Sengupta commented that it was not clear to him what accounted for the difference between the growth rates in the staff's scenario based on policy adjustments and the comparable scenario in the 1987 World Development Report. As he understood it, the Fund's scenario--which included a growth rate for developing countries of 4.7 percent--was based on specific assumptions about the elasticity of developing country exports to changes in the rate of economic growth of the industrial countries. He wondered what the outcome would be if the scenario was based on specific consumptions concerning the amount of investment that was required in developing countries--and the associated required savings--to achieve a particular rate of economic growth in developing countries. In that connection, he also wondered whether any gap in the projected required savings and investment in developing countries could be a parameter for estimating the amount of recycling that would be needed from industrial countries to sustain the needed investment and economic growth in developing countries. In other words, it would be useful to formulate a scenario based on the developing countries' point of view; accordingly, the scenario would be based on a particular rate of economic growth for developing countries that was considered desirable and feasible, and the scenario would suggest whether it would be possible to sustain that rate of growth by the projected flow of resources from the industrial countries to the developing countries.

It was the business of the Fund to make pronouncements on the sustainability or desirability of the path of exchange rates, Mr. Sengupta considered. Presumably the staff was in a position--owing to its expertise and the model that it had developed--to take a position on the sustainability and desirability of the path of exchange rates. Some member countries probably would not wish the world economic outlook paper to be published if it contained the staff's views on the sustainability and desirability of the path of exchange rates, but he himself would not mind if such a paper was published. The medium-term scenarios that the staff had developed need not be published; alternatively, a modified version of the scenarios--excluding data on individual countries--could be published. The main goal was to have the medium-term scenarios be used by member countries in the making of their policy decisions. In that connection, the availability of the staff's views on the sustainability and desirability of the path of exchange rates would certainly be helpful.

The Director of the Research Department said that the staff would work on the kind of alternative scenario that Mr. Sengupta had described. The scenario would explore the policies that were needed in industrial countries in order to ensure a particular rate of economic growth in the developing countries. Those policies would probably have to be designed to generate a flow of capital that was sufficient to achieve the desired rate of economic growth in the developing countries. However, it would take adequate policies by both the industrial and developing countries to generate a sufficient flow of capital to the developing countries.

The staff certainly had views on the appropriateness of the path of exchange rates and was of course willing to discuss them, the Director of the Research Department remarked. The sharing of those views was one of the purposes of the series of informal sessions on exchange rate developments that had been held. The staff would continue to share its views on future occasions.

The Chairman made the following summing up:

Our discussion on Friday and today has covered a wide range of topics. I will organize these summary remarks around four main themes that were touched on in the interventions of most speakers. These are: the nature of the short-term economic outlook; medium-term prospects and policy issues in industrial countries; how to deal with debt problems and reinvigorate the growth process in the developing world; and questions of international cooperation.

1. <u>Economic prospects in the short term</u>

Directors agreed with the staff that there were important uncertainties in the short-term outlook. Most speakers felt that moderate growth was likely to continue over the next year or so. They noted that recent indicators of output in industrial countries suggested some rebound from the more sluggish performance early in the year. Moreover, it was pointed out that underlying rates of inflation were relatively subdued in most countries and that there did not appear to be serious signs of cyclical strain. The fact that growth estimates for the developing countries had generally been revised upward was also regarded as an encouraging sign.

A number of Directors, however, felt that the staff's projections might turn out to err on the optimistic side. These Directors noted that inflation has shown some signs of picking up in the

United States and that business activity has been sluggish in several countries whose currencies have appreciated. Moreover, interest rates have shown a tendency to rise and the debt situation remains fragile. Some of these Directors also pointed out that, even if the staff's projections were to materialize, this would still constitute a considerably less satisfactory economic performance than had been considered necessary to deal with problems confronting the world economy. The continuation of growth at an annual rate of below 3 percent in the industrial countries meant that the economic environment facing the developing world would remain difficult. Progress in ameliorating the debt situation would therefore continue to be slow.

2. <u>Medium-term prospects and policy issues in industrial countries</u>

Directors welcomed the staff's analysis of economic policy interactions through the development of alternative scenarios and the greater use of indicators. It was felt that the approach pursued was a helpful one that could be extended in subsequent WEO exercises. Some speakers asked that the coverage of alternative scenarios be extended to countries and country groups outside the three major economies.

Most Directors drew attention to the continued sizable external payments disequilibria under the "accommodating finance" scenario, in which policies were assumed unchanged, and interest rates and exchange rates were assumed to remain constant. There was general agreement that payments disequilibria of the projected size were unsustainable. If no action were taken, therefore, there could be a number of adverse consequences, including renewed exchange rate instability, higher real interest rates, a slowdown in world economic growth, and a rise in unemployment and protectionism. Such an outcome would be particularly damaging to developing countries and to efforts to strengthen the management of the debt situation.

There was no dissent from the proposition that, in dealing with fiscal and current account imbalances, policies need to be framed in a medium-term context, carefully avoiding fine-tuning. Nevertheless, many Directors noted that the major countries find themselves in different positions, which, naturally, influences the process of policy choice. As far as the United States is concerned, it is generally agreed that the large size of the federal fiscal deficit remains a major factor clouding the economic outlook. Directors were encouraged by the substantial progress that had been made in reducing this deficit in fiscal year 1987. Nevertheless, if the intended improvement in the net foreign balance of the United States is to occur, it was considered essential for the absorption of savings by the public sector to continue to shrink at an adequate rate. Fiscal correction in the United States was also viewed as necessary to restore confidence in the future stability of exchange rates; to enable a medium-term reduction in real interest rates to occur; and to provide a more healthy environment for the solution of the debt problem. As far as those countries that have strong external positions and that have made better progress in strengthening their fiscal positions are concerned, Directors stressed the importance of achieving a sufficiently robust rate of growth. There was widespread agreement that Germany and Japan need to aim for a rate of growth of domestic demand that is faster than the underlying growth in their productive potential. Directors generally endorsed this element of the staff's indicators analysis. Most speakers felt that the intentions which Japan and Germany announced at the time of the Louvre meeting of the major industrial countries were appropriate. A number of Directors underlined the importance of these countries standing ready to take further action to sustain demand, should this become necessary. They also considered it desirable for those smaller industrial countries and developing countries that had large surpluses to ensure that the growth of output and imports made an appropriate contribution both to their own economic objectives and to the global adjustment process.

The importance of structural or microeconomic policies received special emphasis in the interventions of many Directors. It was pointed out that structural reforms are essential if faster growth and lower unemployment are to be achieved on a durable basis and without inflationary consequences. Such reforms will help underpin the growth of saving and investment and improve the allocation of resources. Close attention must be paid to the need to deal with rigidities, market imperfections and protectionism, tax disincentives, creeping subsidization, etc. Improved market efficiency was also felt to be helpful in increasing the responsiveness of payments flows to shifts in competitive positions.

Given appropriate macroeconomic policies and a commitment to structural reforms, most Directors felt that exchange rate stability among the major currencies, along the lines of the Louvre Accord, would be conducive to effective adjustment and strengthened business confidence. Some Directors, however, pointed out that external imbalances seemed likely to remain at unsustainable levels, even in the staff's relatively favorable third scenario. These Directors therefore considered that additional policy actions, beyond those currently contemplated, would be required if a sustainable payments pattern were to be achieved without the need for further exchange rate adjustment.

3. The debt situation and economic growth in developing countries

With respect to the debt situation, a spectrum of views was apparent in the discussion. On the one hand, a number of Directors felt that recent trends were reasonably encouraging. They pointed out that growth had resumed in most indebted developing countries; the decline in investment ratios had been arrested; there were signs that the "menu approach" to financing was being welcomed; and the global environment was not too unfavorable. At the other end of the spectrum, several Directors took a quite different view. They pointed out that growth was still low in a historical context, and had completely bypassed whole groups of countries, such as those in sub-Saharan Africa. At the same time, investment was at a level that barely maintained constant the existing capital stock in many countries. Private lending remained at very low levels, and the prospects for an increase in such lending did not appear very bright. Furthermore, the recent rise in the LIBOR has meant a deterioration in the outlook for debt servicing.

Despite this disparity in the assessment of the current situation, there are, I believe, a number of propositions that command widespread support. The first is that the basic objectives of the cooperative debt strategy remain broadly valid. These are: the need for growth-oriented adjustment measures in the indebted countries themselves; the preservation of a supportive world environment and an open trading system; and the maintenance of an adequate flow of private and official finance. Not only are these aspects of the debt strategy still valid, they are fundamentally interdependent.

A second point of agreement is the continued need for a case-by-case approach to the problems of heavily indebted countries. In particular, it is recognized that low-income countries cannot find a solution to their difficulties by incurring further debt at commercial rates. Realism demands that effective adjustment programs in these countries be supported by additional flows of concessionary aid. The potential role of the structural adjustment facility was mentioned by a number of speakers in this connection, as well as the desirability of promoting concessional flows through other mechanisms.

Middle-income developing countries are in a different situation. Nevertheless, they too need capital inflows if adjustment programs are to realize their economic potential and meet the test of political feasibility. All Directors want to see a durable increase in the flow of resources from abroad to support the development effort in these countries. Many Directors feel this can best be achieved on the basis of strengthened adjustment policies leading to a gradual return to normal market access. Any other solution, these speakers felt, would undermine adjustment incentives and risk cutting the indebted countries off from access to credit markets for a protracted period. Other Directors, however, doubt that strengthened adjustment policies alone are sufficient to unlock renewed flows of funds. Most Directors stressed the need for negotiated understandings between debtors and creditors, with the active participation of the international institutions and governments of creditor countries. The objective of such understandings would be to create a situation in which indebted countries could afford to borrow for potentially productive investments. Several Directors pointed out that if developing countries are enabled to obtain additional financing, it would not only support their own development efforts, it would also strengthen economic activity in the industrial world and, perhaps, facilitate the correction of current account imbalances among the major countries.

4. International cooperation

In conclusion, let me add a few words on international cooperation. This theme was touched on by many Directors, with particular reference to two topics: protectionism, and the use of indicators in international policy coordination. The dangers of a relapse into intensified protectionism were underlined by virtually all speakers. It was pointed out that trade frictions had been steadily increasing for a number of years. Protectionism imposes obvious costs in the form of reduced efficiency in the international allocation of resources, a less efficient balance of payments adjustment mechanism, and a diminished capacity of indebted countries to grow out of their current difficulties. At the same time, it carries more insidious dangers in the potential for escalation to a trade war and the threat of provoking a serious recession. All speakers called once more for members' authorities to exercise economic statesmanship and to resist pressures from sectoral interests for protection.

One vehicle for creating an economic climate that is conducive to resisting protectionism and promoting better balance and higher growth in the world economy is to improve the coordination of economic policies of major countries. The more systematic use of indicators as a means for exercising Fund surveillance can help in this regard. Directors welcomed the progress that had been made in the staff paper in extending the use of economic indicators. They favored the further development of this work with a view to arriving at more specific policy recommendations.

2. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR SEPTEMBER-NOVEMBER 1987

The Executive Directors considered the designation plan (EBS/87/186, 8/31/87) and the operational budget for the quarterly period from September to November 1987 (EBS/87/187, 8/31/87, and Cors. 1 and 2).

The staff representative from the Treasurer's Department indicated that SDR 60 million in currency transactions anticipated before the end of the quarter had not occurred. Thus, the distribution of the use of currencies differed somewhat from that shown in Table 4 of EBS/87/187.

Updated tables would be issued to show the actual use of currencies and amounts used in designation, under the operational budget and designation plan, respectively.

Mr. Nimatallah expressed concern that the increase in the ratio of overdue repurchases to adjusted usable ordinary resources might hamper efforts toward increasing the resources of the structural adjustment facility. He appealed to all countries concerned to meet their obligations to the Fund as soon as possible.

Mr. Goos associated himself with the concerns expressed by Mr. Nimatallah. He supported the decisions.

The Executive Board then adopted the following decisions:

a. SDR Department - Designation Plan for September-November 1987

The Executive Board approves the designation plan for the quarterly period beginning September 14, 1987 as set out in EBS/87/186 (8/31/86).

Decision No. 8690-(87/136) S, adopted September 14, 1987

b. Operational Budget for September-November 1987

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/87/187 (8/31/87), page 3, footnote 1, and the operational budget for the quarterly period beginning September 14, 1987, as set out in EBS/87/187.

Decision No. 8691-(87/136), adopted September 14, 1987

3. TRADE POLICIES - RECENT DEVELOPMENTS AND ISSUES

The Executive Directors considered a staff paper on recent developments and issues in trade policies (SM/87/191, 8/4/87).

Mr. Nimatallah made the following statement:

I very much welcome this opportunity to discuss the issues behind trade problems. The members of this organization must be aware of the compelling and urgent need to enhance trade, and improve the global allocation of resources. This is a tall order. Nonetheless, the time has come for a genuine effort by the Fund to play its role, side by side with the CONTRACTING PARTIES to the General Agreement on Trade and Tariffs (GATT), in addressing the fundamental causes of trade protection.

Today's discussion is meant, primarily, to identify the impact of industrial policies of developed countries on developing countries, despite the fact that the staff paper (SM/87/191) deals with trade protectionism, in general. The emphasis of the Board discussion should be on ways to prevent countries from resorting to protection, and urging them instead to adjust.

The Fund should not stand by and place the burden of eradicating protectionism totally on the GATT; the Fund has a great deal to offer in this area. It has the responsibility to go beyond the symptoms and address the fundamentals behind the recent deterioration in the trade climate. Countries must be convinced that it is in everyone's self-interest to avoid short-sighted, protectionist solutions and to opt, instead, for long-term structural adjustment.

The close links between trade, finance, and structural adjustment suggest that industrial policies restricting trade flows have harmful effects on developing countries, both directly by limiting market access, and indirectly by aggravating structural and macroeconomic imbalances for the world economy as a whole. This condition, if allowed to continue, is bound to compromise world growth, limit opportunities for developing countries to overcome their balance of payments and debt difficulties, and discourage new investment and diversification in those countries. It will also raise serious questions about the appropriateness of an outward-oriented strategy for the developing countries, particularly those with debt service burdens. Indeed, I see the recent rise in protectionist pressures as the one factor that could undermine future progress in implementing what is fundamentally a sound debt strategy.

The first order of business is, therefore, to diagnose the root causes of the intensification of protectionist pressures, particularly in industrial countries. A candid assessment of the situation suggests that the prevention of protectionism is very much within the Fund's sphere of competence. Let me elaborate.

Pressures for protection are largely symptoms of deficiencies and imbalances in nontrade areas, including labor market rigidities, distortive subsidies, and, more generally, inadequate macroeconomic and structural adjustment in the economy.

Large macroeconomic imbalances are eroding the ability of governments to resist domestic protectionist sentiments. Sensible economic managers know that fiscal deficits and high public debts reduce governments' flexibility in dealing with economic problems and eventually lead to unsustainable external imbalances. In the absence of adjustment, more of a burden falls on other policy tools and, as a result, protectionist sentiments increase. More often than not, governments succumb to these domestic pressures and impose protectionist measures instead of adjusting. Urging countries to accept the need for macroeconomic adjustment at the outset will help prevent the emergence of protectionism; in this context, the Fund has a mandate to play an important role.

Furthermore, large structural distortions and rigidities are also a serious problem behind the rise in protectionism. For example, the decline in manufacturing in general in industrial countries has been causing widespread concern in some of those countries; the question is, why has manufacturing declined relative to services as a source of GDP?

In large part, the decline in manufacturing is a natural development for which there are numerous historical precedents. What we are witnessing is a shift in comparative advantage in the industrial countries from manufacturing to services. This shift is healthy and should be encouraged. Unfortunately, the shift is being resisted by pressure groups representing shrinking industries. These pressure groups do not fully realize that the average costs of manufacturing in the industrial countries have been rising relative to those in certain newly industrialized countries (NICs). This cost differential has been due to ever-increasing wages demanded by labor unions in the industrial countries, and to higher real interest rates brought about by government borrowing to finance ever-growing fiscal deficits.

Unfortunately, instead of the industrial countries concentrating on maintaining reasonable average costs and on improving the quality of their goods through more research and development, they are blaming the NICs and other developing countries for having an "unfair advantage" of lower average costs of production. The Fund has a great deal to say in this area as pricing and costs have much to do with the competitiveness of each Fund member.

Another structural problem is unemployment in the industrial countries, particularly in Europe, where structural rigidities still prevail. Unemployment, of course, is due to demographic, social, structural, technological, and various economic changes. Since the changes behind unemployment are of a long-term character, they therefore require long-range solutions. Unfortunately, however, labor unions and other groups press for more jobs and short-term solutions through higher fiscal spending and the perpetuation of inefficient enterprises.

Part of the difficulty that is delaying the courageous stance that needs to be taken against macroeconomic imbalances and structural rigidities in industrial countries is the periodic need for elections, which allow pressure groups to use the democratic process to promote their own narrow interests. I am not, of course, against democracy and elections, but there must be a better way to preserve political democracy and economic efficiency. With more national education and international pressures, governments can gather national and international support for resisting unhealthy protectionist trade bills promoted by these selfish interest groups. Actually, in the United States, President Reagan has been successful in resisting such bills by speaking to the public at large, pointing out the potential high costs of these bills to consumers. Good progress on structural adjustment has helped his administration in this endeavor.

At present, the economic cost of succumbing to pressure groups and delaying structural adjustment is appallingly high, both to the countries involved, and to the world at large. For example, the proposed Textile and Apparel Trade Bill currently under discussion in the U.S. Congress would cost consumers an estimated $10 billion a year, if adopted. All that, to protect about 47,000 jobs. Unfortunately, I do not have the quantification of the potential cost of this proposed measure to trading partners of the United States in the developing world. I hope the staff, as it pursues these matters, can quantify the enormous loss to the world as a whole due to these trade bills promoted by various interest groups. Of course, I do not mean to single out the United States in citing these examples; it so happens that data on the United States are more readily available. More quantifications of the cost of protection are needed on other industrial countries' protection acts, at least for educational purposes.

Clearly, the Fund can, and should, play a major role over the coming years in promoting preventive measures in each member country. I cannot agree with those who say the problem of trade is solely the problem of the GATT. I think the GATT has the role of promoting curative approaches, while the Fund has the role of promoting preventive measures. The Fund should use its surveillance function to ensure that the policies in industrial countries are consistent with, and conducive to, global economic growth; that imbalances are brought under control; and that the world economy is made more hospitable to free trade.

Too much is at stake for the Fund's approach to be other than blunt and direct. It is incumbent upon this organization to ensure that structural adjustment is carried out with more vigor in the industrial countries, as this, in itself, will further enhance growth potential and reduce the need for protection. Inefficient enterprises, particularly in the industrial sectors in the developed countries, pose a great burden on those countries themselves, and on the areas to which they should migrate. To hide behind the shortsighted argument of "unfair advantage" is, as the staff puts it, to discredit the very basis of trade, namely, differences in comparative advantage. In this context, I welcome the recent trend toward trade liberalization in the developing countries. The Fund has played, and should continue to play, a helpful role in encouraging this trend.

Over the last several years many of my colleagues and I have been arguing tirelessly for exchange rate stability within limited zones. After all these years, the major currency countries have committed themselves to exchange rate stability, and it seems to be working well and to everyone's benefit. I am hoping now that my colleagues will take it upon themselves, as I do, to maintain an unflagging effort over the coming years to pursue the important issue of freedom of trade. We should not rest until free trade becomes a collective commitment of all members of the Fund.

I agree with the staff that there are two major avenues for the Fund to follow. One is surveillance, and the other is publicity. For the purpose of securing the structural and macroeconomic adjustment needed to prevent protectionism, the best means, of course, is Fund surveillance, both bilateral and multilateral. The Fund should take a more vigorous stance in urging industrial countries to accelerate their efforts to reduce structural rigidities. There should be more quantified sections in staff reports for Article IV consultations and the World Economic Outlook to identify reluctant countries and put more pressure on them. The world economic outlook surveys should also atempt to quantify the repercussions on the rest of the world of production policies in the major industrial countries. I have not seen, so far, for example, a full consideration of the distortive impact of subsidies. It would be helpful to identify the true cost of subsidies in terms of wasted resources in Article IV consultation reports and in the World Economic Outlook.

When it comes to countering the pressure of domestic interest groups, I think the Fund should go all out, through international and other public forums, to promote and to disseminate information on the benefits of structural adjustment and free trade. This should be a persistent educational effort, led by the Managing Director, and based on a quantification and a candid assesment of the potential costs and benefits.

It is pertinent here to coordinate the Fund's efforts closely with those of other multilateral organizations, particularly the GATT and the World Bank. It would be helpful if the Fund gave its encouragement and support to the GATT in preparation for the forthcoming round that will emphasize adherence to the "standstill" and "rollback" agreement. The World Bank has been in a good position to conduct sectoral studies that can help feed into Fund research. I hope to see continuity in following up on country behavior between consultations, as well as strengthened in-house research on country industrial policies, in particular, and protectionist policies, in general, and their direct and indirect impact on trade, actual and potential. Based on this research, two reports could be issued, one in the form of trade information notices produced perhaps on a quarterly basis; and another on an annual basis, to be discussed by the Board just like the papers on the international capital markets. The Fund should follow developments closely on both capital and goods markets.

The Fund has the obligation to step in and safeguard free trade, as this is within its sphere of competence, according to the Articles of Agreement. The Board bears the responsibility, now, to take a positive attitude toward urging the removal of all the fundamental impediments to free trade, particularly structural rigidities. Several European countries, in particular, do not seem to be able to reduce their unemployment by economic expansions, simply because they are burdened with structural rigidities that hamper their growth potential. They seem to resort to protectionism, depriving themselves and the rest of the world of more growth and prosperity, rather than facing the inevitable and adjusting structurally.

It is high time that both developed and developing countries carry out their responsibilities fully. The industrial countries, especially the large ones, have delayed their structural adjustment long enough, causing substantial harm to themselves and to their trading partners. The time has come for them to reverse this and practice what they so convincingly preach. I am sure they will be the first to benefit from a better global allocation of resources and trade expansion.

Extending his remarks, Mr. Nimatallah said that owing to the growing interrelationships between the industrial and the developing countries, it was clearly important to sustain trade as well as financial flows. It seemed that the Fund could do more to encourage international trade, if Executive Directors recognized that fundamental imbalances, and the deficient policies used to correct those imbalances, were creating the pressure for protectionism on leaders and governments of member countries. The Fund should take a firm view that those imbalances had to be corrected, and that less protectionism should be resorted to, in order to sustain free trade.

Mr. Hogeweg made the following statement:

The staff paper provides highly disturbing reading for someone who is not regularly occupied with trade policy matters. What is still more disturbing is that while it is generally recognized that protection and trade restriction are economically not wise--to put it mildly--special interests and pressure groups manage to gain the upper hand time and again. The question today is what the role of the Fund can be in limiting trade restrictions, recognizing that the GATT has primary responsibility in this field and that each organization should give most attention to its own particular sphere of interest. It should also be recognized that Fund reports are less widely read by ministers and officials responsible for trade policy than would be desirable.

Effective surveillance by the Fund of macroeconomic policies, by contributing to realistic exchange rates, could be conducive to trade liberalization or the avoidance of protective measures. Of course, trade liberalization should not be made dependent upon signs of improved macroeconomic imbalances. In discussing the previous staff paper on protection and liberalization (SM/87/43, 2/3/87) in March, Directors agreed with its conclusion that, in general, protection does not help in diminishing current account imbalances. The Fund could actively note this point in public, as well as, when appropriate, in discussions with authorities during Article IV consultations.

I agree that efforts could be made to devote more attention to the costs of protection and to trade liberalization, as an element of the policy advice which we give. That holds not only for developing, but certainly also for industrial countries, although page 18 of the staff paper suggests otherwise. In this connection, while the Fund's influence is most effective in countries that use the Fund's resources, protectionism is the greatest in industrial countries. Therefore, it is not useful to make a general statement that more trade liberalization is good. But to specify it for particular countries may be a lot of work for staff missions and for the staff in general, which cannot be given more responsibilities without being expanded. Perhaps the Board can decide first what amount of resources may be devoted to this work, so that the staff can then make a proposal on how much it can achieve in this field. At any rate, the Fund should make as much use as possible of GATT data.

Last March this chair suggested that a fact sheet on trade decisions by member countries be made available biannually to the Board prior to Interim Committee meetings. We fully support the suggestion made in the staff paper to use a comparable GATT document for that purpose, possibly in its restricted version.

Finally, on page 22 of the paper, I read that agreement by countries within the context of the Uruguay Round to avoid or reduce the use of trade restrictions for balance of payments purposes--which is allowed under GATT rules--would "encourage sustained import liberalization efforts and enhance the prospects for addressing balance of payments problems with more appropriate policies." Would it not be useful and helpful if the Fund and in particular the Board were to bring this issue to the attention of the parties to the Uruguay Round?

Mr. Foot said that his authorities remained very concerned about rising levels of protectionism, which thus felt needed to be reduced in both developed and developing countries, with respect to manufactured goods, agriculture, and services. They welcomed the focus of the staff paper on the benefits of trade liberalization to both developed and developing countries. Also, they accepted that more open trade had a vital role to play in supporting the debt strategy.

Focusing on the role of the Fund in trade policies, with respect to developed countries, the Fund should put more resources into the surveillance of trade policies during the normal Article IV consultation process, Mr. Foot said. While that would be unpopular with some of those surveilled, it was necessary if surveillance was to have due substance. It would take some time for the Fund to develop the necessary expertise and experience. Priority should be placed on the work commissioned by the Development Committee on the costs of protectionism; they would likely be found to be fairly high, although the extent to which soundly based quantitative estimates could be derived was questionable.

With regard to developing countries, he could strongly support the suggestions made in the staff paper on further examining the trade content of adjustment programs supported by Fund resources, Mr. Foot indicated. While such an exercise would also be unpopular in some quarters, if only because the World Bank paid a better reward for dismantling trade barriers--through adjustment lending--than did the Fund, faster trade liberalization would be in the interest of many developing countries and, particularly, would contribute to curbing inflationary pressures.

The Fund's role in the work of the GATT required strengthening, Mr. Foot remarked. Fund staff should be prepared to provide more pointed opinions on balance of payments prospects and the merits of trade restriction justifications for balance of payments reasons to the GATT balance of payments committee, while maintaining confidentiality. Although there was much room for improvement in the GATT procedures themselves, such an increased contribution from the Fund was supported by the U.K. authorities.

Clearly, the Fund needed to devote more skilled resources to work on trade, Mr. Foot said. It would be interesting to know the percentage of Fund staff resources currently devoted to that subject--most likely less than one-half percent of the Fund's total labor force--and also what comparable figures in the World Bank might be. The Fund staff was large enough that staff redistribution could take place; not enough attention was being paid to trade issues, given the history of the Fund and its present needs.

Mr. Reddy made the following statement:

> I propose to make a few general comments before addressing the main issue--namely, the role that the Fund and other multilateral institutions can and should play in securing a more open trading system.
>
> I would like to begin by characterizing protectionism as the most important cooperative issue facing the international community today. The costs of protectionism, particularly the welfare loss

associated with it, are well known to us all. Yet, protectionism is on the rise, and the main reason is political. In many countries, there is a lack of political will to deal with major macroeconomic imbalances, and there is also a tendency to yield to various pressure groups. Industries facing structural problems are protected in part because of political concerns regarding employment. In these circumstances, I believe that protection is likely to continue until there develops a strong political commitment against it in the industrial countries. However, this does not mean that serious attempts should not be made by international agencies and the world community to contain the spread and intensification of protectionism. Indeed, commendable efforts have already been undertaken, and there are good reasons for them to be intensified further.

I note from the staff report before us that in the 1980s there has been a strong growth in protectionism in industrial countries at a time when world output and trade have slowed down. The number of protectionist measures has increased, the range of industries subject to protection has been broadened, and there is a more rigid application of trade procedures. I note, in particular, that there has been a sharp increase in protectionism in the United States. The evidence is presented very clearly in the table in Annex 1 of the staff paper, which gives indices for nontariff measures in industrial countries between 1981 and 1986. According to this table, nontariff barriers in the United States have increased by 23 percent at a time when nontariff barriers in most industrial countries have either declined or increased only marginally; the increase in protectionism has been in both traditional and new sectors. Because of the large size of its market, the United States has also succeeded in getting foreign exporters to exercise voluntary export restraint and convincing some trading partners to use the United States as a source of imports to help reduce bilateral trade imbalances, thereby causing difficulties to third countries. Given the size of its economy, and its high income level, the United States must play an important leadership role in fostering freer international trade.

As far as the developing countries are concerned, considerable progress has been made with trade liberalization, especially in countries which have adjustment programs with the Fund. In other developing countries, the move toward liberalization has been impeded by balance of payments problems arising from weak external demand and declining terms of trade. Serious external debt problems in the 1980s have also contributed to a lack of progress in trade liberalization by some developing countries. Of course, one must not forget that there are also countries in the developing world which can boast of having the lowest levels of protection--for example, Singapore, Saudi Arabia, and Hong Kong.

The main issue before the Board today is how to strengthen multilateral surveillance of trade. I believe that this is a matter which falls primarily within the jurisdiction of the GATT, and that efforts should be made to improve the effectiveness of GATT in dealing with trade problems. In this context, I note that during the Uruguay Round the functioning of the GATT will be examined, including its surveillance over trade policy, in order to make the GATT more effective in resolving trade problems and in ensuring a more open trading system. I welcome the proposed review of GATT surveillance procedures.

On the role of the Fund, the Fund has been actively promoting trade liberalization in its bilateral and multilateral surveillance activities. While they cannot be quantified, I have no doubt that these activities have produced positive, though limited, results. The Fund has been more successful in securing trade liberalization and more desirable macroeconomic policies in developing countries than in industrial countries. As has been noted on many occasions, Fund surveillance, and therefore its influence on members' policies, has been asymmetrical. A majority of the countries which have adjustment programs with the Fund have undertaken far-reaching trade reforms, but unfortunately the Fund's influence on the trade policies of other countries has been very limited. Therefore, while I am not opposed to the staff proposal for a further examination of the trade content of adjustment programs supported by the Fund, this should not lead to even greater asymmetry in the adjustment process, especially in the trade policy area. Given the relatively high levels of income and employment in industrial countries, the focus of the Fund's attention in the course of its surveillance activities should be on those countries, which are in a much better position to liberalize imports than developing countries.

There have been occasions when macroeconomic imbalances have been used to justify trade restrictions. The Fund must, therefore, continue to focus its attention on such imbalances and structural distortions in the Article IV consultations. I would also welcome greater attention to trade policy problems and a greater quantification of the adverse effects of protection, but would caution against going so far as to duplicate the work of the GATT. The primary responsibility for work in the trade area rests with the GATT, and the Fund should only complement the efforts of that organization. For example, the Fund should not circulate its own six-monthly fact sheet on trade developments to the Board. It would be sufficient if the very comprehensive biannual survey of major trade developments prepared by the GATT could be circulated to the Board and also to ministers prior to the meetings of the Interim and Development Committees.

As far as the multilateral surveillance activities of the Fund are concerned, these activities provide a good opportunity for mobilizing international opinion against protectionism. The

Fund should continue to use the multilateral surveillance procedures for highlighting the costs associated with protectionism. I can also support the publication of a comprehensive trade report as part of the Fund's efforts toward trade liberalization.

Mr. de Groote made the following statement:

The staff paper before us contains a wealth of interesting data, together with convincing arguments on the damaging effects of protectionism. The beneficial effects of increased international commerce on the standard of living cannot be overestimated. The economic growth and employment prospects of small countries like those in our constituency depend especially heavily on international trade. We see three general conclusions that can be drawn from the staff report.

First, we seem to have entered upon an era of neo-protectionism, in which new and more subtle, sophisticated and dangerous trade barriers are replacing traditional blunt instruments like tariffs and quotas, which are too transparent and quantifiable. Countries are increasingly wary of possible retaliation and compensatory fines. The new instruments therefore seldom transgress the letter of the GATT code. Most countries now exhibit great creativity in devising their protectionist measures, on occasion even exploiting the GATT rules which provide loopholes in the form of exceptions to the principle of free trade. For example, the frequently invoked "safeguards clause" contains such terms as "temporary," "sudden," and "major damage," which are not precisely defined.

Second, the principle of nondiscrimination is losing its potency and giving way to that of the creation of bilateral trade equilibria, placing in question the fundamental principle of the "most-favored nation." Countertrade practices whose main raison d'être is the lack of liquidity in certain regions of the world also seem to lend strong support to the proliferation of bilateralism, and at some point it might be useful to examine these practices more carefully at the Board.

Third, it is evident that these more sophisticated methods of protectionism have worsened the situation. When tariffs were the main tools of protectionism, prices were a principal weapon in the battle for the domestic market, a state of affairs which basically served the general interests of the consumer. But where quantitative trade restrictions such as quotas or voluntary export restraints are applied, foreign competitors cannot expand sales by reducing prices. Another advantage of tariffs over quantitative restrictions is that any yield from the higher prices they produce in the domestic market remains inside the country in the form of extra income for the Government.

The implications of the foregoing for the Uruguay Round can be summarized as follows. The primary challenge of these trade negotiations is the re-establishment and strengthening of GATT principles. While we are strongly opposed to protectionism, we feel that a certain flexibility is warranted. For instance, strong arguments for protection may exist when a competitive advantage is based on low wages and poor social benefits for workers. In addition, there is sometimes a case for protecting infant industries. Certain temporary measures which slow down the whole process of adjustment have sometimes succeeded in cushioning the social impact of production shifts from one region to another. But we maintain, of course, that these few exceptions need to be addressed with extreme caution.

As to the Fund's role, we believe care must be taken to complement, and not duplicate, the work of the GATT. We strongly advocate increased collaboration between the Fund, the World Bank, and the GATT on trade issues. Among useful results of such a team's work might be a deeper examination of trade issues in staff reports for Article IV consultations, and greater attention to the impact of trade issues on Fund programs.

We would also urge the Fund to take advantage of its reputation, the persuasive power of statistics, and the media's interest in the issue to launch an information campaign for consumers about the costs of protectionism. Once backed by public opinion, governments would certainly find it much easier to resist the pressures exerted by certain interest groups. I was most interested by some of the remarks made by Mr. Nimatallah at the end of his statement. It is certain that special attention has to be given in the European countries to the fact that the most obvious way to fight unemployment is by the elimination of structural rigidities, and especially trade rigidities. Through the media, the public could also be made aware of contradictions in the behavior of certain governments. For instance, it could be explained that it is virtually impossible for a government to favor adjustment with growth while simultaneously supporting protectionist measures against the adjusting countries; that might be quite a good theme for the Managing Director to develop in his address to the Annual Meeting. Finally, the Fund should continue its efforts in support of flexible exchange rates in order to deprive countries of the excuse that they are forced to resort to protectionism for balance of payments reasons.

I would also like to support the idea developed by Mr. Foot, that we might consider devoting a somewhat larger proportion of Fund resources to trade issues. Admittedly, other areas also require additional Fund resources, but the proposal that less frequent consultations be held with those countries which do not significantly affect the functioning of the international payments system might be a possible solution.

Mrs. Ploix made the following statement:

Since the main analytical issues raised by protectionism were already reviewed last March, I will be very brief on this aspect of the staff paper. Rather, I will concentrate my comments first, on the latest developments in the ongoing round of negotiations, and second, on the role the Fund should play in dealing with trade issues.

As regards the ongoing round of negotiations, which is proceeding well, I just want to recall the two basic principles agreed upon in Punta del Este--a very firm commitment both to renounce any new restrictive measures and to terminate existing distortions to international trade. As noted by the staff, these commitments on "standstill" and "rollback" have, on several occasions, received strong support at the highest political level: in February, the Louvre Accord recalled that all attempts made at addressing economic difficulties by raising trade barriers are bound to fail; in May, the OECD Ministerial Meeting made a meaningful opening on agricultural policy; and finally, in June, the Venice Summit emphasized that protectionism is a counterproductive approach.

As to my country's position in these negotiations, I will only reiterate my authorities' very positive stance. They consider that an opening up and a further liberalization of international trade would have beneficial effects on the efficiency of national economies. Specifically, they are convinced of the negative overall impact of protectionism on unemployment and investment decisions. Likewise, they consider that an open trading system is a major prerequisite for an orderly management of the debt problem. The firm stance taken by the U.S. Administration against mounting protectionist pressures at home is also viewed by my authorities as a significant indication of the major industrial countries' determination on this issue.

On the role of the Fund in the trade area, I have no major difficulties with the approach followed by the staff in its paper. Within its own jurisdiction, the Fund is certainly in a position to assess and exert an influence on trade policies of its member countries. Since its surveillance, either bilateral or multilateral, covers the whole membership, one major objective should be to stress the importance for the industrial countries to lift, or to refrain from raising, protectionist barriers in order to facilitate growth for developing economies. Of course, this role can appear limited, since the Fund cannot avail itself of regulatory powers. Nevertheless, at least through moral suasion, this function exists and deserves to be preserved.

Furthermore, in the context of Fund-supported programs, it is clear that structural reforms in trade regimes should be, in many cases, an integral part of the adjustment process. This is still a complex area in which sensitive issues are at stake, thus making close collaboration with the World Bank all the more useful.

Regarding the documents to be prepared by the staff in connection with the Uruguay Round, one must be mindful of the Fund's limited human resources. Consequently, I am fully supportive of the suggestion made by the staff that a status report on the trade negotiations be made available only every two or three years. Like Mr. Hogeweg, I am also supportive of using GATT data as suggested in the staff paper. Moreover, full use of the available research capability of the World Bank and of the GATT is necessary; any duplication of work by the Fund must be avoided.

As for the relationships between the Fund and the GATT, my authorities are satisfied with the present situation. They particularly welcome the granting to the Fund of observer status to attend the Uruguay Round meetings. In this respect, it is not clear to me whether the Fund will have access to all the committees and subgroups. Perhaps the staff could clarify this point. While my authorities are agreeable to closer links like the ones mentioned above, each institution must maintain its identity and preserve its own specific role.

The Director of the Exchange and Trade Relations Department said that the Fund had observer status at only several of the GATT committees.

The Chairman urged Directors to encourage their countries' support of Fund observership in all committees of the GATT.

Mr. El Kogali made the following statement:

In recent years, international trade relations have been severely strained, while the structure of the overall trading system seems to have changed for the worse as protectionism gathers momentum in industrial countries. The relatively limited moves to liberalize trade have been offset by the proliferation or intensification of nontariff barriers and the implementation of other protectionist devices such as voluntary export restraints, bilateral, and sector-specific trade restrictions, including the Multifiber Arrangement and export subsidies. It is disappointing to note from the staff paper the increasing willingness of major industrial countries to take protectionist actions which directly contravene their multilateral obligations. Without doubt, these actions continue to pose a serious and growing threat to the multilateral trading system as well as to the longer-term sustainability of economic growth. The principle of comparative advantage, which forms the basis for efficient allocation of resources and balanced trade expansion, is thus gravely undermined.

Although it is difficult to quantify the adverse impact of protectionism on world trade, there is no doubt that its implications for the international economy have reached alarming proportions. For instance, the outcome of a 1978 simulation exercise reported in the IMF Pamphlet Series, No. 24--"The Rise in Protectionism"--indicates that the imposition of a 5 percent tariff or equivalent on all imports or manufactures by 13 of the largest OECD countries would engender a 3 percent decline in the volume of world trade, or $37 billion in money terms. The existing proliferation of trade restrictions might produce a more cumulative adverse impact on the growth of world trade, employment, and economic growth. For the developing countries, afflicted by heavy debt service obligations, the dangers of protectionism are more serious. If these countries are to overcome their economic difficulties, they must be able to export. By restricting the developing countries' access to their most important markets, protectionism ties one hand behind their backs. It depresses aggregate demand, reduces the supply of foreign exchange necessary for imports and debt service, discourages investment in the export sector, and limits economies of scale. In these circumstances, severe limitations have been placed on the outward-looking strategy that developing countries can pursue.

Despite the progress in the Uruguay Round, I am somewhat skeptical about the willingness of many governments to effectively implement measures designed to accelerate dismantling of trade restrictions. While many of them have proclaimed their adherence to a free and liberal world trading system, their actions have clearly not matched their ritualistic declarations. More often than not they yield to protectionist pressures and devise ingenious ways to restrict access to their markets. Unless governments adhere faithfully to the "standstill" and "rollback" agreements of the Uruguay Round, no real progress will be made in the global campaign to liberalize trade.

A matter of most serious concern to developing countries is the fact that the incidence of tariff and nontariff measures applied by industrial countries is relatively high in sectors in which developing countries have actual or potential comparative advantage. As the staff has noted, in recent years a number of developing countries have put into effect measures aimed at reducing restrictions on imports, within the framework of adjustment programs supported by the Fund, the World Bank, or both. The promotion of exports through a restructuring of domestic production has been a central objective of these measures. But the recent upsurge in bilateralism and other protectionist devices such as voluntary export restraints, quantitative import restrictions, tariff quotas, countervailing and antidumping duties, as well as advanced fixing of prices, jeopardize developing countries' trade liberalization efforts and their economic strategies. I endorse the staff analysis of the implications of the industrial countries' protectionist barriers for our countries, and urge all the industrial nations to adhere strictly to GATT principles and to make progress toward trade liberalization on the basis of comparative advantage. To achieve this, the industrial countries must now take strong initiatives to generate confidence among developing countries and ensure that the process of liberalization will be truly reciprocal in order that all may benefit from it.

I fully endorse the view expressed by Mr. Nimatallah that the industrial countries must take strong steps to remove macroeconomic imbalances and structural rigidities in their economies through the implementation of strong adjustment policies, without which they would only be paying lip service to the principles of free trade. Delays in carrying out necessary economic adaptations by industrial countries have fueled protectionism and seriously undermined the adjustment and export diversification efforts of developing countries. In this connection, I would like to refer to page 125 of the 1973 Economic Report of the U.S. President, and strongly support the U.S. President's position that if countries on both the deficit and the surplus sides of payments imbalances follow active policies for the restoration of equilibrium, the process is likely to be easier than if the deficit countries try to bring about adjustment by themselves. In any case, deficit countries would be unable to restore equilibrium unless surplus countries at least followed policies consistent with a reduction of the net surplus in their payments position. Trade liberalization and the growth of the world economy depend crucially on a more active involvement of the industrial countries in an effective and comprehensive adjustment process.

With regard to the role of the Fund, there is no doubt that trade issues cannot be ignored, given the fact that world trade is central to international financial relations. But the Fund must be careful not to encroach upon the jurisdictions of either GATT or UNCTAD in trade matters. Close collaboration between the three institutions is necessary and I support that as well as, in particular, the current practice of the Fund regarding presentation of statements in support of member countries' cases before the GATT.

The Fund, through its financial leverage, has influenced the trade policies of several developing countries. Clauses dealing with multiple currency practices, bilateral trade and payments arrangements and exchange and trade restrictions on current payments and transfers for international transactions are regularly incorporated into Fund-supported programs as either quantitative or qualitative requirements. This is in addition to the standard clauses prohibiting a member from imposing or intensifying import restrictions for balance of payments purposes. But the impact of Fund surveillance on the trade policies of major industrial countries has been insignificant. This weakness must now be corrected, possibly by ensuring that the policy indicators being developed include variables that capture the flow of goods, services, and capital between all members of the Fund.

As part of its Article IV consultations, the Fund has broadened its analysis of, and work in, trade developments and trade policy. However, for the Fund to fulfill its broad responsibilities to facilitate the expansion of international trade, and notwithstanding the inherent technical difficulties, further efforts should be made to quantify the effects of protectionism, including nontariff barriers, particularly for developing countries. This would help put the cost of protectionism in clear quantitative perspective. Regular reports in the form of information notices on the trade policy decisions of major industrial countries would be helpful to the Board. The Fund, through the Managing Director and/or any other means at its disposal, should continue to expose the dangers of protectionism wherever the opportunity presents itself.

I urge the international community to do everything in its power to combat the growing scourge of protectionism and to strengthen the multilateral trading system. The developing countries have suffered from the effects of protectionism for a long time but there is now growing recognition that the imbalances which characterize the largest industrial economies themselves cannot be eliminated unless and until trade becomes fully governed by the principles of comparative advantage. May that day not be too far off.

Mr. Sliper said that he supported the content of the staff paper and the whole approach of the Fund in promoting trade liberalization and domestic structural adjustment. He particularly endorsed the views expressed in the report concerning trade-finance links and the importance of improved market access in helping developing countries with their debt problems.

The staff's view that reduced reliance on trade restrictions would be more likely if market access for developing countries could be substantially liberalized was well taken, Mr. Sliper indicated. Early action by the industrial countries with respect to their standstill and roll-back commitments and early negotiation and implementation of agreements to reduce agricultural and other types of protection and export subsidization were important elements in ensuring continued active participation by the developing countries in the Uruguay Round.

The proposal for more rigorous examination of the impact of a country's trade policies on its domestic economy and on other members, including developing countries, was welcome, Mr. Sliper commented. The staff's proposals for strengthening its work in the trade area were also supported, subject to the proviso that the Fund liaise closely with other international bodies in order to ensure no duplication of work in that field. For example, the OECD was undertaking considerable work in quantifying the effects of protection of the agricultural sector in OECD countries.

Mr. Finaish made the following statement:

The staff report clearly shows that pressures for protection have increased markedly in recent years; that bilateral and sectoral approaches have been used increasingly to deal with trade frictions; and that an increasing number of trade problems are being discussed and negotiated outside the multilateral framework, which is a source of concern. The multilateral trading system contributed importantly to the sustained postwar expansion in international trade, and it is of paramount importance that the trade frictions among industrial countries be resolved in that framework.

As the staff report correctly emphasizes, developing countries have faced increasing protectionist barriers in industrial countries against their traditional industrial exports, including textiles, clothing, footwear, and leather goods. Furthermore, when developing countries successfully exploit their comparative advantage and diversify into new areas such as petrochemicals, steel, and electronics, they often face discriminatory protection. It is most unfortunate that the revival of protectionism in industrial countries has occurred at the same time that many developing countries have taken measures to liberalize their trade regimes. The pursuit of liberal trading policies would become difficult for developing countries if they were unable to take advantage of opportunities in the industrial countries' markets. The risk that the current degree of access to world trade markets may be restricted even further, and that important industrial countries' markets may close progressively, makes it difficult for developing country governments to ignore the protectionist demands of producer interest groups and continue with their trade liberalization policies. Given the need for adjustment in developing countries which face difficulties in servicing their debts, let alone in financing reasonable growth in imports, and given the large share of industrial countries in world trade, the industrial countries have a responsibility to resist protectionist pressures and allow the developing countries to increase their exports.

Certain protectionist measures in industrial countries are directed specifically against developing countries. For example, the Multifiber Agreement discriminates against developing countries and imposes restrictions on their exports, whereas trade among the industrial countries in clothing and textiles is generally free of nontariff restrictions and subject to normal GATT rules. A major purpose of the Multifiber Agreement is to provide assurance to industrial countries that imports from low-cost developing country exporters will not be allowed to sharply reduce employment and domestic producers' market shares. However, these sectoral restrictions weaken the incentive to correct the underlying structural disequilibrium, and thereby increase the size of the needed adjustment and the associated consumer and welfare costs of protection. We found the staff discussion on the estimates of the costs of protection in industrial countries very interesting, and can endorse the suggestion tha+ a more systematic attempt be made to collect and disseminate estimates of those costs prepared by national authorities and others within and outside the Fund.

The staff has also made reference to the industrial country trade barriers against developing country exports of petrochemicals, particularly those from oil-producing countries which have a comparative advantage in this area. The staff noted that trade in petrochemicals is distorted by disparities in tariff and non-tariff barriers among industrial countries, and the developing country exporters are concerned that diversification into areas of comparative advantage will be inhibited by industrial country protectionism. It is disconcerting that even though developing country exports of petrochemicals are in the initial stages, pressures have appeared for more intensive trade barriers and the European Communities (EC) have increasingly restricted petrochemical imports, in some cases transforming the more liberal provisions of the ceiling system into the quota system. The staff paper pointed out that the frequency of disputes in petrochemicals and other sectors would be reduced if the necessary structural adjustment in a number of industrial countries were to occur more rapidly and if trade liberalization in all countries provided more room for expanded trade on the basis of comparative advantage. I am in agreement with these views and would like to add that most of the oil-producing Middle Eastern countries already have highly open economies and do not restrict or apply any tariff on a large part of their imports.

It needs to be emphasized that the economies of a number of oil-exporting countries are relatively undiversified; they export mostly oil and oil products, and the income of these countries originates in large part from exhaustible oil resources. Thus, the argument that the Generalized System of Preferences (GSP) was intended to help the less developed countries, whereas the Gulf countries have a per capita income higher than that of the EC, needs to be qualified. If per capita income ratios were calculated in terms of nondepletable GDP, the resulting ratios for the oil exporters would be significantly lower than what is indicated by the conventional ratios based on total GDP. The infant petrochemical industries are essential to the development of the oil exporting developing countries because as the exhaustible oil resources are depleted, these countries need to accumulate physical capital and establish industries in accordance with comparative advantage to ensure high per capita incomes. Among the various industrial investment alternatives, petrochemicals are ideally suited to the resource base of the oil producing economies because of their capital- and energy-intensive nature and the fact that they can use natural gas as a feedstock. This suggests that migration of petrochemical production toward the areas endowed with the natural resource is a logical outcome of the workings of economic laws of production and location.

Finally, turning to the issue of the role of the Fund, the Fund should maintain close links with the GATT in order to actively support the latter's role in maintaining and strengthening an open multilateral trading system. Because neither the public awareness of the costs of protection nor the political will to resist bilateral and protectionist trade measures are sufficient, the Fund must continue to stress that protection is costly and encourage its members to adopt open trading systems. It is important, however, that the desirable pace of liberalization of trade regimes by developing countries be considered against the backgrounds of the progress already achieved by the developing countries, and, in sharp contrast, of the revival of protectionism in industrial countries. Therefore, due emphasis should be given to the major problem of industrial country protectionism. The Fund could play a more effective role by enhancing surveillance over the major industrial countries, and the indicators exercise should help in this regard. The coverage and analysis of trade policy matters in Article IV consultation reports on major trading nations, whose trade policies have important implications for the openness of world trade in general, should be further expanded.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/135 (9/11/87) and EBM/87/136 (9/14/87).

4. DJIBOUTI, EQUATORIAL GUINEA, AND LIBYAN ARAB JAMAHIRIYA - 1987 ARTICLE IV CONSULTATIONS - POSTPONEMENTS

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the periods for completing the 1987 Article IV consultations with Djibouti, Equatorial Guinea, and Libyan Arab Jamahiriya to no later than October 9, 1987. (EBD/87/230, 9/9/87)

Decision No. 8692-(87/136), adopted
September 11, 1987

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by an Advisor to Executive Director as set forth in EBAP/87/199 (9/10/87) is approved.

APPROVED: April 18, 1988

LEO VAN HOUTVEN
Secretary