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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/14

3:00 p.m., January 27, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	Mawakani Samba
C. H. Dallara	M. Lundsager, Temporary
J. de Groote	
	S. de Forges
	T. Alhaimus
	M. Sugita
G. Grosche	
Huang F.	
	Jaafar A.
A. Kafka	H. A. Arias
	M. Foot
H. Lundstrom	
M. Massé	G. D. Hodgson, Temporary
E. I. M. Mtei	A. Abdallah
	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	G. Ortiz
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	N. Coumbis

L. Van Houtven, Secretary
S. L. Yeager, Assistant

Also Present

IBRD: F. Vakil, Western Africa Regional Office. African Department: E. L. Bornemann, R. O. Carstens, I. Kapur, B. P. Ledoux. European Department: L. A. Whittome, Counsellor and Director. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; G. Belanger, K. M. Huh, M. R. Kelly, M. Xafa. External Relations Department: M. Goldstein. Fiscal Affairs Departmetn: C. Schiller. IMF Institute: E. Croce, O. B. Makalou. Legal Department: F. P. Gianviti, Director; W. E. Holder, A. O. Liuksila, J. M. Ogoola, J. K. Oh, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. M. Boughton, A. Lanyi, D. Folkerts-Landau, D. J. Mathieson. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; E. Decarli, O. Roncesvalles. Western Hemisphere Department: M. Caiola, R. A. Elson, M. R. Figuerola, I. C. Tandeciarz. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, L. K. Doe, L. P. Ebrill, J. Hospedales, H.-S. Lee, G. Nguyen, A. Ouanes, G. W. K. Pickering, I. Puro, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, A. Bertuch-Samuels, J. de la Herrán, J. J. Dreizzen, G. Ercel, V. Govindarajan, L. Hubloue, O. Isleifsson, Z. b. Ismail, J. M. Jones, S. King, H. Kobayashi, S. Kolb, R. Msadek, J. A. K. Munthali, K. Murakami, A. Mustafa, J. E. Rodríguez, V. Rousset, M. Sarenac, L. Tornetta, H. van der Burg, E. L. Walker, B. D. White, Yang W.

1. COTE D'IVOIRE - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors continued from EBM/86/13 (1/27/86) their consideration of the staff report for the second review of the stand-by arrangement for Côte d'Ivoire (EBS/85/291, 12/30/85; and Cor. 1, 1/23/86).

The staff representative from the African Department said that the medium-term scenario had been based on information available through November 1985 and therefore did not reflect the recent sharp increase in coffee prices. Prices had, however, begun to decline recently, and the size and quality of the Ivorian coffee crop might not meet earlier expectations. Although it was difficult at present to assess the impact of price fluctuations on the financial situation of the Stabilization Fund, on balance, the impact was probably positive. The staff would assess the impact of commodity price changes on the economic and financial situation during a mission to Côte d'Ivoire scheduled for February to conduct the 1986 Article IV consultation and discussions on a follow-on program. The mission would also look at cotton prices, which had declined recently. A revised medium-term scenario would then be prepared based on the information available. So long as commodity prices were extremely volatile, rapid price changes could be expected to dramatically alter the assumptions underlying the medium-term scenario.

The recruitment of 1,300 unemployed university graduates had been announced in September 1985 in the context of presidential and parliamentary elections, the staff representative continued. The measure had not been envisaged at the time the 1985 program was discussed with the authorities. He understood that employment of those graduates would take effect beginning January 1, 1986 and that its financial impact had already been reflected in the preliminary figures for the 1986 budget. The authorities' objective of reducing the rate of growth in the civil service over the medium term remained unchanged.

Audits of the five specialized banks had been completed, and the authorities' letter of intent indicated that they were preparing a program of measures to address the problem, the staff representative remarked. The forthcoming mission would discuss those measures in detail as well as any additional measures which might be needed under a new program supported by the Fund.

The financial performance of the public enterprises had improved considerably, the staff representative observed. Among the measures implemented in 1985, the realignment of the public enterprises' salary structure with that of the government sector had resulted in a substantial reduction in many public sector salaries. That measure had required considerable political courage and had given rise to some social unrest when it was announced. The program for restructuring the public enterprises continued to be implemented effectively; nearly all the programs had been prepared in close cooperation with the World Bank. Further progress in developing the private sector was expected as part of the policy reforms to be supported by a third structural adjustment loan being discussed with the World Bank.

Under present policies, a growth rate of approximately 3.5 percent in real terms was consistent with achieving a viable balance of payments situation in the medium term, the staff representative from the African Department considered. To that end, the staff would be discussing additional structural adjustment measures with the authorities. In this context, the outcome of the discussions with the World Bank on a third structural adjustment loan would be of crucial importance toward reaching the goal of a higher growth rate.

The Executive Board then took the following decision:

1. Côte d'Ivoire has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Côte d'Ivoire (EBS/85/113, Sup. 2, 6/4/85) and paragraph 24 of the letter from the Minister of Economy and Finance dated April 30, 1985.

2. The letter from the Minister of Economy and Finance dated December 13, 1985 shall be attached to the stand-by arrangement for Côte d'Ivoire, and the letters dated April 30, 1985 and August 1, 1985 shall be read as supplemented by the letter dated December 13, 1985.

3. Accordingly, the performance criteria through end-February 1986 for net domestic assets, the net position of the public sector with the banking system, the stock of domestic arrears of the public sector, the stock of external debt arrears, and new external commitments shall be as specified in paragraph 12 and Table 1 of the letter dated December 13, 1985.

4. The Fund decides that the second review provided for in paragraph 4 of the stand-by arrangement is completed and that Côte d'Ivoire may proceed to make purchases under the stand-by arrangement.

Decision No. 8193-(86/14), adopted
January 27, 1986

2. HONDURAS - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Honduras (SM/85/341, 12/30/85). They also had before them a report on recent economic developments in Honduras (SM/86/8, 1/13/86).

Mr. Pérez made the following statement:

Despite the limited impact of the recovery in industrial countries on the Central American region during the past two years and the political instability that has characterized the area throughout the 1980s, the Honduran economy performed satisfactorily during 1985. The authorities continued their efforts to promote a progressive adjustment of the economy and encourage economic growth. The economic recovery, which began in 1984, was maintained through 1985, while the rate of inflation continued on a downward trend. These achievements resulted from the implementation of monetary and credit policies that reasonably facilitated the financing of productive activities while avoiding the expansionary trends recorded in the past. As in previous years, Honduras maintained a significantly lower rate of inflation than that recorded by its main trading partners.

The most recent data show that in 1985 the Honduran economy grew at a rate of 3 percent, a figure slightly higher than the rate of 2.8 percent reached in 1984, mostly as a result of favorable developments in the agricultural sector. My authorities consider that economic performance was also helped by measures taken to promote exports and maintain exchange rate stability. The growth estimates of the authorities are slightly higher than those of the staff, since the former are based on more complete and updated statistical information on agricultural crops and export performance than the data available at the time of the staff visit.

With respect to public sector finances, the authorities succeeded in reducing the overall deficit. Latest available estimates for 1985 point to an overall deficit of 7.7 percent of GDP, which represents a reduction of 4 percentage points compared with 1984.

The financial situation of the Central Government improved as a result of revenue increases brought about by better tax administration and enforcement, and expenditure savings related to the cost of the electoral process, which was L 50 million lower than anticipated. My authorities wish to stress that their main objective in the fiscal area continues to be the gradual reduction of the fiscal deficit through a combination of measures aimed at increasing revenues and reducing expenditures, albeit with greater emphasis on the latter. The authorities also believe that fiscal adjustment should proceed gradually, in view of the political and economic circumstances of the country and the region as a whole.

In accordance with the objectives of reducing the fiscal deficit and decelerating the inflation rate, the authorities carried out a cautious monetary policy with a view to providing credit to the public sector and supporting the productive activities of the private sector leading to the reactivation of the economy. As a result, credit to the public sector was maintained in nominal terms at levels similar to those prevailing in 1984, while credit to the private sector was increased moderately. The Honduran authorities strongly believe that sound management of fiscal and monetary policies will contribute substantially to strengthening the current exchange rate of the lempira.

Despite an increase of 10 percent in export earnings, the global outcome of the balance of payments was less favorable than expected owing to delays in financial assistance disbursements from government agencies and international financial institutions. The balance of payments surplus reached only L 20 million instead of the L 80 million estimated in September 1985. Imports grew 8 percent in 1985, reflecting the initial trade liberalization measures adopted by the authorities. In addition, Honduras fulfilled all its financial commitments to international financial institutions and remained current in interest payments on its external debt, including the portion attached to rescheduling agreements. In view of the increase in exports, the low rate of inflation, and the adequate level of imports, the authorities consider that a modification of the lempira's exchange rate is not necessary at this time.

During 1986, and within a medium-term framework, the authorities will continue their efforts toward adjustment of the fiscal and external sectors in order to set up a favorable basis for maintaining a satisfactory rate of economic growth. The new administration taking office at the end of this month has indicated its willingness to continue the adjustment efforts along the same lines as the preceding Government. Consequently, the new authorities will give special priority to the elaboration of a financial program that will appropriately combine adjustment and growth objectives. They are aware that public expenditures have reached levels that cannot be financed adequately through tax collection; therefore, they intend to progressively reduce expenditures. However, they also wish to point out that their margin for maneuver is small because Honduras' democratic process and its strategic position in the region compel the country to maintain a high level of current expenditures. Honduras' tax burden is one of the highest in Central America; thus, the introduction of additional taxation would have to be preceded by a rationalization of public expenditures without jeopardizing the badly needed improvement of social conditions in the country. In this regard, the Government will continue its efforts to reduce the size of the public sector while going ahead with those projects or activities aimed at developing the Honduran economy and improving the overall social situation. A basic principle underlying expenditure policy is that domestic savings must finance a larger part of public investment. The administrative fiscal controls will be strengthened, while monetary and credit policies will continue to aim at providing noninflationary financing to the public sector and sufficient resources to the private sector. The authorities intend to maintain the growth of bank credit at a rate consistent with a balance of payments equilibrium target.

Prospects for the external sector seem favorable in view of the substantial improvement of coffee prices and the financial assistance that Honduras will receive which, in addition to new resources, should include the delayed disbursements originally scheduled for 1985. The authorities consider higher coffee prices will result in a L 150 million improvement in the current position of the balance of payments. However, the authorities will continue the process of rescheduling part of the commercial external debt to provide a more confortable setting for the management of international reserves. In addition, the authorities will give priority to important projects in the economic and social areas. The authorities consider that the design and implementation of policies aimed at promoting and diversifying exports is essential for the attainment of external equilibrium. From that perspective, they are currently analyzing a set of alternatives directed to increasing Honduran exports to other countries within and outside of the Central American Common Market. The authorities are firmly convinced that the adoption of policies to manage demand and promote supply will benefit the present exchange rate for the lempira.

The authorities expect that the Executive Board will show a flexible attitude when assessing the results of their economic program, considering that the adjustment strategy requires more time and resources than usual under normal circumstances. Experience shows that a quick turnaround of economic performance is more difficult when countries are faced with a persistently adverse external environment. For those reasons, the program adopted by the Government should be viewed as a strong attempt to set the basis for a sustained recovery of the Honduran economy.

Mr. Weitz said that Honduras was confronting the basic dilemmas and frustrations experienced by many developing countries trying to implement a consistent adjustment effort despite practical, economic, social and political limitations, as well as a hostile external environment. During the early 1980s, increasing imbalances in the country's economic and financial positions had further complicated the situation: real GDP growth had been negative, unemployment had increased, a significant BOP deficit had been registered, external arrears had accumulated widespread, import restrictions had been implemented, the fiscal deficit as a percentage of GDP had reached a double-digit figure, and the annual rate of inflation--at about 10 percent--had been significantly higher than that prevailing in Honduras' trading partners.

Over the past two years, the Honduran economy had achieved an important turnabout despite the lingering effects of those disequilibria, Mr. Weitz continued. Real growth in output had surpassed 2.5 percent in both years, and the domestic rate of inflation had been halved and was continuing to decrease. The fiscal deficit was almost 4 percentage points of GDP lower in 1985 than two years previously, credit expansion had decelerated, and more important, there had been a continued shift of credit allocation from the public sector to the private sector.

In assessing the economy's performance, the staff had raised doubts as to whether the recovery was sufficiently broad-based to produce a viable balance of payments situation, Mr. Weitz observed. In particular, it questioned whether the stabilization effort was sufficient to bring about a sustained improvement in the external position over the medium term and to maintain or even improve upon recent achievements on the growth and price fronts. His authorities strongly cautioned against judging Honduras' performance too severely. In their view, overall performance had been good, and in some areas remarkable.

Revenue performance had been slightly positive, Mr. Weitz remarked. Total revenues had increased by nearly 3 percentage points of GDP over the past two years, owing largely to strengthened tax measures and tax administration. The authorities recognized that continued improvement in the fiscal area would, however, be limited in the absence of some shift in the tax burden from the foreign sector to domestic transactions. Overall fiscal performance however, did not show similar improvement. For example, the growth in current expenditures had somewhat offset revenue performance. The authorities recognized the main factors behind that development, many of which were rigid and recurrent while others were extraordinary and temporary. The measures taken to improve the institutional framework for monitoring public sector expenditures were therefore welcome. The recently enacted law to facilitate the divestiture of many public entities posing a financial and economic burden to the Central Government and the Central Bank was a necessary and courageous action. Continued improvement on the fiscal front was vital to realizing the objectives of the stabilization effort.

The authorities' overall monetary stance had also been positive, although it posed potential risks in some areas, Mr. Weitz commented. Interest rates continued to be positive in real terms and were essentially determined by market forces. The significant shift in bank credit operations from the public sector to the private sector had undoubtedly had positive effects on the recovery of output over the past two years. That policy had, however, contributed somewhat to widening the balance of payments gap; future credit policy would therefore have to be more in line with the growth of financial savings in the banking system.

The external sector had also shown some positive developments, Mr. Weitz observed. During the past 12 months, important steps had been taken to further liberalize exchange restrictions, a process which had begun in 1984. Those measures would increase the overall efficiency of resource allocation, which could be improved further by making the present system more transparent. Regarding the exchange rate, Mr. Pérez had presented the views of the Honduran authorities very clearly. Although flexible exchange rate policy could enhance a country's external competitiveness, in view of the authorities' position on a delicate issue and because the Honduran economy also faced a difficult external situation, he favored a more cautious approach with respect to Honduras. Moreover, a recent staff paper on aspects of program design had pointed out an interesting relationship between the volume of traditional non-oil exports and fluctuations in flow and demand. According to the staff, Honduras showed the highest elasticity--1.71--between nontraditional exports and the imports of industrial countries. Thus, because Honduras' nontraditional exports were highly sensitive to world trade, negative trends in world trade or obstacles to that trade could offset any gains in competitiveness resulting from changes in the exchange rate system.

Mr. Arias noted that despite the uncertainty expressed by the staff during the Board discussion on the 1984 Article IV consultation with Honduras (EBM/85/21, 2/11/85) concerning the durability of the gains achieved in reducing inflation and increasing output, results in 1985 confirmed the positive trends in those areas. Output growth had been maintained at 1984 levels and the rate of inflation had been reduced further, from 4 percent to 3.6 percent.

The public sector deficit had been reduced sharply to 7.7 percent of GDP in 1985 as a result of revenue-raising measures introduced in 1984 and the completion of the El Cajón hydroelectric project, Mr. Arias observed. Continued improvement in fiscal performance was essential, and the authorities should implement the proposed tax reform and improve the financial position of the decentralized agencies as soon as possible as to reduce the net transfers from the Central Bank to the Central Government. In that respect, he welcomed recent legislation permitting the diverstiture of some public entities, which was expected to facilitate budgetary control over those enterprises as well as to improve their management structure.

In the monetary field, credit expansion to the private sector had been important in helping to reduce unemployment and in generating economic activity, Mr. Arias continued. Moreover, that expansion had not resulted in excessive demand pressures nor in the emergence of inflationary pressures. The maintenance of real positive interest rates had also contributed importantly to the continued growth of domestic savings.

Determining an appropriate exchange rate for Honduras was a complex issue, Mr. Arias remarked. However, he agreed with the authorities that, because of the financial constraints on Honduras' trading partners in Central America and the country's dependence on export quotas for its main exports, a devaluation would not benefit the Honduran economy in any substantial way.

Although the staff had stressed that it was important to avoid relying on balance of payments foreign assistance in the future, in the past such financial support had enabled the Government to implement its economic programs in such a way as to establish the basis for sound and economic growth, Mr. Arias observed. Continuous flows of such assistance over the medium term would facilitate that growth process.

Mr. Hodgson said that he generally agreed with the staff appraisal on Honduras. Some progress had been made in 1984-85 toward initiating an economic recovery and controlling inflation, but Honduras' external position remained very weak. Continuing, large fiscal imbalances and an inflexible exchange rate policy were putting pressures on the balance of payments, and external arrears had continued to increase. The medium-term projection of large current account deficits, a need for exceptional balance of payments financing, and worsening external debt indicators, raised serious questions as to the viability of Honduras' development strategy. Although the recent increase in coffee prices might help temporarily to ease the external position, the new Administration would have to carefully scrutinize its adjustment strategy, and he strongly encouraged the authorities to develop and implement policies that could be supported by the Fund.

Better fiscal performance was crucial to sustain economic growth and improve the overall financial position, Mr. Hodgson continued. Further efforts were needed to increase government revenues while at the same time shifting the tax burden away from foreign trade toward domestic transactions. Serious consideration might be given to increasing the scope and rate of consumption taxes as well as to reforming the income tax system. Although government expenditures as a percentage of GDP had declined in 1985 owing to lower investment outlays associated with the El Cajón hydroelectric project, current outlays had increased. A more balanced approach was needed to contain total public expenditures, particularly those related to current spending, which had increased in each of the past five years and were at present equal to 20 percent of GDP. He welcomed the authorities' intention to improve the financial performance of public sector enterprises by allowing for more automatic tariff adjustments. The initial steps taken to sell loss-making public sector enterprises were also welcome.

Although the expansion of bank credit had decelerated in 1985, further restraint would be needed if the adjustment process was to be successful, Mr. Hodgson considered. The authorities' intention to maintain a positive real interest rate structure merited support and should promote the growth of private financial savings and an efficient allocation of credit. The recent decision to encourage private sector investment in medium-term government bonds, rather than sight bonds held by the Central Bank, was a move in the right direction, but the authorities should be prepared to adjust the yields on such instruments in a flexible manner.

The spread between lending and deposit rates--ranging from 5 percent to 9 percent--was high, Mr. Hodgson continued. Though the need for real positive yields on saving instruments was clear, the high cost of intermediation imposed an excessive cost upon borrowers. He wondered why the spreads were so large. Also, what further measures might be introduced to make financial markets function better?

The steps taken during the past two years to liberalize the exchange system were welcome, but further action was needed to simplify the system and eliminate discriminatory elements, Mr. Hodgson remarked. In the light of the recent unsatisfactory performance of nontraditional exports and the worrying medium-term outlook for the balance of payments, the authorities should seriously consider devaluing the official rate for the lempira and moving toward unification of the exchange rate at a realistic level. The policy of selectively promoting exports of certain sectors through fiscal subsidies and duty exemptions on imported inputs was inefficient and placed a further burden on the fiscal position. Providing appropriate price signals through the exchange rate would be a far more efficient and less costly form of policy intervention.

Ms. Lundsager noted that since the Board's previous discussion of the Honduran economy, several favorable trends had been maintained. Real growth had remained positive at about 3 percent, inflation had remained low, the budget deficit had fallen, and the overall payments position had improved slightly. Nevertheless, despite the improvement in the overall economic situation, the medium-term outlook--based on the authorities' development plan and on recent trends in the current account--and the relatively low level of foreign exchange reserves gave rise to some concern.

The current account, excluding official transfers, remained high at 11 percent, and Honduras had grown increasingly dependent on official transfers, which were now equivalent to 4 percent of GDP, Ms. Lundsager continued. Even with those sizable transfers and official capital inflows, arrears continued to increase. Although the authorities expected to reschedule overdue obligations to commercial banks, the high current account deficits and the resulting high dependence on foreign loans and grants raised some doubts as to the feasibility of attaining medium-term payments viability without increasing external debt.

While the authorities' medium-term goals were commendable, especially the emphasis on private sector investment, the present mix of policies might not provide the needed incentives, generate the desired rate of real growth, or promote growth in the most effective manner, because the production of tradable goods was to be increased through a variety of ad hoc measures, including fiscal incentives and liberalized payments schemes provided on a selective basis, Ms. Lundsager observed. The steps that had been taken toward trade and payments liberalization were welcome. A piecemeal approach to exchange liberalization, however, risked stimulating an inappropriate allocation of resources because it made it difficult to determine production priorities, especially with regard to nontraditional exports, where Honduras enjoyed a comparative advantage. The authorities should instead adopt a more direct approach, adjusting the official exchange rate according to market signals or preferably unifying the several rates into a flexible system. Appropriately managed monetary and fiscal policies could help contain any inflationary pressures that might arise following such exchange adjustments. The recent measures taken up by several other countries in the region to permit more exchange rate flexibility lent weight to the need for more flexibility in Honduras' exchange system. Furthermore, the loss of some of its share of Caribbean Basin exports to the United States might be an indication that Honduras' exchange rate was overvalued. She wondered what impact exchange adjustments in other countries had had on the competitiveness of Honduran exports, both traditional and nontraditional.

She welcomed the authorities' recognition of the need for positive real interest rates to stimulate savings and the need for adequate provision of credit to the public sector, Ms. Lundsager added. The authorities should, however, be careful to avoid an excessively expansionary monetary policy which could further erode the payments position or lead to a resurgence of domestic inflationary pressures. As to fiscal developments, the authorities should consider implementing a tax reform that would reduce dependence on trade-related taxes and broaden the domestic tax rate without increasing the overall tax burden. Economies in current expenditures--which represented 20 percent of GDP--particularly in personnel expenditures, might be possible. She especially welcomed the emphasis on improving the public enterprise sector, including the divestiture of some entities. That private investors were willing to purchase at least 12 of the smaller firms was reassuring. The authorities' efforts to move toward more automatic adjustments in public utilities tariffs was also welcome.

Although the authorities' desire to move gradually to adjust their economy was understandable, too gradual an approach would not lead to the higher rate of economic growth that was their primary goal, Ms. Lundsager remarked. Further adjustment measures, such as those she had suggested, should be considered.

The staff representative from the Western Hemisphere Department said that the interest rate spread in the banking system reflected the fairly weak structure of Honduras' financial system. The capital position of private banks had eroded over the past few years, partly as a result of the severe recession and the decline in industrial sector activity. Thus, the large spread between loan and deposit rates reflected the banks' need to recoup some of their profits and strengthen their positions. The staff considered Honduras' interest rate policies to be appropriate in the circumstances, particularly in view of the weak external position and the need to encourage domestic savings and discourage capital flight. The previous stand-by program had sought to encourage the placement of government bonds outside the domestic banking system. Those efforts had, to some extent, been successful, although most of the activity had been related to so-called sight bonds. Efforts were continuing to encourage the placement of government bonds with longer maturities outside the banking system, which was probably the best means to further expand financial intermediation.

One of the criteria that Honduras should take into consideration in determining exchange rate policy was its position vis-à-vis its competitors in Central America, the staff representative continued. In particular measures had been taken in Costa Rica, El Salvador, and Guatemala over the past year to improve the competitiveness of the exchange rate. Ultimately, those adjustments should facilitate the re-establishment of a stable pattern of viable exchange rates for the region as a whole. Taking into account the behavior of Honduras' domestic prices vis-à-vis foreign prices and the importance of regional trade in Honduras' trade, the value of the lempira in mid-1985 exceeded its 1980 base period value by nearly 30 percent. Thus, Honduran competitiveness had eroded steadily since the beginning of the decade, primarily as a result of pegging the lempira to the U.S. dollar. That trend had been reversed somewhat with the depreciation of the U.S. dollar against other major currencies since mid-1985, so that for 1985 as a whole, the real effective value of the lempira had depreciated slightly. The staff would encourage the authorities to consider devaluation as a possible option in their stabilization strategy, particularly in view of exchange movements in the U.S. dollar and the currencies of its Central American trading partners.

Mr. Pérez noted that the Executive Board was discussing Honduras' economic situation at a time when a new Government was taking office in Tegucigalpa following the presidential election a month previously. Under the circumstances, he was unable to provide specific information on the economic measures being contemplated by the new Administration. Nevertheless, the new Government was very much aware of the country's current economic situation and attached particular importance to correcting the two main disequilibria in the economy--namely, the deficit of the public and external sectors.

The new Government intended to reduce the overall public sector deficit in the medium term by increasing revenues through better tax administration and enforcement and by decreasing public outlays, Mr. Pérez continued. Because Honduras had the highest tax burden in Central America, increasing public revenues through new taxes was not considered to be an appropriate means for solving the fiscal imbalance. The Administration considered that the main weight of adjustment should fall on the expenditure side of the budget; thus, one of the Government's first tasks would be to evaluate the expenditure programs contemplated in the budget, particularly with respect to the public enterprises.

The Government would seek to correct the external sector disequilibria by promoting exports through measures allowing for an increase in nontraditional exports to the Central American Common Market and other countries, Mr. Pérez remarked. The new Administration considered that the potential positive effects of devaluing the lempira would be more than offset by the negative impact on prices and salaries, which would jeopardize the progress that had been made in both of those areas. Moreover, there were sociological considerations. The lempira had been pegged to the U.S. dollar for more than 50 years, and the new Government as well as the other political parties, entrepreneurs, labor unions, and the Honduran people strongly felt that that relationship should continue and that a modification of the exchange rate system was not convenient at the present time.

The Chairman made the following summing up:

Executive Directors were in general agreement with the thrust of the appraisal in the staff report for the 1985 Article IV consultation with Honduras.

Directors considered the recovery of economic activity, the slowdown in inflation, and the improvement in public finances that had occurred in 1984 and 1985 as positive developments, especially in view of the uncertain external environment. However, Directors also observed that Honduras's underlying financial and external positions continued to be weak, and some Directors questioned whether the recent gains were sustainable. Directors therefore emphasized the need for strengthening efforts to reduce the external current account deficit to a level that could be sustained over the medium term.

Directors welcomed the significant improvement in the public sector finances that had been achieved in 1985, but pointed to the need for a further reduction in the overall fiscal deficit to strengthen domestic savings and the foreign balance. Directors were of the view that, notwithstanding the recovery of government revenues in the past two years, a further tax effort, including a shift in the burden of taxation toward domestic transactions, should be part of the Government's adjustment program. At the same time, Directors encouraged the authorities to moderate the growth of current government expenditures, noting that these outlays had risen sharply in recent years. Directors also urged the authorities to take measures to improve the financial position of the rest of the public sector, to strengthen control over public enterprises, and to accelerate the process of divestiture of such enterprises that began last year.

Noting the rapid expansion in bank credit to the private sector in relation to the growth of private sector financial savings in 1984-85, Directors emphasized the importance of restraining bank credit expansion. They welcomed the authorities' intention to continue to maintain domestic interest rates at positive real terms and urged them to widen the range of financial instruments in order to promote private savings.

Directors stressed that policies of demand restraint should be accompanied by action to eliminate exchange restrictions which lead to distortions in resource allocation. They viewed favorably the steps taken recently by Honduras to liberalize its exchange system, but it was noted that the system was complex and that liberalization had been implemented in a piecemeal fashion. Given the external imbalances of the economy, Directors stressed that a realistic, simplified, and competitive exchange rate system would be an important element of a strategy directed toward export promotion and growth. It was suggested that this matter be carefully explored with the new Administration on the occasion of contacts between the Fund and the authorities.

It was recommended that the next Article IV consultation with Honduras be held on the standard 12-month cycle.

3. INTERNATIONAL MONETARY SYSTEM - PROPOSALS IN G-10 AND G-24 REPORTS - PROCEDURAL ISSUES

The Executive Directors considered a staff paper examining the interrelationships among the issues and proposals set forth in the report of the Group of Ten (G-10) and the report of the Group of Twenty-Four (G-24) on the functioning of the international monetary system and suggesting a broad strategy for Board examination of the two reports (SM/85/335, 12/19/85).

Mr. de Groote noted that, as a result of the September 22, 1985 announcement by the Finance Ministers of the five major industrial countries, Group of Five, of coordinated actions to redress the excessive appreciation of the U.S. dollar and the introduction during the Annual Meetings in Seoul of the U.S. program for a growth-oriented strategy for tackling the debt problem, the outlook for progress toward a common understanding concerning actions to be taken in some of the major areas of monetary reform were at present much greater than they had been six months previously. Moreover, the staff paper pointed out that because the various elements of the international monetary system were closely interrelated in their operation, it would be difficult to make progress in any area without taking supportive actions in other areas sooner or later. The emergence of that kind of a systematic view increased the prospects for a modest overall improvement of the international monetary system.

The G-10 and the G-24 reports agreed that the short-term volatility of exchange rates and the large, persistent misalignments of real exchange rates over the medium term were matters of serious concern and that the present system had failed to generate sound, consistent policies to eliminate them, Mr. de Groote continued. The reports disagreed, however, on the need for closing systemic loopholes by establishing some trigger mechanism that would activate appropriate incentives and pressures toward sound, coordinated policy action. The G-24 report proposed a system of target zones incorporating implicit pressures toward policy coordination in the present exchange system, whereas the G-10 report rejected the notion of such built-in incentives and instead called on member countries to give greater weight to international considerations in formulating their domestic policies.

In view of the Group of Five's common assessment of exchange rate trends and its agreement on the desirable direction of future exchange rate actions, the Board should not limit itself to low-profile proposals for increasing exchange rate stability as it had tended to do in the past, Mr. de Groote remarked. The Group's acknowledgement of the need for a greater coordination of interest rate policies was also encouraging. He therefore looked forward to the discussion on target zones and related mechanisms to provide greater incentives for coordinating policy actions. A closer consensus concerning the desirable course of exchange and interest rates for the key currencies, whether quantitative, perhaps in the form of target zones, or qualitative, in the form of a judgmental assessment, would open the way for a considerable expansion of the Fund's surveillance function, in both the multilateral and bilateral context.

The world economic outlook exercise would be an appropriate occasion for assessing the internal consistency and soundness of the policy understandings that had been reached among the major industrial countries and their overall implications for the global economic outlook, Mr. de Groote considered. That multilateral exercise could perhaps result in clear recommendations on the desirable course of policy, as the G-24 report had suggested. The exercise could usefully be combined with the Fund's annual consultations with individual members. Annual consultations with the major industrial countries would also allow the Board to focus on the dynamics of their adjustment path and to devise clear guidelines for international adjustment.

Another major concern was the debt problem, Mr. de Groote commented. Though the G-10 report did not deal with that issue, the debt problem was closely connected with the functioning of the international liquidity system and the role of the Fund. Moreover, the world economic outlook, as determined by the policy actions of the major industrial countries, should be explicitly incorporated in discussions of the Fund's role in the adjustment process and of the financial outlook of the developing countries.

Failure by the major industrial countries to agree on closer policy coordination would inevitably delay the adjustment process and aggravate the debt problem and, at the same time, prolong the instability of exchange rates and the risk of major liquidity crisis, Mr. de Groote continued. The U.S. program for alleviating the debt problem through a growth-oriented strategy, though a needed and welcome initiative made even more challenging the Fund's obligation to take appropriate action in all relevant areas. The Fund must stand ready to assist countries that had embarked on growth-oriented and structural adjustment programs, especially if the deterioration of the external environment created a need for additional balance of payments support. That possibility would have to be explicitly dealt with during the Board's discussion of international liquidity and the Fund's role in the adjustment process. It also raised immediate questions about the adequacy of the Fund's resources and the need for an SDR allocation to support the adjustment process. In the circumstances, his previous proposal for using SDRs to finance Fund programs and even the notion of Fund operations based entirely on the SDR might warrant renewed consideration.

Finally, in discussing the functioning of the international monetary system, Directors should adopt a pragmatic and cooperative approach, Mr. de Groote recommended. Pragmatism was needed to formulate solutions for present problems, while recognizing that conditions in coming years might be completely different and that international monetary reform was an ongoing process. A cooperative approach was called for because the Fund was the only forum in the world where issues of monetary reform could be discussed by industrial and developing countries together; it therefore had the responsibility to reach truly common solutions.

Mr. Weitz said that his authorities attached great importance to the Board's discussion of the proposals in the G-10 and G-24 reports, in view of the present global economic environment--especially the new difficulties and risks associated with the debt problem--and the expectations generated during the recent Annual Meetings in Seoul. Both reports presented a comprehensive exposition of the views endorsed by their respective ministers on the functioning of the international monetary system and a number of proposals and suggestions aimed at improving that system. In addition, in March Ministers of the Group of Twenty-Four would meet in Buenos Aires, Argentina to discuss the outcome of the Board's deliberations as well as the debt problem and the transfer of resources.

Although his authorities considered that the staff had done an excellent job in summarizing the points contained in the two reports, some of their statements reflected a shift in emphasis that could be misleading, Mr. Weitz observed. For example, on the subject of target zones, it was stated that "the key proposal in the G-24 report is that a system of target zones should be established for the major currencies," whereas paragraph 5 of the G-24 report stated that "adoption of target zones for the exchange rates of major currencies could help achieve the objective of exchange rate stability and sustainable levels of payments balances."

The staff paper also indicated that "issues related to the transfer of resources, especially to official development assistance, would be taken up at the meeting of the Development Committee in April 1986," Mr. Weitz continued. His authorities considered it important to analyze the problem of transfer of resources in the context of the functioning of the international monetary system because the problem was closely related to many other issues being dealt with. As the Development Committee would meet after the Interim Committee, he wondered when the Interim Committee would have the opportunity to examine the problem of the transfer or resources and what would be the relationship between the two Committees in dealing with that issue.

Regarding priorities, the debt problem, the transfer of resources, liquidity, and the role of the Fund should be given urgent consideration, Mr. Weitz remarked. On the role of the Fund, priority should be given to conditionality and the use of Fund resources; the creation of a new facility to help finance interest rate increases; and issues relating to quotas and access limits, as well as the decision-making process. His authorities were disappointed over the timing envisaged for the study of quotas and of the decision-making process.

The staff paper had made no mention of follow-up action, Mr. Weitz observed. The Group of Twenty-Four had proposed that "a suitable institution mechanism should be evolved for in-depth and joint examination of the two reports. A representative Committee of Ministers from developing and industrial countries, which could perhaps take the form of a joint subcommittee of both the Interim and Development Committees, should be formed for this purpose. It should conduct its business on the basis of consensus." Further discussion of that point was expected to take place during the Group's forthcoming meeting in Argentina. Moreover, paragraph 10 of the Interim Committee's communiqué stated that "the Committee held a preliminary exchange of views on the reports on the international monetary system presented by the Group of Ten and the Group of Twenty-Four. It was agreed to request the Executive Board to study the issues raised in these reports with a view to facilitating a substantive consideration by the Committee at its next meeting." The proposal to form a Committee of Ministers as soon as possible was incompatible with that statement.

Although it was important that all concerns and suggestions made in both reports be analyzed, not all the issues raised in the G-24 report had been properly detailed in the paper before the Board, Mr. Weitz observed. For example, although it was stated that "the issues on conditionality raised in the G-10 and G-24 reports are covered in the staff papers prepared for the Board discussion of the 1985 conditionality review," the review papers had not covered the concerns expressed in G-10 and G-24 reports in a comprehensive manner. Conditionality was clearly an important aspect of the discussion on the role of the Fund. Moreover, his authorities hoped that the seminar on the design of Fund programs could be held before the April meetings.

The paper on the debt problem, which was to be discussed in March, would present an analysis of the evolution and prospects of the Baker debt initiative, Mr. Weitz noted. The paper should also deal with other aspects of the debt problem that had been raised in the G-24 report, such as the problem of low-income countries and small developing countries. He asked the staff to provide a broad summary of the work being done on that report.

His authorities considered that the report from the Managing Director to the Interim Committee should take the form of a global paper summarizing the Board's discussions, Mr. Weitz remarked. The paper should analyze the work that had been done and indicate what remained to be done in order to facilitate the discussions of the Interim Committee.

Mr. Foot said that he supported the procedural arrangements proposed by the staff for studying the various proposals and recommendations set forth in the two reports. The staff had correctly pointed out that there were connections between the different issues under consideration but that those interconnections were not such as to require that the issues be discussed simultaneously. Indeed, to do so might lead to a confused and badly focused discussion. The staff's proposal balanced the desire to avoid that risk with the need for progress on a number of fronts in tandem. It was essential that the priority of some topics be recognized to ensure that they were given appropriate attention and that the results of the Board's deliberations be presented to the Interim Committee in a clear and fruitful way. Considering the Board's opportunities and obligations in the area of monetary reform, he endorsed Mr. de Groote's remarks on the central role of the Fund and its Executive Board.

Mr. Nimatallah observed that in the 13 years since the introduction of the present international monetary system, the international community had had sufficient time to gain an appreciation of its workings, strengths, and weaknesses. It should therefore also be in a position to reappraise that system objectively with a view to strengthening it. A number of weaknesses in the system, particularly those with respect to the external debt problem, were giving rise to mounting concerns within the international community about the system's stability and its ability to withstand any further stress. The Executive Board should capitalize on the opportunity afforded by the discussion of the G-10 and G-24 reports to agree on a set of measures aimed at eliminating at least some of those weaknesses.

The G-10 and G-24 reports agreed on the need and desirability to strengthen the international monetary system, and he fully concurred with that view, Mr. Nimatallah continued. Despite some differences in approach and emphasis, both reports agreed that a strengthening of the system would entail improving the stability of the exchange rate system, ensuring the adequacy of international liquidity, continuing the role of the Fund, and enhancing the effectiveness of surveillance. He shared that view. The key questions were how to achieve those objectives and which modalities were best suited and most workable.

Although indebtedness would continue to be a feature of the international monetary system, he hoped that the present external debt problems would be alleviated and that their intensity would subside within a decade or so, Mr. Nimatallah remarked. Until then, the debt problem should be closely monitored and discussed at the Board on the appropriate occasions. He welcomed the paper on the progress made toward resolution of the external debt problem being prepared in the context of the forthcoming report on the world economic outlook.

The transfer of resources was inherently an issue of economic development, Mr. Nimatallah considered. He welcomed the Fund's recent involvement in certain aspects of the transfer of resources: the periodic discussions of developments in international capital markets; the establishment of the Trust Fund followed by the Special Disbursement Account, which was to benefit low-income member countries; and the consideration of the establishment of a Fund facility to help such members meet higher interest costs.

The staff paper's explanation of the respective positions of the two Groups was lucid and helpful, Mr. Nimatallah commented. That they had more in common than not was encouraging and would greatly facilitate the task of finding common ground on how best to strengthen the international monetary system. He hoped that the two Groups would adopt an attitude of flexibility and greater cooperation as the Board's work progressed.

To resolve as many issues as possible, it was important that the Board define its priorities at the outset and proceed accordingly, Mr. Nimatallah considered. He supported the staff recommendation that discussions be organized around specific topics and that progress in each subject area be made in parallel. In view of the close interrelationships among the various topics and the need to review them in some simultaneous fashion, he viewed the Board's discussion of the components of the international monetary system as one long, continuous session, leading eventually to concrete and practical recommendations to the Interim Committee.

Mr. Zecchini said that discussions of the issues covered in the G-10 and G-24 reports should be both thorough and fruitful. A thorough discussion would encompass a comprehensive analysis of a wide range of subjects, including the functioning of the exchange rate system, international surveillance, the management of international liquidity and the function of the SDR, the role of the Fund--including transfer of resources in the context of adjustment--and external debt. Because there was a risk that the Board would be overwhelmed by academic or doctrinal debates or face an unwillingness to reach a consensus on the changes to be introduced, he wished to stress that the discussions must be fruitful. They should be aimed at achieving decisions that could help ministers in negotiating the final package of measures at a later stage. If such an attitude were not adopted, the Board's debate could become endless and inconclusive.

The staff paper had clearly indicated the various points on which the two reports were in agreement as well as those where significant differences existed both in terms of analysis and the policy recommendations put forward, Mr. Zecchini noted. Broadly speaking, the G-10 report gave a relatively positive assessment of the present international monetary system, while proposing some changes to improve its functioning. The G-24 report was more critical of the system and presented more far-reaching proposals. All parties would have to make an effort to reach the broad consensus necessary to devise and implement possible changes successfully. It was important to agree on a comprehensive and balanced package of measures rather than look for the minimum common denominator of the two proposals.

The flexibility of the exchange rate system had contributed to external adjustment but had also shown some unsatisfactory characteristics, Mr. Zecchini observed. Exchange rates had been extremely volatile and prolonged misalignments had occurred. Recently, there had been a growing tendency to guide the movements of the exchange rates of major currencies at the international level. He was therefore looking forward to a thorough examination of the viability of a target zone proposal.

Both reports held the view that surveillance had not been sufficiently effective and should be strengthened, Mr. Zecchini remarked. A truly multilateral surveillance could enhance the probabilities of a more comprehensive compatibility among national economic policies and could help foster higher economic growth and greater exchange rate stability. The instruments that would be the most suitable to reach those goals must be explored with a view to integrating multilateral and bilateral surveillance procedures.

In the past decade liquidity creation had experienced a certain instability owing to swift and sometimes unwarranted changes in the attitude of financial markets toward lending to several developing countries, Mr. Zecchini commented. In the light of that instability, an argument could be made for increasing the share of reserve instruments that were subject to international management. He therefore particularly welcomed the initiation of a new program of studies on the role of the SDR.

The work program for studying the G-10 and the G-24 reports did not encompass a discussion of the level of Fund quotas and the intervals between quota reviews, Mr. Zecchini observed. As the staff report had pointed out, preparatory work for the quota review would start at the end of 1986, and he agreed that those issues could be discussed in that context. However, since the Interim Committee could advise the Board to advance the timetable, he wondered whether it might not be helpful to obtain the reactions of the Board on those matters at an early stage.

As to the program of work, he agreed that during the first phase, discussions of each subject should proceed separately in order to reach an agreement in specific areas, despite the complex interrelationships among the various subjects included on the agenda, Mr. Zecchini remarked. To present Ministers with a coherent, assimilable output on which to build an agreement, in the second phase an assessment should be made of the progress achieved in each area and the interconnections between the points of agreement as well as points of disagreement in order to verify the acceptability of the package of measures that had emerged as a result of the Board's discussions. To be acceptable, the package would have to meet the needs of all parties in a balanced and equitable way. In addition, Ministers would need a document on which to focus their remarks when negotiating a decision. The summings ups of Board discussions would not meet that need because they presented a fragmented picture. Rather, a concise document should be prepared, defining the points where consensus had been achieved and formulating alternative proposals for the areas where differences remained, so that the Interim Committee would be in a better position to provide guidance to the Board. Either management or a drafting group composed of members of the Board and management could prepare the document, which could be considered by the Board prior to the Interim Committee's meeting.

Mr. Grosche said that the staff's presentation of the assessments and recommendations contained in the G-10 and G-24 reports was excellent and helpful, providing a concise summary of the major issues that had been addressed and clearly identifying areas of agreement and disagreement. He agreed with the staff that the substantive discussion of the issues should be organized around specific topics rather than a review of the reports as a whole. He also supported the staff's procedural suggestions for dealing with the reports' proposals.

While the interconnections among the various topics did not seem to require their simultaneous discussion, a certain order of priorities would be helpful, Mr. Grosche considered. For example, it seemed appropriate that the Board complete its planned program of study on the SDR before considering specific proposals concerning the SDRs future role. Likewise, it would be desirable, first, to review the present exchange rate system, including the recent experience following the Group of Five's September 1985 meeting, and, then, to review the principles and implementation of surveillance and before considering any modifications of procedures. Those considerations were already reflected in the timetable for the Board's discussions until the Interim Committee's spring meeting. In sum, he suggested that the Board follow the procedures outlined in the staff paper.

Mr. Pérez said that the staff paper had presented the views of both groups on the issues to be discussed as well as their interconnections in a balanced manner, which would help the Board to focus on the substance of the issues and to provide the Interim Committee with an initial reaction to the proposals for improving the international monetary system. During the recent discussion of the work program his chair had stressed that some of the linkages among the main issues contained in the reports might be overlooked if each issue was analyzed separately. The staff report also recognized the major interconnections and raised the question of how to deal with those linkages in the most appropriate manner. While it would not be appropriate to discuss all the relevant topics simultaneously, he considered that a brief paper assembling the conclusions reached on each particular issue should be prepared to serve as a basis for an initial analysis of the functioning of the system as a whole. The paper would allow the Board to reconsider its initial conclusions on separate issues and to analyze other aspects that had not been taken into account during the previous discussions. At the same time, the paper could facilitate the Interim Committee's consideration of the main topics.

On the transfer of resources, he welcomed the inclusion of a paper on the issues involved in establishing a Fund facility to help members meet higher interest charges, Mr. Pérez remarked. His chair had often stressed the importance of that question. He would be interested to know when the document would be available and hoped that it could be circulated in time for the Board's discussion on the debt problem. Although the issue of transfer of resources pertained to the Development Committee, it was also related to the debt problem, and the staff of both the Bank and the Fund should collaborate closely in preparing the paper on the debt problem and the transfer of resources.

He endorsed Mr. de Groote's comments on the climate in which the Board's discussions should be conducted, Mr. Pérez commented. Pragmatism and cooperation would be essential if the Board's discussions were to be fruitful.

Mr. Alfidja noted that the staff paper was well balanced, covered all the interconnected topics raised in both reports, and accurately represented the views and recommendations of the Group of Ten and the Group of Twenty-Four on the issues raised. Those topics were of particular importance to the members of his constituency, who strongly felt that the volatility of exchange and interest rates, the asymmetry of surveillance, the uneven distribution of international liquidity, and the debt problem called for urgent and concerted solutions.

Mr. Huang said that the staff paper presented a comprehensive, concise and evenhanded description of the recommendations put forward in the G-10 and G-24 reports for improving the functioning of the international monetary system. He had a few observations to make on the plan for examining the two reports.

The G-24 report viewed the present level of quotas as inadequate and proposed a substantial increase in quotas under the Ninth General Review as well as advancing the time of the review, Mr. Huang observed. He recalled that during the Board discussion of access limits for 1986 (EBM/85/177, 12/9/85), Mr. Lundstrom had pointed out that the inadequacy of quotas had led to the establishment of the enlarged access policy and that the need to phase out that policy highlighted the importance of quotas; he had also questioned whether the tentative schedule for beginning preparatory work on the Ninth General Review--late 1986--would enable completion of the review by March 1988. His chair shared those views and concerns. A timely assessment by the Board of the need to advance the Ninth General Review was called for so that the Interim Committee could make a decision on the subject at its forthcoming meeting.

Because of its importance and urgency, the debt problem merited serious deliberation by of the Interim Committee, Mr. Huang remarked. He understood that the Chairman of the Interim Committee had urged that the material for the Committee's substantive consideration be available to members by the end of February 1986. He wondered whether the Board would be able to meet that deadline, especially as it would not discuss the debt problem until late March. Although the debt problem was not dealt with in the G-10 report, the G-24 report had laid solid groundwork for a substantive discussion of that topic. In addition, new developments since the announcement of the Baker initiative would need to be assessed. He therefore would like to see the debt problem discussed in depth at an earlier date.

The recommendation by the Group of Twenty-Four on follow-up action that called for establishing a joint Committee of Ministers from developing and industrial countries to consider the proposals contained in the two reports, merited attention, Mr. Huang considered. The Board should perhaps appraise that recommendation in connection with the proposal for convening an international monetary conference.

Mr. Hodgson noted that the staff papers suggested a logical ordering of the key issues contained in the G-10 and G-24 reports. It was therefore appropriate that the schedule of meetings follow a similar sequence beginning with the exchange rate system, followed by consideration of international liquidity and the SDR, leading to questions about Fund surveillance and, finally, the general role of the Fund.

Three issues were of particular interest to his chair, Mr. Hodgson noted. First, the G-5 accord on exchange market and policy coordination reached last September, along with subsequent developments, indicated some modification of the views expressed in the G-10 report. His authorities continued to believe that there was no practical alternative at present to a system of floating exchange rates--a view that was probably shared by most other G-10 members. Nonetheless, the G-5 accord signaled that exchange rate misalignment had become a serious problem, which, if ignored, could prevent the achievement of medium-term macroeconomic goals. The increased concern about exchange rate developments, which reflected both a greater willingness to intervene and, more important, even greater efforts at policy coordination among the G-5 countries, was a welcome development. The Fund, however, had had little involvement in the recent efforts of the Group of Five, despite the emphasis in the G-10 report on Fund surveillance of all members' policies. His authorities considered that a review of surveillance practices was one of the most important aspects of the current exercise.

Second, the G-24 report had raised a number of issues related to the debt problem that were not directly addressed in the G-10 report, Mr. Hodgson observed. He would prefer that the Board deal with that subject in a direct, rather than oblique, manner. The issue could logically be discussed in the context of the Board's consideration of the debt situation scheduled in March. Some thought could also be given to the transfer of resources to developing countries at that time.

Finally, although the role of the Fund was discussed under a number of headings in the two reports, the fundamental question remained whether the Fund should limit itself to supporting short-term balance of payments adjustment, or whether it should be prepared to provide longer-term support with greater emphasis on structural problems, Mr. Hodgson remarked. Over the past ten years or so, the Fund had clearly moved some distance from its traditional focus on short-term adjustment. Was it desirable that that shift in perspective be continued? In any event, the Fund's catalytic role would continue to be important, and the Fund would need resources and flexibility to fulfill that role. Any further reduction in access limits should therefore be approached cautiously. It would also be wise to begin work on the Ninth General Review of quotas at an early stage if the Fund was to have adequate resources to fulfill its role and if borrowed resources were to be phased out gradually without creating any dislocations in its lending practices.

Mr. de Forges said that the staff paper presented the main points of the two reports in a balanced manner and that he supported the proposed organization and schedule of the Board's discussions.

Although the two reports reflected different viewpoints and sensitivities on broad issues, they often agreed in their evaluation of those issues, Mr. de Forges observed. Their arguments and proposals deserved to be fairly examined, as had been mandated by the Interim Committee at its previous meeting.

He wished to stress the importance and contribution that the two reports had made to the Board's consideration of the issues facing the international monetary system, Mr. de Forges added. He also wished to convey his authorities' request for updating the G-10 report. Developments since its publication, particularly concerning the exchange rate system and surveillance, as well as enhanced Fund-Bank cooperation, needed to be examined so that the issues could be considered in their most present context.

Mr. Lundstrom said that in the view of his constituency, deliberations on the proposals contained in the two reports should aim at narrowing the gap between the positions of industrial and developing countries on as many issues as possible. That approach would facilitate future cooperation in and through the Fund. Moreover, a qualified majority was required for decisions on many of those issues. Therefore, the Board should pay special attention to areas where prospects for reaching a consensus were reasonably good.

His chair supported the suggested program of Board discussions and most of the issues covered in the staff paper ahead of the Interim Committee meeting, Mr. Lundstrom continued. More specifically, he agreed with the staff's comments on the interconnections between the various issues and how, against that background, the work should be organized. It would be helpful if the conclusions derived from those discussions could be assembled with a view to exploring the inferences that might be drawn from the interconnections. The suggestion made by Mr. Zecchini and others that a concise paper covering interrelated questions and presenting a systematic overview of the conclusions and options emerging from the Board discussions be prepared for Interim Committee members might fulfill that need.

His constituency considered the question of the functioning of the exchange rate system to be of primary importance, Mr. Lundstrom remarked. It was hoped that the Board discussions would provide concrete proposals to the Interim Committee for changing the existing system as well as broad options for its future general evolution. Because the G-10 and G-24 reports differed significantly in their appraisals of the functioning of the floating rate system as well as in their proposals for its modification, it was important that a thorough study of the proposals for the exchange rate system, and especially the proposal for target zones, be undertaken.

Considering existing disagreements on the issues related to the exchange rate system, there was a risk that no agreement on even limited reforms could be reached at the moment, Mr. Lundstrom continued. Therefore, emphasis should be placed on the discussion on surveillance, where differences of opinion did not seem to be as great. For example, both reports had emphasized the need to make surveillance more symmetrical and effective as a means to better economic convergence. More effective surveillance could complement and strengthen, and, to a cetain extent, substitute for, exchange rate measures aimed at increased international discipline.

In discussing surveillance, special emphasis should be placed on developing instruments that would affect all member countries, including the major industrial countries, Mr. Lundstrom considered. He supported most of the concrete proposals on new and improved surveillance procedures presented in the staff paper. Many of those proposals were not technically complicated and could be ready for implementation shortly after a decision had been taken. He therefore endorsed the suggested procedure of presenting the Interim Committee with a set of suggestions for rendering surveillance more effective and asking for guidance on their implementation. The Interim Committee should also take a position on whether the present principles of surveillance needed to be changed.

On liquidity, his constituency attached particular importance to discussions on the role of the SDR, Mr. Lundstrom noted. It should be emphasized, however, that the debate on liquidity concerned much more than the SDR. His chair supported the plan suggested in the staff paper to deal with the different aspects of liquidity as they arose during the Board's consideration of various issues and in their logical context.

On the role of the Fund, it was important that the progress report on Fund-Bank cooperation give a comprehensive account of that issue, Mr. Lundstrom considered. He also attached importance to the continued discussion of problems of prolonged use and overdue obligations.

The debt situation would be discussed by the Board on several occasions in coming months in connection with the Baker initiative and various other issues, Mr. Lundstrom observed. At present, he wished to emphasize that trade policy aspects of the debt problem and the issue of capital flight should be treated comprehensively.

Mr. Dallara said that the staff paper had set forth a useful plan for examining the many interrelated issues that were raised in the G-10 and G-24 reports, and that in spite of the many linkages, discussions could nevertheless be structured in an orderly fashion. He doubted, however, that it would be possible to define and determine definitive solutions to the many complex issues during the coming weeks. The Board should therefore focus on issues with a view to seeking the Interim Committee's guidance for further work following the Committee's spring meeting. In the course of the Board's deliberations, he hoped that the differences of view evident in the two reports could be narrowed.

The exchange rate system was an important area of concern, and he welcomed early discussions focusing on particular aspects of the system, Mr. Dallara continued. Although the present system had provided a useful framework for dealing with the multiple global shocks of the 1970s and early 1980s, it had not been as stable as desired, and there were broad concerns about its functioning. Related to those concerns were protectionist pressures, which also could not be ignored. Both reports had put forward various ideas for improving the functioning of the international monetary system, and he looked forward to discussing those ideas in detail.

Strengthened surveillance had important potential for strengthening the system, Mr. Dallara observed. His authorities had made a number of suggestions aimed at strengthening surveillance, and thereby the operation of the monetary system, ranging from greater publicity of certain aspects of Article IV consultations to more frequent use of the special consultation provisions embodied in Board decisions. He looked forward to detailed consideration of those and other proposals during the upcoming discussion of surveillance in the hope that a consensus could develop on particular proposals that could be outlined to the Interim Committee.

The staff paper mentioned that surveillance procedures could be designed to support whatever conclusions were reached on the operation of the exchange rate system, Mr. Dallara observed. He wished to underscore that, conversely, changes in surveillance procedures might also strengthen the functioning of the exchange rate system.

Issues related to international liquidity had been considered on a number of occasions--for instance, the discussion of international capital markets--and certain aspects would be touched upon during the Board's forthcoming discussion of the world economic outlook, Mr. Dallara noted. He particularly looked forward to the discussion on the role of the SDR in the international monetary system.

On the role of the Fund, he agreed with the staff that no particular discussion was required because many aspects of the question had already been dealt with or would be considered in the course of Board discussions on other issues, Mr. Dallara remarked. The recent discussion on conditionality had provided an opportunity to focus on one aspect of the Fund's role as would the forthcoming discussions on surveillance. Fund-Bank collaboration was a subject of particular concern, and he looked forward to the progress report to be discussed in the Board in the next few months. His authorities attached importance to the possibilities for Fund-Bank cooperation in connection with the use of Trust Fund reflows and the development of enhanced techniques for more effective collaboration in assisting members using those resources.

On the issue of the transfer of resources raised in the G-24 report, he wished to point out that the Baker initiative was clearly designed to help outline a framework within which resources could be mobilized to support adjustment and growth in major debtor countries, Mr. Dallara commented. He looked forward to the discussion related to that initiative and other aspects of the debt problem during the forthcoming Interim and Development Committee meetings. Finally, he agreed with Mr. de Groote on the importance of the spirit of cooperation during the Board's deliberations so that progress could be made in all areas.

Mr. Salehkhou noted that the staff paper provided a succinct, comprehensive presentation of the G-10 and G-24 reports without offering any substantive appraisal or discussion of the various topics. Nevertheless, as an initial review covering the central themes and major points in order to establish a common ground for examining individual proposals and recommendations, the paper offered a thorough, objective, and well-organized summary of the two reports.

He agreed with the staff's broad strategy for examining the reports, Mr. Salehkhou continued. Both reports recognized close interconnections among the various issues related to the functioning of the international monetary system. He wondered, however, whether the proposals and recommendations set forth in the two reports should be appraised together or separately. Although substantive consideration of individual topics might not be inherently misleading, paying insufficient attention to the theoretical and institutional linkages among the various aspects of the international monetary system might not lead to its improvement but might even impair its functioning. Continued impartial consideration of those interconnections was especially important if procedural and/or institutional changes were to be undertaken. Despite the logical hierarchy among the issues involved and the need to give substantive consideration to each subject area according to a rationale priority, with work on each topic proceeding in parallel, a specific timetable should be established for considering all topics in the reports. Moreover, although the extent and severity of present global economic and financial problems required that greater priority be given to those issues most adversely affecting the majority of the international community, other issues of vital importance should not be left unattended. Omission of two critical issues confronting many less developed countries--external debt and the transfer of resources--was one of the major shortcomings of the G-10 report. He hoped that the staff would pay due attention to those issues.

At the outset he wished to express his broad support for the positions set forth in the G-24 report, Mr. Salehkhou remarked. In considering each subject, the staff should address not only the recommendations but also the analysis underlying each of the five major topics in the two reports. In that connection, he noted that the staff paper failed to mention the Group of Twenty-Four's proposal concerning the establishment of "a suitable institutional mechanism...for an in-depth and joint examination of the two reports." He invited staff comment on that point. He also noted the passing mention of the timely topic of transfer of resources.

In discussing the origin of the reports, the staff paper had given precedence to the G-10 report, Mr. Salehkhou noted. He recalled, however, that prior to the Williamsburg Economic Summit in 1983 and the subsequent adoption of the G-10's report on June 21, 1985, the Group of Twenty-Four had prepared an "Outline for a Program of Action on International Monetary Reform" in 1979. That document had been endorsed by the Group of Seventy-Seven and presented to the international community at the 1979 Annual Meetings in Belgrade.

In its October 7, 1985 communiqué, the Interim Committee had requested "the Executive Board to study the issues raised in these reports with a view to facilitating a substantive consideration by the Committee at its next meeting," Mr. Salehkhou said. Therefore, until the Board study was concluded, no judgments or observations should be made public, especially by officials whose international role necessitated an impartial and reserved attitude. The international nature of both the Development and Interim Committees also required that any prior consultations take place with the membership of the Committees at large rather than on a selected basis.

Mr. Mtei noted that developing countries continued to emphasize the need for a fundamental reform of the international monetary system, and he therefore welcomed a thorough analysis of the issues presented in the G-10 and the G-24 reports with a view to devising a system that responded more fully to the needs of developing countries. The staff had done an excellent job in comparing and contrasting the various views in the two reports. It was important that the Fund, because of its expertise and as the institution at the center of the international monetary system, be in the forefront in studying the problems and trying to build a consensus on what ought to be done to meet the legitimate concerns of all of its members, developed and developing countries alike.

As a practical matter, the wide range of issues covered by both reports required that the staff establish some priorities in ordering its work program, Mr. Mtei observed. He agreed that work on the exchange rate system was a matter of priority. He also attached particular importance to the debt problem and the transfer of resources in view of the emerging consensus in the international community that developing countries should be helped to grow out of their debt in order to ease the burden of adjustment. On the management of international liquidity, he believed that serious attention must be given to assessing the future role of the SDR. He was uncertain whether, as the staff had suggested, that issue should be put aside until other matters had been dealt with. Rather, he considered the topic to be important in its own right, because some important members of the Fund seemed to have had second thoughts as to the role prescribed for the SDR in the Articles of Agreement.

Considering the complexity of the issues to be discussed, he wondered whether consideration could not be given to drawing on expert opinion from outside the Fund to examine the issues in tandem with the staff's work, Mr. Mtei remarked. In any event, a compilation of brief bibliographies on each of the various issues with a view to presenting contrasting viewpoints would be helpful.

Mr. Sengupta observed that the staff paper had presented with remarkable clarity and objectivity the points raised in the G-10 and G-24 reports, particularly with respect to the exchange rate and surveillance. He had no problem with the general framework proposed for the substantive paper on each of the topics to be discussed.

He would focus his remarks on areas where further staff studies were necessary to bring out clearly the merits of the arguments contained in the reports so that the Executive Board and Interim Committee would have before it all aspects covered of the issues for discussion and decision, Mr. Sengupta continued. The discussion on international monetary reform was a continuing process, but it was important that the discussions proceed systematically. Even where intensive work had already been done, such as on exchange rates and surveillance, the proposals on which decisions would be taken had yet to be worked out, and the Board would have to meet several times before it could give final shape to those proposals. The report to the Interim Committee should indicate clearly those areas where decisions could be taken and those areas where further guidance was needed before formulating proposals.

The proposed staff papers on the functioning of the exchange rate system and Fund surveillance would form a good basis for initiating the Board's discussion, Mr. Sengupta considered. If some of the more fundamental suggestions presented in the two reports were accepted, further work would be needed on surveillance procedures. He noted that the forthcoming report on the World Economic Outlook would be prepared in light of the recommendations in the reports, and the Group of Ten and the Group of Twenty-Four looked forward to discussing it in its new format. He agreed with Mr. de Groote that the developments since the reports had been written, especially the recent G-5 consultations, had highlighted the need for policy coordination and had created a favorable atmosphere for discussing the functioning of the international monetary system. Recent events had also underlined the need to establish a mechanism for consultation or surveillance, as suggested by the Group of Twenty-Four within the Fund, instead of reporting to ad hoc discussions among a small number of industrial countries without the participation of other concerned countries.

The staff was preparing three papers on the question of international liquidity and the SDR, Mr. Sengupta noted. Because of the considerable divergence of views on that subject, he hoped the papers covered all the recommendations contained in the two reports. Decisions on other topics such as exchange rate policies and surveillance, especially with respect to the major industrial countries, would also have an impact on international liquidity creation and availability--a fact that should be kept constantly in mind during the examination of the liquidity issues. The question of the role of the SDR in the international monetary system was an important and difficult one, which would probably require study and the discussion extending beyond the April meetings.

The G-24 report had laid considerable stress on the role of the Fund, Mr. Sengupta observed. Because of the importance of that role, further work was needed in certain areas. The recent review of conditionality had not covered a number of recommendations by the Group of 24, which needed to be examined and implemented if growth-oriented adjustment was to be achieved. The review of conditionality had not examined the proposition outlined on page 13 of the staff paper, that "the reorientation of conditionality criteria from demand deflation to growth-oriented structural adjustment implies a need to lengthen program periods and to increase the level of financing." Moreover, the Group of 24 had also called for liberalizing the criteria applied for drawings under the compensatory financing facility expanding coverage to balance of payments deficits resulting from the effects of other exogenous factors, basing drawings on the amount of shortfall rather than on quotas, and making the compensatory financing facility quick-disbursing.

With reference to Fund programs, Mr. Sengupta continued, the G-24 report noted that "some Fund programs have broken down because of excessively rigid performance criteria, which were not revised in light of unforeseen developments beyond the control of the borrowing country." Similarly, the Group had also argued against the mechanical application of sanctions against defaulting members and had called for "more flexible application...of Article V, Section 7(g) and also to evolve new mechanisms to provide longer-term assistance for orderly adjustment of these countries." Those ideas needed to be examined and presented to the Interim Committee for discussion and decision, if not in April then at its subsequent meeting.

Further work was needed on concessionality in Fund lending, Mr. Sengupta went on. Despite the progress made so far with respect to Trust Fund reflows, though concessional, were aimed at a relatively small number of countries, and efforts were being made to change the character of those reflows through excessive conditionality. The G-24 recommendations contained other important elements, such as reducing the burden of costs on developing countries through the establishment of an interest subsidy account on a regular basis. The study of concessionality and Fund lending was especially important at present because the rate of charge had recently been increased to a high level and because an increasing number of borrowing members facing severe balance of payments problems were defaulting on payments to the Fund. It was not clear how the staff proposed to study the issue of overdue obligations.

It was vital that the staff prepare a preliminary paper on the possible need to advance the Ninth Quota Review, as suggested by the Group of Twenty-Four, Mr. Sengupta remarked. On the debt problem, he agreed with the outline of papers suggested and expected that all of the G-24 recommendations of--and not just the Baker initiative--would receive thorough consideration. The question of the transfer of resources to developing countries was of critical importance to the orderly adjustment of those countries and to ensure that growth did not suffer in the process. He hoped that the staff would prepare an independent paper discussing a growth-oriented adjustment strategy as background paper for the world economic outlook exercise, even if substantive discussions of the issue took place in the Development Committee.

He had earlier proposed that a compendium report be prepared for the Interim Committee, which would contain the results of the Board's deliberations and indicate the areas where further work was needed, Mr. Sengupta recalled. He agreed with Mr. Zecchini that a compilation of the summings up of the Board's discussions would give a fragmented picture instead of providing a document for negotiation. A comprehensive paper might be prepared by the staff or by a drafting committee composed of members of the Board. In either event, the Board should discuss the paper thoroughly before its presentation to the Interim Committee.

Mr. Alhaimus said that the staff paper presented a balanced outline of the proposals made in the G-10 and G-24 reports, and he had no problem with the suggested broad strategy for the Board's consideration of those proposals. It would be difficult to cover adequately every element of those reports before the Interim Committee's April meeting, but he was satisfied that the more important and perhaps more feasible proposals had been included in the individual staff papers being prepared on various aspects of the reports. He noted that the quota review and the related issue of decision-making had not been included in the work program or staff papers for discussion before the April meeting. While consideration of those issues before April might not be feasible, they should be examined before preparatory work on the next quota review began later in the year.

Although the subject of the transfer of resources fell mainly within the competence of the Development Committee, he urged that the issue be integrated into the discussion of the international monetary system, Mr. Alhaimus remarked. Indeed, the transfer of resources had been one of the main issues discussed by the Committee of Twenty on the reform of the international monetary system in the 1970s.

Mr. Sugita said that he broadly supported the studies and work program proposed by the staff. In that respect, there were a few basic points to which his authorities attached importance.

In his authorities' view, the weakness in the functioning of the present exchange rate system did not reflect the deficiencies of the system itself, but rather the insufficient degree of policy coordination and the difficult world economic environment in which the system operated, Mr. Sugita continued. Consequently, his authorities believed that improved exchange rate stability should be sought within the present institutional framework. He therefore regarded the proposals for target zones and for objective indicators to be farfetched, because they did not take into account political realities and the state of present knowledge regarding the relationship between the exchange rate and other economic variables. He therefore had some reservations about devoting a separate paper to that subject.

If the existing institutional framework was to be improved, the effectiveness of surveillance would assume primary importance, Mr. Sugita considered. Improvement in the effectiveness of surveillance, however, had to be sought in a way that would enhance cooperation and coordination among countries concerned rather than through pursuing mechanical improvements and procedures. An appropriate form of improved surveillance, including its forms, modalities, and publicity, had to be decided upon in view of that ultimate objective.

Mr. Kafka said that the idea of discussing the issues of the G-10 and G-24 reports according to the separate topics and respecting their logical hierarchy, as put forward in the staff paper, seemed to be a sound beginning. The need to reconsider each topic in the light of discussions of the remaining topics also seemed extremely likely, and he agreed with Mr. Zecchini and Mr. Sengupta that eventually a comprehensive paper would be needed to provide a basic document for negotiations in the Interim Committee meetings in April or more likely, in October. For that and other reasons, he cautioned against excessive optimism as to how far the Board would be able to progress before April, especially as some particularly important papers--for example, those on debt, transfer, and surveillance--were not yet available. Indeed, he expected that the work load would become even heavier between April and October.

On surveillance, he particularly liked the statement on page 3 of the staff report that overseeing of the performance criteria was itself a form of surveillance, Mr. Kafka commented. That was an important statement, since at times the staff had suggested that overseeing performance criteria really had nothing to do with surveillance and that therefore the surveillance for countries with or without programs was perfectly even-handed. In fact, the overseeing of performance criteria was for all practical purposes the only effective type of surveillance which the Fund had.

Mr. Wijnholds said that the staff paper was a useful survey of the main issues dealt with in the G-10 and G-24 reports and brought out in a balanced way the areas of agreement and disagreement. He agreed with the staff's view concerning the logical hierarchy of the issues to be discussed, and with the suggested program of work until the Interim

Committee's April meeting. He did not however consider it a good idea to discuss the SDR question in two stages. He also wondered about the announcement that the report on the world economic outlook to be issued in March would be prepared in light of recommendations in the two reports, apparently without having sought the Board's views on those matters. The staff paper also stated that further modifications in the world economic outlook and procedures would be "considered" on the basis of Directors' comments. He wondered on what occasion was the Board to provide such comments.

He looked forward to the Board's discussion of the debt situation and hoped that by that time a first case under the Baker Plan would have materialized, Mr. Wijnholds added. Furthermore, he considered that the question of transfer of resources to developing countries, especially relating to official development assistance, was a matter for discussion in the World Bank Board and the Development Committee. As for communication between the Interim and Development Committees, he wished to point out that a recent communication from the Chairman of the Interim Committee to members, which had recently been circulated to Executive Directors, had proposed, inter alia, to invite the Chairman of the Devlopment Committee to attend the Interim Committee meetings.

He had considerable doubts about Mr. Zecchini's suggestion for drafting a negotiating document, Mr. Wijnholds remarked. The Managing Director's summings ups and introductory comments on the subjects in the Interim Committee had worked well in the past. He was afraid that the drafting of a negotiating document might not be an efficient exercise, particularly if Directors became bogged down in long drafting sessions.

In discussing linkages, the staff had mentioned that strengthening the supervision over international banks had "clear implications" for international liquidity, Mr. Wijnholds noted. He did not agree that the implications were clear cut. The strengthening of bank supervision, including such measures as building up a stronger capital base, was generally considered necessary among the authorities in international financial centers in order to safeguard the banking system and thereby the international financial system. And without a sufficiently strong international banking system, the supply of liquidity from that source could easily be threatened. Of course, some supervisory measures might have had an impact on banks' attitude toward lending to so-called problem countries, but that impact should not be exaggerated. It would be unfortunate if the impression were created that a general relaxation of supervisory rules would be advisable to stimulate lending to problem countries and alleviate liquidity shortages.

Mr. Jaafar endorsed the views expressed by Mr. Lundstrom, Mr. Nimatallah, and Mr. Pérez. The areas of agreement indicated in the two reports were positive and helpful and should be emphasized. In other areas, Directors should search for a consensus in a pragmatic manner.

He had no difficulty with the broad work strategy proposed in the staff paper, Mr. Jaafar added. He was, however, concerned that the Board was trying to accomplish too much in its rush to complete a substantive consideration of the topics prior to the April meeting of the Interim Committee. Priority should be given to those topics that could be satisfactorily covered prior to the April meeting, leaving other topics for the next phase of the Board's work program up to the Annual Meetings.

Regarding the Managing Director's report to the Interim Committee, his chair supported the recommendation made by Mr. Sengupta, Mr. Jaafar remarked. On a related matter, he expected another paper on the role of the Fund in the light of discussions on exchange rate surveillance, the debt problem, and international liquidity.

Mr. Romuáldez said that the staff paper had summarized the issues presented in the G-10 and G-24 reports accurately and fairly, and he agreed with the proposed strategy for Board consideration of those issues. The additional comprehensive paper suggested by a few Directors could be useful, but like Mr. Wijnholds, he wondered if it was realistic or practical at the present stage, particularly in view of the short period until the Interim Committee Meeting and the heavy schedule already facing the Board.

The Director of the Research Department said that a number of papers under preparation touched on the debt problem, including one being prepared in connection with the world economic outlook exercise, the paper on export credit, and a study of issues arising in connection with the implementation of the Baker debt initiative. The paper being prepared in connection with the world economic outlook exercise would consider the evolution of the debt situation and its broad policy implications, including the relationship between available resources and Fund-supported adjustment. The paper would also discuss scenarios or sensitivity analyses developed for the recent world economic outlook exercise.

The Board would have an opportunity to suggest further modifications in the analysis and procedures for the world economic outlook exercise in the course of its discussion on surveillance, which would take place before the exercise was completed, the Director continued. The development of study of policy interactions in that exercise was an ongoing process, and each successive exercise benefited from Directors' comments and suggestions.

One Executive Director had suggested that the assessment of the future role of the SDR should not be delayed until after the studies of the SDR were completed, the Director recalled. Two papers on the SDR had been scheduled for Board discussion before the Interim Committee meeting, as well as a discussion on an SDR allocation. Directors would have an occasion following those discussions to appraise the need for further studies.

A paper was also being prepared on some of the broader issues arising in connection with a facility to assist members facing balance of payments problems arising from higher interest rates, the Director stated. That paper was expected to be submitted to management in mid-February.

A paper summarizing the Board's discussion of issues in the two reports might be useful, the Director of the Research Department commented. If requested to do so by the Board, the staff could coordinate the preparation of a paper reporting on those issues where progress had been made as well as those issues where further guidance was being sought.

The Treasurer noted that a number of Directors had suggested examining the possibility of advancing the Fund's work on the Ninth Quota Review and, in that context, advancing the work on issues related to decision-making in the Fund. To that end, several Directors had also requested a staff paper on the possible need to accelerate the Ninth Quota Review for submission to the Interim Committee. Work on the quota review had to be completed not later than March 31, 1988, and according to the Rules and Regulations, formal proceedings must begin not later than March 31, 1987. Thus, preliminary work would normally start in the later part of 1986. However, during the Board's recent discussion on the work program (EBM/85/163, 11/12/85), some Directors considered that the preliminary work could be advanced somewhat. The staff understood from that discussion that preliminary work might begin after the next Interim Committee meeting.

Other aspects of the Fund's operations would have a bearing on the timing of the quota review, the Treasurer observed. For example, the Fund's liquidity position would be reviewed in March, at which time the medium-term and long-term evolution of the Fund's liquidity could be assessed. To date, the liquidity reviews had not indicated any practical constraints on the Fund's lending activities, but they had pointed to some uncertainty in the longer run. Also, the Fund's access policy for the coming year would be discussed in the fall, and a decision might be taken to phase down borrowing and to accommodate that phase down through an increase in quotas. Subject to the guidance of the Board, the staff could prepare papers on the broad issues that were expected to arise during the quota review, including possible acceleration of the Ninth Review, following the spring meeting of the Interim Committee.

Mr. Dallara noted that the staff paper indicated that preparatory work on the quota review would begin in late 1986 unless the Interim Committee advised that the timetable should be advanced. Although the Treasurer had indicated that it might be possible to accelerate the review, his substantive comments relating to the Fund's liquidity did not seem to point in that direction. Thus, the timetable set forth in the Articles should prevail in determining when preparatory work began.

The preparation of a report by the Board to the Interim Committee for its Spring meeting was not likely to be productive at the present stage, Mr. Dallara considered. A report by the Managing Director summarizing the views of the Board might be the most productive approach in the present circumstances.

The Chairman noted that Executive Directors had considered the staff paper to be clear, balanced, and concise. The method and program of work for considering the recommendations in the two reports was, according to most speakers, generally acceptable, although several speakers had indicated a preference for an earlier discussion of the quota review and a more systematic treatment of the role of the Fund in the transfer of resources and in relation to growth-oriented strategies. Some Executive Directors had also indicated that the issue of conditionality required further in-depth consideration. As the Board had agreed at its previous meeting (EBM/86/13, 1/27/86), that topic would be discussed further.

Some Directors had referred to a global or compendium paper, presenting a logical synthesis of the Board's discussion of the various issues which would be prepared for the Interim Committee's Spring meeting, the Chairman continued. That was, in his view, a good suggestion, and his report to the Committee could be based on such a paper. At a later stage, when differences of views had crystallized more fully, drafting sessions such as those suggested by a few Directors could be helpful in firming some positions prior to taking action to reform some aspects of the international monetary system. His presentation to the Interim Committee would include a status report on the Board's discussions and would indicate those areas in which Directors desired the Committee's further guidance.

Several Directors had commented on the need for the pragmatic, cooperative approach to the Board's work on the two reports, the Chairman observed. An Executive Director had also indicated the need to narrow differences as much as possible: that, in his view, was the essence of what had to be done.

Executive Directors concluded for the time being their discussion on issues in the G-10 and G-24 reports relating to the functioning of the international monetary system.

APPROVED: September 15, 1986

LEO VAN HOUTVEN
Secretary