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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/78

10:00 a.m., May 9, 1986

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

Executive Directors	Alternate Executive Directors
	Mawakani Samba
C. H. Dallara	M. K. Bush
	E. L. Walker, Temporary
	H. G. Schneider
M. Finaish	T. Alhaimus
H. Fujino	
	B. Goos
	Song G., Temporary
	S. Ganjarerndee, Temporary
	H. A. Arias
T. P. Lankester	
	H. Fugmann
M. Massé	L. Leonard
	W. K. Parmena, Temporary
F. L. Nebbia	
Y. A. Nimatallah	
P. Pérez	
H. Ploix	
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
S. Zecchini	N. Kyriazidis

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

Also Present

IBRD: N. Ramachandran, Latin America and the Caribbean Regional Office. Administration Department: D. S. Cutler. African Department: M. E. Edo. Central Banking Department: H. Mehran. European Department: L. A. Whittome, Counsellor and Director; U. Dell'Anno, P. Dhonte, K.-W. Riechel, K. A. Swiderski, J. S. Van't dack. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; G. Belanger, J. T. Boorman, M. R. Kelly. External Relations Department: M. Goldstein, I. S. McDonald, B. Nowzad. Fiscal Affairs Department: V. Tanzi, Director. Legal Department: W. E. Holder, R. H. Munzberg. Middle Eastern Department: B. A. Karamali. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; M. P. Dooley, N. M. Kaibni, F. Larsen. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat, G. Djeddaoui, P. D. Péroz. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; P. B. Clark. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Language Services: A. J. Beith, Director. Bureau of Statistics: V. Marie, J. R. McKee, M. R. P. Salgado. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, G. D. Hodgson, K. Murakami, G. Nguyen, A. Ouanes, P. Péterfalvy, D. C. Templeman, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: M. Arif, A. Bertuch-Samuels, B. Bogdanovic, J. de la Herrán, J. J. Dreizzen, R. Fox, S. Geadah, V. Govindarajan, L. Hubloue, Z. b. Ismail, S. King, R. Msadek, A. H. Mustafa, J. K. Orleans-Lindsay, J. Reddy, J. E. Rodríguez, S. Simonsen, H. van der Burg, B. D. White.

1. KINGDOM OF THE NETHERLANDS - NETHERLANDS ANTILLES - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with the Netherlands Antilles (SM/86/80, 4/18/86). They also had before them a report on recent economic developments in the Netherlands Antilles (SM/86/81, 4/22/86).

Mr. Polak made the following statement:

Economic activity in the Netherlands Antilles is heavily dependent on the exports of services, in the form of tourism, offshore banking activities and oil refining. The situation in these sectors has changed abruptly for the worse in recent years, and these changes most likely will be permanent. Mainly as a consequence of the devaluation of the Venezuelan bolivar, tourism receipts have fallen by one third since 1983. The repeal of the withholding tax on certain interest payments in the United States in 1984 greatly reduced the attractiveness of the Netherlands Antilles as an offshore banking center; the effects of this will be mainly felt from 1987 onward. Changing oil market conditions led to the transfer of the Shell oil refinery to a Venezuelan group, at a much reduced wage bill and with less income for the Government.

The main effects of these changes in the economic environment will be felt in the medium term. Allowing for some increase in tourism receipts, the level of gross receipts from the export of goods and services is nevertheless expected to fall by some 10 percent below the 1984 level by 1989. The required adjustment in the fiscal sector will even be greater; the staff has calculated this at NA f. 360 million, or some 40 percent of 1984 expenditure (approximately 20 percent of 1984 GNP).

Meanwhile, during 1985, some temporary favorable developments have occurred. The fall in oil prices will considerably improve the balance of payments. Moreover, the authorities have used this opportunity to raise gasoline taxes, and, as a consequence, the remaining required fiscal adjustment is now calculated at NA f. 290 million. Since the Netherlands Antilles guilder maintains a fixed parity with the U.S. dollar, the fall in the latter has improved the competitiveness of the Netherlands Antilles, to some extent offsetting the deterioration of earlier years. Receipts from the offshore banking sector showed considerable buoyancy in 1985, virtually eliminating the current account deficit. Severance payments from the Shell Company, in connection with the takeover of the oil refinery, added substantially to the country's reserves. As mentioned, however, these factors will be one-shot affairs.

Thus, the required medium-term adjustment remains considerable. The authorities agree with the staff that the medium-term fiscal adjustment has to come mainly from cutting the wage bill. They believe, however, that considerable room exists to rationalize and streamline the government sector and to reduce fringe benefits; during 1985, they have taken various steps in this latter direction, e.g., by eliminating wage indexation and the system of vacation bonuses. They believe that in these ways they can build up the confidence needed to implement more drastic cuts in wages.

The Netherlands Antilles authorities are committed to maintain a fixed parity with the U.S. dollar. They don't see a role for a devaluation as part of their adjustment process as their present exchange rate policy has served them well to maintain confidence and to keep inflation low.

Monetary policy remains geared to maintaining the fixed exchange rate parity. Recently, measures have been taken to enhance the Central Bank's autonomy and to limit the monetary financing of the government deficit.

The authorities are aware that next to the fiscal adjustment, efforts should be made to develop other productive sectors in order to compensate for the loss in the traditional sectors. To this end, they have requested the World Bank to undertake a study to help them identify the areas in which profitable activities might be undertaken. The report of the Bank mission is expected shortly.

As the staff report indicates, important deficiencies exist in data collection. The authorities are taking measures, with the help of technical assistance provided by the Netherlands, to reverse this situation.

Finally, I want to convey the appreciation of my Netherlands Antilles authorities for the work the staff has done in identifying the problems facing them and advising them on how to tackle these.

Mr. Pérez observed that the Netherlands Antilles had suffered a series of external shocks affecting the dominant economic sectors of the country. The decline in tourism revenues resulting from the bolivar devaluation in 1973 and the economic recession in Venezuela, the loss of preferential tax treatment by the offshore financial sector, and the closure of the oil refinery in Aruba had darkened the medium-term outlook for the Netherlands Antilles.

Economic and financial developments had been better than expected in 1985 and had contributed to an improvement in the short-term prospects for the economy, Mr. Pérez continued. The combination of temporary, large liquidation payments by the Shell Company, the continuing high level of tax payments by the offshore financial sector, and the recent takeover by the Venezuelan group PDVSA of the Shell oil refinery in Curaçao had provided the country with some margin for adapting to the new economic conditions, as had the decline in oil prices, the recent depreciation of the U.S. dollar, and the less than expected decline in foreign exchange receipts. However, that did not mean that the authorities could afford to delay the necessary adjustment. To face the consequences of the sharp change in the structural conditions of the country, two types of action must be undertaken: the authorities must prevent a deterioration in the present sound external economic position by maintaining the country's competitiveness; at the same time, they must define and adopt a medium-term strategy to promote new economic activity.

A reduction in nominal wages, together with adjustment by the public sector to the fall in fiscal revenues, appeared to be the key elements in the effort to adjust domestic expenditures to the permanent drop in foreign exchange inflows, Mr. Pérez said. A reduction in nominal wages in particular was needed to restore competitiveness if the authorities wanted to preserve the peg of the Netherlands Antilles guilder to the U.S. dollar. In that regard, the Government's reluctance to reduce nominal wages by 15-20 percent in 1985 was a matter of concern, because any doubt about their intentions to adjust would contribute to a loss of momentum. Of course, the Government had taken a number of positive steps. For example, the reduction in the vacation allowance and the modest cut in minimum real wages since 1982--together with greater flexibility in labor practices-had been steps in the proper direction. Nevertheless, given the magnitude of the problem, the measures adopted by the authorities were clearly insufficient. The Netherlands Antilles was endowed with a highly qualified labor force, but that fact alone was not justification for the high level of labor costs by comparison with the rest of the region, especially if the desire was to ensure that the Netherlands Antilles became more attractive to foreign investors.

Given the severe external shocks experienced by the economy, it was clear that an adjustment in the standard of living must take place, either through a cut in nominal wages or through a depreciation of the Netherlands Antilles guilder, Mr. Pérez commented. The first course of action was preferable in his view, since the adjustment would take place at a lower level of inflation; any hesitation by the authorities to adopt such an option would force them to implement a more active exchange rate policy.

On the fiscal side, the gap between expenditure and revenue, both present and prospective, was a matter of concern, Mr. Pérez noted. A sharp reduction in the fiscal deficit was called for, mainly through expenditure reductions rather than increases in taxes. In that regard, a case could again be made for strong action to tighten the public sector wage policy in order to reduce public outlays and encourage moderation in wage negotiations in the economy as a whole. Moreover, the Government should undertake a substantial reform of the public sector in order to eliminate redundancies following the separation of Aruba from the rest of the islands. On the monetary side, he joined the staff in welcoming the steps adopted by the authorities to set limits on the amount of overdraft facility available to the Central Government. Such limits should help with monetary control. In sum, he encouraged the authorities to undertake an unwavering course of action geared to restoring the country's competitiveness, which was a precondition for the sectoral reorganization of the economy.

Mrs. Walker noted that the Netherlands Antilles had suffered several external shocks in the past year, the impact of which would be felt by the economy in future. Unfortunately, the authorities had been pursuing expansionary policies--including wage policies--that, together with the external shocks, promised a bleak economic outlook for the medium term in the absence of action to reverse the deterioration in the foreign exchange earnings of the islands and to bring about improved competitiveness that could promote a recovery in economic activity.

While prospects for 1986 remained relatively positive--with the current account expected to be close to balance--the favorable developments that had produced them were unlikely to be repeated and similar performance in 1987 and beyond could not be assured, Mrs. Walker continued. The staff had projected that growth of foreign exchange receipts could fall by approximately 10 percent between 1984-89, which would affect imports as well as revenues of the public sector, and a corresponding reduction in expenditures in the public sector would be necessary to promote a sustainable external balance. It was estimated that a package of expenditure cuts and revenue increases representing 40 percent of expenditures, or 20 percent of estimated GNP in 1984, would be needed over the period 1984-89. While underlying imbalances might be concealed in the short term, they would appear if the authorities did not take action soon on the fiscal front.

Wage cuts were certainly a necessary element of the fiscal package, Mrs. Walker considered. Mr. Polak had indicated that the authorities accepted that a reduction of the wage bill should be part of the fiscal adjustment, and they had apparently already taken some measures toward that end. Noting that the staff had called for a 10 percent reduction in costs per employee within one year, she urged the authorities to consider serious wage cuts in the civil service to help improve the profitability of existing industries and attract new ones. Efforts by the Government to control costs in the public sector could serve as a model for the private sector, which also needed to reduce labor costs and improve efficiency.

Employment prospects in the Netherlands Antilles were worrying, particularly in the private sector, Mrs. Walker commented. Development of that sector, especially in the area of tourism, should be pursued; in that respect, she welcomed the offer of the World Bank to assist the authorities in reviewing the necessary structural adjustments in the tourist sector and other economic sectors. The intention of the authorities to stimulate the creation of new and more diversified manufacturing activities that could generate new foreign exchange earnings was welcome. In that context, the tax incentives enacted during 1985 toward that end could be helpful in promoting export industries.

Monetary policy in the Netherlands Antilles was geared toward maintaining a fixed exchange rate between the guilder and the U.S. dollar, Mrs. Walker observed. While the authorities were apparently committed to maintaining that parity, a study should be made of the possibility of adjusting the exchange rate to increase competitiveness, particularly given the erosion in the foreign exchange earnings in the offshore financial sector. Limited expansion of and credit to the public sector was also called for, and she therefore welcomed the adoption of the new statutes of the Central Bank. Credit to the private sector had been sluggish, perhaps because of a lack of private sector activity or heavier demand for credit by the public sector. She wondered what effect the credit ceilings were having on demand for private sector credit. Finally, the authorities should recognize the potential impact of the recent exogenous shocks on the future of the Netherlands Antilles economy, and they should take the measures necessary to accommodate the changes in the structure of the economy. Improvements were required in the competitiveness of existing industries, and the development of additional industries and services were needed to provide the economy with further resources for growth and expansion.

Mr. Leonard, noting his support for the staff appraisal of the Netherlands Antilles economy, agreed with Mrs. Walker that it might be desirable at some stage to study the possibility of exchange rate adjustment. However, at present, the fixed exchange rate seemed to be providing a strong anchor for other policies, and it might be wise to make use of that anchor, at least in the near term, to avoid repercussions in other areas of the economy that might occur if the fixed exchange rate were abandoned. While he agreed that competitiveness must be maintained, not least through keeping wages at a level that would ensure reasonable parity with unit labor costs in other countries in the region, competitiveness alone was not sufficient; there also had to be development of the productive base through which that competitiveness could be given operational effect. He was thus happy to note that the World Bank had been called upon to advise the authorities on what activities might be undertaken to provide employment and alternative sources of export earnings for the future.

The staff representative from the European Department observed that declining credit to the private sector in the Netherlands Antilles was not a product of crowding out; rather, uncertainty in the islands made people nervous about borrowing even for mortgages. And credit for the financing of consumption had been falling not so much as a result of the imposition of credit ceilings by the Central Bank but because people were becoming more prudent.

As in the discussion of the 1985 Article IV consultation with the Netherlands Antilles, Executive Directors had raised a number of questions on the exchange rate, and their concerns had been made known to the authorities, who were certainly becoming increasingly aware of the need to improve competitiveness one way or the other, the staff representative continued. However, they were sensitive to the importance of the fixed exchange rate in the Netherlands Antilles economy. In addition, they had pointed to the fact that international reserves were quite high, which gave them some leeway to adjust in a noninflationary manner without changing the exchange rate.

Mr. Polak remarked that the authorities in the Netherlands Antilles felt that wage adjustment was far preferable to an exchange rate change. It was all well and good to speak of competitiveness, but in fact there was no way for the islands to compete with some of the surrounding countries like Haiti or the Dominician Republic, where the per capita incomes were two to three times lower than in the Netherlands Antilles. In that respect, competitiveness would not be achieved with a depreciation or even with wage control; more important was for the authorities to find the type of activities or industries that could flourish in the area. With the Netherlands Antilles' connections, good education, and close links to the United States, the tourist industry could do well in spite of high wage levels. And a recent World Bank mission had looked closely at that and other areas that might be developed in future. Finally, he agreed with Mr. Leonard that the peg to the dollar, together with the helpful depreciation of the U.S. dollar against other currencies, provided a strong anchor in the Netherlands Antilles. While there had been from time to time discussion in the islands of a change in the parity, there was less sympathy for such a change at present than there might have been a year or so earlier.

The Chairman made the following summing up:

> Directors noted the abrupt changes to which the economy of the Netherlands Antilles had been exposed in recent years. They observed that the islands were faced with large imbalances, caused foremost by a sharp deterioration in the external environment, but also by high domestic costs and insufficient fiscal discipline. The medium-term outlook remained clouded by the drop in prospective earnings from the oil refinery and the offshore financial sectors, as well as by some loss of tourist revenue. Directors noted that the islands had benefited from the recent decline in oil prices, a low inflation rate, and the absence of any significant external debt, as well as from temporary favorable developments in 1985, including buoyant receipts from the offshore banking sector and severance payments from the oil company. They urged that these advantages be used to smooth, rather than delay, the adjustment process.

Directors agreed that fiscal policy had the primary responsibility of aligning domestic absorption to the reduced income-generating capacity of the islands. They stressed the need to reduce public spending drastically in the medium term and they identified the reduction in public sector labor costs and the strengthening of the financial position of public enterprises as the major tasks facing the authorities. In that connection, Directors pointed out that through leadership in wage restraint and determination in reducing public outlays, as well as through measures to raise additional tax revenue, the authorities could effectively improve external competitiveness and restore confidence in the economy and could thus lay the basis for attracting new activities, a development which so far had been hindered by the high level of wage costs.

Directors welcomed the fiscal adjustment measures that had recently been implemented or proposed, but emphasized that those measures represented only the very start of a comprehensive adjustment program and that they did not sufficiently address the problem of high labor costs. The authorities were commended for tightening the limits on central bank credit to the public sector in support of such adjustment. The maintenance of the fixed exchange rate with the U.S. dollar was seen by some as a strong and useful anchor, but other speakers noted that such a policy depended very much on the ability of the country to keep costs down, and they encouraged the authorities not to exclude consideration of greater exchange rate flexibility if that were needed.

It is expected that the next Article IV consultation with the Netherlands Antilles will be held within 18 months.

2. WORK PROGRAM

The Executive Directors considered the following statement by the Managing Director on the work program until the 1986 Annual Meetings:

> Now that the spring meetings of the Interim Committee and Development Committee are over, we should give consideration to our work program for the period ahead, taking into account guidance provided by the Committees. In this statement, I shall be concerned with the main elements of our work program for the period until the Annual Meetings and the next meetings of the two Committees at the end of September 1986.

1. Further consideration of issues raised in G-10 and G-24 reports on the international monetary system

In its communiqué, the Interim Committee has indicated that it intends to give further consideration at its next meeting to the issues raised in the reports of the Group of Ten and Group of Twenty-Four, based on further work by the Executive Board. Considering the mandate for further work that has been given to us, it seems convenient to organize our work program on this subject around three broad topics:

(a) Fund surveillance and the functioning of the exchange rate system;
(b) the SDR;
(c) the role of the Fund.

These topics are dealt with in turn below.

(a) Fund surveillance and the functioning of the exchange rate system

On the subject of the exchange rate system, the Interim Committee suggested that the Executive Board "consider further whether there are any modifications...that could contribute to enhancing exchange rate stability and the mutual consistency of economic policies without sacrificing the essential flexibility of the system." Additional guidance for improvement in the operation of the exchange rate mechanism can be found in the Committee's deliberations on the role that Fund surveillance needs to play in the international monetary system. To strengthen the multilateral setting for surveillance, the Committee has asked the Executive Board to "consider ways in which its regular reviews of the world economic situation could be further adapted to improve the scope for discussing external imbalances, exchange rate developments, and policy interactions among members. An approach worth exploring further was the formulation of a set of objective indicators related to policy actions and economic performance, having regard to a medium-term framework. Such indicators might help to identify a need for discussion of countries' policies."

As background for a Board discussion of these topics, the staff will prepare an exploratory paper on indicators of economic policies and performance. That paper would set forth a framework for organizing the information about medium-term performance and prospects of industrial countries that would enable judgments to be formed on policy adjustments needed for international compatibility of economic policies and performance and for a viable balance of payments pattern. The paper is planned to be issued in mid-June and has been placed on the Board's agenda for July 14. The Board discussion on that date can provide guidance for further work on surveillance and the functioning of the exchange rate system.

(b) The SDR

Recognizing that the SDR can play a useful role as a component of international reserves and as a unit of account as well as its potential for a "safety net" against unexpected contingencies, the Interim Committee has asked the Executive Board to "continue its discussions on the role of the SDR in the present international monetary system and on SDR allocation in the light of proposals, aiming at the different possibilities of obtaining a more balanced and stable proportion of SDRs in members' reserves that have been put forward in that Board, and to report to the Committee at its next meeting on the progress in these discussions." Furthermore, the Committee stressed the monetary character of the SDR which should not be a means of transferring resources and recommended that the Executive Board "study possible improvements in the monetary characteristics of the SDR that would increase its attraction and usefulness as a component of monetary reserves."

The following papers in the current work program will deal with the potential role of the SDR in an evolving international monetary system. The first, entitled "Proposals Regarding Arrangements to Accompany SDR Allocations," will take up the ideas that have been advanced in this Board on this subject by Mr. de Groote, Mr. de Maulde, and Mr. Sengupta. To be issued by the end of May, it has been scheduled for Board consideration on June 27.

Two proposed papers will address the factors that bear upon the willingness to hold SDRs. One will examine various possible approaches to achieving a more balanced and stable relationship in members' holdings of SDRs and other reserve assets, including the possibility of some form of a revived reconstitution rule and will be scheduled for Board consideration in the period before the informal recess. The other paper will deal with the issues arising from possible arrangements to permit the use of SDRs in exchange market intervention by central banks and to establish a clearing facility for SDR-denominated financial instruments. This paper will be circulated in late summer. Executive Directors will also have available for the meeting mentioned above in this paragraph a paper on "The Growth of Voluntary Transfers of SDRs Among Participants and Prescribed Holders."

The staff also has in hand a study dealing with countries' reserve management practices, including, in particular, an assessment of views and practices with respect to SDR assets and liabilities; it is expected to be issued after the Annual Meetings.

As you know, the Articles of Agreement call on me to make proposals concerning SDR allocations not later than six months before the end of each basic period; and if it is not feasible to put forward a proposal that is consistent with the provisions of Article XVIII, Section 1 and that has broad support among participants in accordance with Section 4(b) of the same Article, I must so report to the Board of Governors and to the Executive Board in the second part of June. For that purpose, I shall be in touch with Executive Directors to ascertain whether there is any shift in positions on this matter.

In connection with preparations for the September meeting of the Interim Committee, we should plan a Board discussion in early September, say, on September 5, on the subject of possible allocations of SDRs in the next basic period beginning January 1, 1987. The staff will for that purpose prepare a paper incorporating the necessary statistical and other material.

(c) The role of the Fund

The decision on enlarged access is to be reviewed annually "in light of all relevant factors, including the magnitude of members' payments problems and developments in the Fund's liquidity." At the time of the next annual review, which should be completed before the end of 1986, we are also required to review the guidelines on access limits under the policy on enlarged access as well as access limits applicable to the compensatory and buffer stock financing facilities. If Executive Directors were to favor a preliminary discussion before the Annual Meeting in order to elicit guidance from the Interim Committee, the staff would prepare for this purpose a paper reviewing experience to date with the current access limits under the enlarged access policy and discuss the potential need for Fund financial assistance by members in 1987. Particular attention will be paid to the increased need for flexibility in the application of the policy on enlarged access, as noted in the paragraph on the debt situation in the recent Interim Committee communiqué. Together with a complementary staff paper on experience with access limits under the compensatory and the buffer stock facilities, this subject could be scheduled for Board consideration in early September. In that event, a staff paper analyzing the implications for the financing needs of the Fund would also be prepared in connection with the semiannual review of the Fund's liquidity position.

As regards the Ninth General Review of Quotas, under Rule D-3 the Executive Board must appoint, not later than March 31, 1987, a Committee of the Whole to prepare a report on the matter. As planned, it is intended to initiate preliminary discussions on the quota review in the latter part of 1986, on the basis of appropriate staff papers.

A staff paper on theoretical aspects of design of Fund programs, carried over from the previous work program, is now planned to be issued in early July. It will focus on relationships among the objectives of Fund programs, instruments for achieving them, and the indicators of performance used in assessing them. A related paper entitled, "Program Design and Performance Criteria" will examine experience with different types of performance criteria (including their specification and measurement) in Fund programs and assess their suitability for achieving program objectives. It will also seek ways of improving performance tests to ensure that they are effective in safeguarding the revolving character of Fund resources. The above two papers have been scheduled for discussion on July 30.

On the subject of debt strategy, the Interim Committee has welcomed the progress that is being achieved in strengthening it along the lines proposed by Secretary Baker in Seoul. The Committee reaffirmed the central role of the Fund and emphasized that the strategy should continue to be tailored to individual cases. The staff's annual survey on "The International Capital Markets: Developments and Prospects - 1986," scheduled for consideration on September 3, will provide the Board with the opportunity to review this important area, as it will pay particular attention to recent evolution with regard to lending activities of the World Bank, the regional development institutions and to participation by commercial banks. For this Board discussion, Directors will also have available a review of recent developments in official debt reschedulings as well as a note on BIS/OECD export credit statistics. The papers on international capital markets and on official debt mentioned above will also provide the basis for a review of the experience with enhanced surveillance. It will be recalled that the Board had agreed last September to have such a review in about a year.

2. <u>World economic outlook</u>

The summer 1986 world economic outlook will, as usual, update the projections presented in the spring and provide a revised assessment of current policy issues. Special attention will be given to the indicators of policies and performance in industrial countries. Policy issues will be considered against the background of these countries' medium-term economic objectives and the staff will bear in mind the suggestion by the Interim Committee that "increased emphasis...be given in the world economic outlook to policy interactions among industrial countries in order to strengthen the basis for assessing the international repercussions of the policies and objectives of the major industrial countries, and also to help promote the further development of recent initiatives to enhance policy coordination among these countries." Attention will also be given to updating the prospects for growth and adjustment in heavily indebted countries.

In this section of the paper, it is intended to give consideration to the problem of flight capital and to prospects for commodity prices; more detailed consideration of these matters will be undertaken for the world economic outlook exercise in the spring of 1987. Executive Board consideration of the world economic outlook is scheduled for September 10, to be concluded on September 12.

Publication of the updated world economic outlook will take place shortly after the Annual Meetings. As usual, Executive Directors will have an opportunity to offer specific comments prior to publication.

3. Area departments' work program

During the five months through end-September, the work program of area departments indicates that some 70 Article IV consultations will need to be taken up by the Executive Board. In the same period, up to 30 papers concerned with the use of resources in credit tranches are expected to be submitted to the Executive Board, of which around two thirds would be reviews under existing stand-by arrangements and the remainder would be requests for new arrangements.

It is likely that several requests for the use of resources under the structural adjustment facility will reach the Board during this period. The Fund staff is already working actively with staff of the World Bank to prepare the discussions with authorities in at least eight member countries on policy framework papers. In cases where arrangements could accompany requests for, or reviews under, stand-by arrangements, the staff is preparing for negotiations with authorities on the programs to be presented in support of these requests. Procedural aspects for cooperation between the Fund and Bank staffs and the authorities in the development of framework papers are evolving, and some missions are already in the field discussing policy frameworks in a few member countries.

4. Annual Report

The Board recently has considered the outline for this year's Annual Report and reviewed the procedures for considering the draft in the Committee of the Whole. The staff will provide a unified text of both Part I and Part II at the latest by June 23, and I understand Directors have agreed to provide written comments prior to the first reading in Committee which is tentatively scheduled for July 9 and July 11, with an understanding that it may be necessary for the Committee to meet on the intervening Thursday (July 10). The second reading, for which it is expected that only the revised pages would be reissued, could take place on July 28 and the report approved by the Board on lapse of time basis by August 5.

Printed copies should become available in the second week of September and release to the public is tentatively set to take place on Thursday, September 18.

5. Operational matters

Following our preliminary discussion on April 30 of "Provisioning Against Loan Losses in the Context of the Fund," it was agreed that we have substantive consideration of this issue on May 19. The agenda for that day will also include as a separate item the periodic six-monthly report on overdue financial obligations to the Fund.

Final data for the Fund's income in FY 1986 are expected to become available around mid-May, on the basis of which a paper on the Fund's income position will be prepared, proposing a draft decision regarding the disposition of the Fund's net income for FY 1986 including attribution of income in excess of target resulting from the rate of charge of 7 percent for the second half of FY 1986. As agreed on April 30, this paper will also provide updated projections of income for FY 1987 taking into account all the relevant factors and will deal with the issue of the rate of charge for 1987, the remuneration coefficient and a further analysis of alternative ways of burden sharing; it will be brought to the Board's agenda by mid-June.

Directors will recall that we need to have a comprehensive review of the remuneration coefficient before May 1, 1987. In light of the Board discussion in mid-June mentioned above, it may be appropriate to conduct that review during the first half of the financial year. If so, the staff paper for that purpose would be issued for discussion after the Annual Meetings.

As regards the treatment of overdue financial obligations to the Fund, a staff paper on legal options available to the Fund following the declaration of ineligibility will be issued shortly and could be considered in the Board in the first part of June. Reports on overdue financial obligations to the Fund of individual member countries will be issued as needed. In July, a quarterly statistical update of overdue financial obligations to the Fund will be issued for the information of Executive Directors.

A report for the Board's semiannual review of the Fund's liquidity position will be brought to the agenda in early September. The designation plans and the operational budgets for the June-August and September-November quarters are tentatively scheduled for consideration on June 13 and September 12, respectively. A paper on "Disbursement of Supplementary Financing Facility Subsidies" is expected to be issued in early July, probably for lapse of time decision.

In view of the interest shown by several Executive Directors in the Fund's approach to policies and practices with respect to accounting and budgeting for capital expenditures, an exploratory staff paper dealing with methods of accounting for capital expenditures (SM/85/246, 8/27/85) was issued to the Executive Board some time ago. It is intended to bring it to the agenda, together with a complementary paper on capital budgeting which has been issued recently (see section 7 below), in the period before the Board's informal recess.

6. 1986 election of Executive Directors

With the regular election of Executive Directors to be held during the next Annual Meeting, it will be necessary to constitute soon an ad hoc Committee on Rules for the Election. A staff paper for consideration by the Committee dealing with regulations for the election will be prepared. The determination of the two members with the largest creditor position vis-à-vis the Fund on the average for the preceding two years will have to be made at the beginning of August. The Committee is expected to complete its work in time for the Executive Board to consider its recommendations and agree on draft rules to submit to the Board of Governors before the informal recess.

7. Administrative and related matters

The 1986 staff compensation review has been rescheduled for Executive Board consideration on May 21. Directors will recall from my previous work program statement of November 1, 1985 that at that time it had been the expectation that the report of the Joint Bank/Fund Committee of Executive Directors on Staff Compensation would become available to the two Executive Boards in March 1986. Recently, however, the Chairman of the Joint Bank/Fund Committee indicated to the Board that the Committee's report would not be ready for consideration by the two Executive Boards until after the Annual Meetings.

A paper on review and appeals procedures in connection with the recent job grading exercise is expected to be issued shortly for the information of Executive Directors. Another paper concerning provisions of an early retirement scheme for downgraded staff is planned to be issued soon, possibly for Board consideration around the end of May.

A paper dealing with alternative approaches to budgeting for capital assets, and presenting options for consideration, has been circulated recently (EBAP/86/84, 4/9/86). As mentioned above in section 5, it is intended to bring it to the agenda together with the complementary paper on accounting for capital assets, in the period before the informal recess.

8. Other matters

A staff study on Islamic Banking has been issued recently; Directors may wish to indicate whether and when (and in what format) they wish to have a discussion. It could then be scheduled accordingly.

Three studies are being prepared and will be circulated to the Board for information. The first paper dealing with "Experience with Exchange Rate Flexibility in Developing Countries" will be issued shortly. A biennial report on external payments arrears of Fund members will examine developments in external payments arrears and arrangements for reducing them, with particular reference to the exchange system. This report is expected to be circulated in August. A third study on "Forward Exchange Market Arrangements" will review Fund members' arrangements for forward exchange markets and their experience with respect to official facilities for hedging against exchange rate risks. It is hoped that the available experience of members that have such arrangements can be drawn upon to identify techniques by which, for instance, the risk of central bank losses and consequent monetary expansion might be reduced. This study is expected to be circulated in October.

The Annual Report on Technical Assistance is planned to be issued in early June. A periodic semiannual report on the frequency of Article IV consultations will be circulated in August for the Board's information. A paper on Fund/Bank collaboration on statistical data collection, storage, and processing is under preparation.

I should also mention that the Board will need to consider at an appropriate time provisional agendas for the next Interim Committee and Development Committee meetings, with the timing and procedure for the latter being coordinated with the World Bank.

Mr. Arias indicated his agreement with the general thrust of the Managing Director's statement, which took into consideration the guidance provided by the Interim Committee. The work program covered a number of delicate subjects that would directly affect not only the role of the Fund but the global economic and financial environment as well and thus placed a heavy responsibility in the hands of the Executive Board.

He had only three points to make on the work program itself, Mr. Arias continued. First, his preference was for a preliminary discussion of access limits before the Annual Meetings. Second, he recommended moving forward the work of the Committee of the Whole on the Ninth General Review of Quotas to, say, the middle of 1986. Although the Committee would need some statistical information for the current year, that should not prevent it from making some progress toward coordinating matters and initiating a general discussion on the subject of quotas. Finally, his chair attached a great deal of importance to the structural adjustment facility as a source of resources, particularly for countries with very low per capita incomes. It was to be hoped that the time required for the preparation of policy framework papers would not be an obstacle to proceeding with a request from a country for use of resources from the structural adjustment facility.

Mr. Fujino remarked that before turning to the work program, he would comment briefly on the Tokyo Economic Summit, for which his country had served as host. The text of the Economic Declaration produced at the conclusion of the summit meeting had been supplied to the Secretary of the Fund for circulation to Directors, and he had little to add to the text. In paragraph 5, it was clearly stated that the Group of Five (G-5) "reaffirms that it remains essential to maintain a firm control of public spending within an appropriate medium-term framework of fiscal and monetary policies." Paragraph 7 of the Declaration had operational implications for multilateral surveillance; the participants had reaffirmed that the members would cooperate with the Fund and that the Managing Director would play a role in the multilateral surveillance exercise. The Group of Seven (G-7) would review the economic objectives of individual members at least once a year to see whether those objectives were compatible, and the Group of Five would review economic forecasts for each member of the Group, taking into account economic indicators of the sort mentioned in the Declaration. When there were significant deviations from the intended course of economic performance to be monitored by those indicators, an effort would be made to reach an understanding on appropriate remedial measures.

Mr. Sengupta welcomed the indication that the Group of Five and Group of Seven would hold discussions among themselves and with the Managing Director on the compatibility of economic policies. However, Mr. Fujino's mention of the "intended course" of economic performance implied that a discussion of the indicators would lead to agreement on the intended course of performance to be monitored by them. In other words, it seemed that the Group of Five and Group of Seven would arrive at some understanding about the way the indicators should move, taking into account the compatibility of members' economic policies. He would appreciate confirmation of that point.

Mr. Polak wondered whether it was fair to raise such issues at the present meeting. It might be preferable to wait for a week or two before holding an extended discussion on the plans of the Group of Seven.

Mr. Nimatallah agreed with Mr. Polak that specific questions could be raised at a later date. For the moment, it was sufficient to recognize the significance of the agreement that Ministers would meet and talk about their economic policies on a regular basis.

Mr. Lankester stated that he would caution against too early a discussion of the details of the Tokyo Economic Declaration, even on the lines suggested by Mr. Polak. For the time being, the emphasis should be on technical work on the indicators so that, later on, a discussion of some substance could be held.

Mr. Sengupta said that he fully accepted that it might be too early for members of the Group of Seven to answer the sorts of questions he had raised; however, he was rather concerned about Mr. Lankester's indication that such questions should not be asked until after a great deal of technical work on the indicators had been completed. As he saw it, the technical work would be done by the Fund staff in any event, but it was important for the Executive Board as a whole to understand precisely what had been agreed at the Tokyo Economic Summit; and those clarifications should be provided in, say, a week or so.

Mr. Fugmann stated that while he understood Mr. Lankester's concerns, he agreed with Mr. Polak that it would be helpful for Directors to know the implications for the Fund's role and for the work program of what had been agreed at the Tokyo Economic Summit.

Mr. Nimatallah stated, that at the present stage, his preference was to express to the Group of Seven, through Mr. Fujino, the appreciation of the Board of the steps that had been initiated.

Mr. Schneider observed that it had been his intention in the course of his remarks on the work program to ask some questions about the agreements reached at the Tokyo Economic Summit. He understood from the concerns raised by some of his colleagues that it might be too early to ask such questions at the present meeting; but he would not want to wait too long before receiving clarification.

The Chairman said that he understood that it was the desire of Directors to understand more clearly the relationship between the multilateral surveillance exercise to be conducted in the Fund and that to be conducted by the Group of Seven. It was also his understanding that Directors were willing to postpone a discussion of that relationship and the raising of specific questions until members of the Group of Seven themselves had had a chance to digest what had been agreed in Tokyo. He then invited Directors to continue with their remarks on the work program.

Mr. Pérez, remarking first on the proposed further consideration of items in the G-10 and G-24 reports on the functioning of the international monetary system, considered that the focus should be on three main areas: Fund surveillance and the exchange rate system; the SDR; and the role of the Fund. His chair agreed that the Fund should explore the establishment of objective indicators which related to policy and performance in the main industrial countries as a framework for multilateral surveillance. The Group of Seven had taken a stand on that issue at the Tokyo Economic Summit, backing the course of action proposed at the April 1986 Interim Committee meeting. The Group of Seven had also taken an additional step in suggesting a set of economic indicators to be used in the conduct of surveillance of the major economies. The remaining question was how the mechanism would work. In that connection, and despite Mr. Fujino's explanations, the role of the Fund had not been made clear in the Tokyo Economic Declaration. Like Mr. Polak, Mr. Fugmann, and others, he hoped that the Executive Directors representing G-7 countries would clarify that and other matters before substantive consideration in the Board of the paper on indicators.

Proposed staff papers on the SDR properly covered all the relevant aspects mentioned in recent discussions on that subject, Mr. Pérez noted. His chair in particular was interested in ways of increasing the attractiveness of the SDR, the SDR yield, and operating procedures. The Chairman himself had noted in the most recent Board discussion on the possibility of an SDR allocation, that "without a willingness to hold SDRs there will be no allocation of SDRs." As he saw it, without an allocation, the world would witness the demise of the asset; hence, a thorough investigation of ways to make the SDR more attractive was called for; in that connection, an inquiry to central banks--which were the potential recipients of SDRs--could prove fruitful.

On the various subjects that could arise under the subtopic "the role of the Fund," Mr. Pérez said that he favored an early and preliminary review of the current guidelines on access limits and the general policy of enlarged access before the September meetings. Such a review was particularly important in the light of the decision on access limits that would be taken at those meetings and in light of the concern expressed by several members of the Interim Committee that the transfers of financial resources from the Fund to borrowing members could become negative during the next few years. On other matters, he was happy to note that the paper on the design of Fund programs had been scheduled for discussion at end-July, together with an accompanying paper on program design and performance criteria. Before that, it would be useful for the Board to review the paper on inflation and the measurement of fiscal deficits, currently scheduled to be discussed in seminar toward the end of May. Also, a global paper on the role of the Fund that tied the various subtopics together should be issued and discussed as a basis for the Fund's review of the international monetary system.

Further consideration of the debt strategy would apparently be undertaken in two steps, Mr. Pérez observed. First, the debt strategy would be looked at during the discussion on developments and prospects in international capital markets. A week later, on the occasion of the updating of the world economic outlook exercise, it would be reviewed again. Although the Interim Committee had emphasized the need for the debt strategy to be "tailored to individual cases," a full discussion of the general situation should not thereby be precluded. A discussion of the debt strategy had taken place in 1985 following the Annual Meetings and the launching of Secretary Baker's debt initiative. The discussion at the time had revolved around the contents of Secretary Baker's proposal and had elicited some preliminary reactions from Directors. For the 1986 discussion, the format of the paper on capital markets should perhaps be modified to allow for a meaningful consideration of the debt situation and strategy. It might be that the paper on international capital markets could benefit from the relevant information and analytical insights of the revised world economic outlook exercise. More generally, the preference of his chair was for the Board to hold a full discussion of the debt problem. Given the variety of issues covered in the capital markets papers under the current format, he had reason to fear that the discussion of the paper might be somewhat diluted, especially given that part of the relevant information was contained in the world economic outlook exercise.

He had noted with interest that the 1986 update of the world economic outlook would devote special attention to the problems of capital flight, Mr. Pérez remarked. Since that subject had become more than an economic issue, it was to be hoped that the staff would take extra care in arriving at a correct measurement of capital flight and in analyzing its origin and dynamics by looking at the role of the commercial banks in the promotion of capital flight and the various tax incentives that encouraged such flows. Finally, with regard to the timetable contemplated for the discussion of the different topics mentioned under the heading "Operational Matters," he agreed with the Chairman's proposal to bring to the Board in June a paper on the Fund's income position and on burden sharing and to leave the thorough review of the remuneration coefficient for a later date.

Mr. Salehkhou said that his reading of the Managing Director's statement on the work program left him with the impression--a wrong one he hoped--that the Fund was backing away from its active role in the management of the world economy. The Fund was at a crossroad in its activities, particularly in the area of debt management. The proposals in the work program regarding discussions on policy issues conveyed the impression that, because of the guidance of the Interim Committee, the Executive Board must continue discussing topics that would generate requests at the next Interim Committee for further studies by the Board. The process was a discouraging one not only for the Board and the staff--whose time could be utilized more productively--but also for member countries. Apart from some intellectual satisfaction, he saw no other benefit to be gained from discussing topics on the basis of papers prepared by the staff when the very same industrial countries proposing the studies later indicated through the media or communiqués that those topics were no longer relevant or necessary.

The latest proposed approach to Fund surveillance and the functioning of the exchange rate system was a far cry from what had been expected some months previously, Mr. Salehkhou commented. In its report, the Group of Twenty-Four had made a number of recommendations on the functioning of the system and had asked for a complete work program on the different topics that the Group saw were at the core of the problems facing the world economy generally and the developing countries in particular. The work program proposed by management did not respond to that request. For example, if the Board were to take up an "exploratory paper on indicators of economic policies and performance" as late as July 14, he failed to see how, in the time remaining before the 1986 Annual Meetings, the Board would be able to produce any concrete proposals for action. On a related matter, he would appreciate some comment on whether or how the Fund would be involved in the "surveillance" of policies to be conducted among themselves by the members of the Group of Five, the Group of Seven, and the Group of Ten. The developing countries relied upon the Fund to bring about some order in the international monetary system, and he had the feeling from recent developments that the world would witness a further widening of the asymmetry of Fund surveillance, to the detriment of the developing countries.

On the SDR, Mr. Salehkhou reiterated the view of his chair that a sizable allocation was in order and that the case for such an allocation had strongly been made by the staff. The variety of proposals regarding the SDR and the continuation of studies on side issues relating to the SDR served as a perfect example of the indication he had expressed earlier that the time of the Board and the staff was being inefficiently used. Consideration should be given to dropping the various studies proposed for the SDR unless the Chairman received a clear signal that an allocation would not continue to be opposed on political or ideological grounds. Without that signal, further studies would only give illusory hopes to member countries and to the outside world that a positive outcome was possible.

The proposed work program on the subtopic relating to the role of the Fund fell far short of what was needed to address the problems faced by developing countries, especially at a time when lending from all sources--including the Fund--had been sharply reduced and when nearly all commodity prices--including oil--were at historically low levels, Mr. Salehkhou commented. Instead of facing the situation with resolve, the Fund seemed to be behaving as if the situation of the developing countries had improved. Indeed, net purchases from the Fund, which had reached $10.6 billion in 1983, had decreased to $5 billion in 1984 and $0.4 billion in 1985. Moreover, net purchases were running at only $0.6 billion for the first four months of 1986. Those figures did not reflect improvements in the world economy so much as a deliberate policy of sharply reduced access on the one hand, and intolerable conditionality on the other.

Another revealing indicator was the fact that the number of highly indebted countries effectively under Fund programs at present numbered fewer than five, Mr. Salehkhou continued. In the circumstances, he wondered whether it was appropriate to discuss access policy at all. The discussion would be purely academic in any event, and it was well known that actual access--a matter decided solely by the Fund staff--was quite different from theoretical access under the policy. More important, except perhaps for very small countries, most members would not submit to adjustment programs of the magnitude sought by the Fund and the World Bank if the resources provided by those institutions were only catalytic in nature. Since the commercial banks were also taking a "wait and see" attitude, he wondered how the countries in question would manage even modest growth rates. What was required was a more active role for the Fund in the management of the debt problem; otherwise, the reputation of the institution as a provider of good advice and financial resources would suffer, since the countries involved would not be in a position to sustain negative flows to their creditors for too long.

In the paper on theoretical aspects of the design of Fund programs and the related paper on program design and performance criteria, he had taken note of the absence of any reference to the necessity for associated growth and adjustment, Mr. Salehkhou said. The tone of the guidance provided in those papers led him to believe that the staff was being invited to further tighten conditionality. He hoped that his impression was incorrect and that due attention would be paid to growth in the design of Fund programs.

He was grateful for the management's continuous support and open-minded concern that had led to the completion of the staff study on "Islamic Banking," Mr. Salehkhou remarked. He would reserve his comments on the substance of the paper until its discussion, preferably in seminar form, say, in the first half of July or any other suitable period before the informal Board recess in August. Finally, he hoped that the discussion on the Fund's income position and on legal options relating to overdue obligations could be scheduled for consideration at end-June or early July.

Mr. Dallara, remarking that he was generally in agreement with the content, priorities, and proposed scheduling of the topics in the work program, noted that the Interim Committee had asked the Executive Board to focus on both the exchange rate system and the strengthening of surveillance, particularly multilateral surveillance conducted in the context of the world economic outlook exercise. The suggested approach was probably appropriate, although it was unclear how the work the Board was being asked to do was related to the world economic outlook exercise itself, which was the focus of the Interim Committee's guidance on the exchange rate system and multilateral surveillance. It was to be hoped that the paper prepared for the Board's discussion would identify the possible use of variables that might be of particular relevance in discussing external imbalances, exchange rate developments, and policy interactions among members. During earlier Board discussions, Mr. Polak had highlighted the potential role that forecasts of trade and current account balances might play in facilitating an assessment of the mutual compatibility of countries' policies and prospects, a role worth exploring further in the forthcoming staff paper.

It was expected that the paper would focus on the industrial countries, although the analysis should be more broadly applicable to other Fund members, Mr. Dallara continued. In that respect, consideration might be given to identifying which indicators could be particularly relevant in assessing policy actions and economic performance for major developing countries as well. In that regard, he had in the past suggested that a chapter or section of the world economic outlook should be devoted to the policy actions of the largest 15 developing countries. It was not clear that such countries would represent the most useful group of developing countries for analytical purposes; and, indeed, others had suggested analyzing developing country policies and prospects on a regional basis in the context of the overall world economic outlook exercise. Of course, the major industrial countries were at the heart of that exercise. As others had already noted, a significant strengthening of international coordination of economic policies among the major industrial countries had already occurred as a result of agreements reached at the recent Tokyo Economic Summit. The approach adopted in Tokyo was consistent with, and supportive of, the work under way in the Fund and should provide some impetus to that work. In addition, the Tokyo agreement was consistent with the thrust of advice provided by many Ministers and Governors at the recent Interim Committee meeting as well as with the many comments and suggestions put forward in the Executive Board by Directors from both industrial and developing countries.

Remarking on the SDR work program, Mr. Dallara observed that the Interim Committee had directed the Board to continue its work on the role of the SDR in the present international monetary system. It was thus important that any additional work on the subject should be approached with a view to achieving potential improvement in the functioning of the present system, which was characterized by multiple reserve currencies--with the dollar continuing to play a dominant, although perhaps not predominant role--open capital markets, and a rather marginal role for the SDR. Taking those factors into account, he wondered whether the proposal to produce and discuss five papers on the SDR represented the best use of the Fund's time and resources. Perhaps consideration should be given to postponing some of the papers listed, or even putting off their preparation altogether. In any case, whatever work was done on the SDR must reflect the stress placed by the Interim Committee on the preservation of the monetary character of the asset.

Remarking on the role of the Fund, Mr. Dallara joined others in welcoming the opportunity that would be provided to review policies on enlarged access prior to the Annual Meetings in order to elicit guidance from the Ministers at the Interim Committee meeting. Among the factors that should be assessed in the review, and which had generally been included in early reviews, were the arrears situation, the prolonged use of Fund resources, the outstanding obligations to the Fund, and the progress members were making toward achieving sustainable payments positions. He recalled in that connection the emphasis that the United States had earlier placed on assessing in individual program proposals the ability of members to repay their obligations to the Fund. It might also be helpful in a review of access policies to recall the historical context in which those policies had been established and to review their evolution in light of the purposes for which they had originally been adopted. On a related matter, he could endorse the suggested schedule for discussions on the Ninth General Review of Quotas and noted in response to comments made earlier by Mr. Arias that an acceleration of the quota discussions was unnecessary and could be counterproductive.

He looked forward to discussion by the Board of the forthcoming paper on the theoretical aspects of the design of Fund programs, Mr. Dallara said. It was to be hoped that the paper would focus on the various theoretical approaches underlining the selection of particular program objectives and instruments and, in that connection, would outline clearly the assumptions inherent in those approaches and describe how they related to the actual circumstances faced by Fund members. If, for example, a theoretical approach underlying the recommendation by the Fund for use of a particular policy instrument rested in part on, say, the assumption that demand for money was a stable function of a few variables, it might be helpful for the Executive Board to consider how that assumption related to the circumstances actually faced by Fund members. In that regard, he recalled a paper in the DM series prepared in late 1977 by Mr. Blackwell that had outlined the rather eclectic manner in which the Fund had brought together the various political approaches--including the monetary approach, the elasticity approach, and the absorption approach--in suggesting to members how they might most usefully devise Fund programs. It might have been helpful if that paper had explored the issues he had raised in somewhat greater detail, and he hoped that the forthcoming document on the design of Fund programs would give Directors a sense of the way in which the Fund brought together various theoretical approaches in providing advice to members on the shape of their economic programs. It would also be helpful if the paper could enable Directors better to understand the theoretical relationships between macroeconomic and structural policy instruments in Fund programs and how such instruments could facilitate the accomplishment of overall program objectives. The reviews of Fund conditionality in recent years reflected the increasing emphasis that had been given in certain Fund programs to structural policies; and it was thus time to assess the theoretical relationships of those instruments that did not have such a history in Fund programs as did other policy instruments. With regard to the paper on program design and performance criteria, it was to be hoped that the staff would not only review the Fund's experience with performance criteria but would also explore how structural components might most efficiently be incorporated into Fund programs, either as performance criteria or as performance clauses consistent with the debt strategy that had recently been endorsed by the Executive Board and the Interim Committee.

Also welcome was the annual survey on international capital markets, which he hoped would give added attention to nondebt-creating capital flows and to the environment in which such flows were most likely to develop, Mr. Dallara said. It would also be helpful if the staff could follow up on the short background paper it had prepared for the earlier discussion on equity swaps.

Remarking on the area departments' work program, Mr. Dallara observed that more than 100 country items were to be discussed in the next five months. The work load was a heavy one, but the assessment of members' economic policies was important. In that regard, he noted that while the consultations and discussions on larger Fund members were comprehensive, he had of late observed some reluctance by Directors to participate broadly in discussions of some of the smaller Fund members. While he would not wish to suggest longer Board meetings, he did hope for somewhat broader Board participation in the Article IV consultation discussions of smaller members. He welcomed the progress to date on the development of policy framework papers and looked forward to the consideration by the Board of the initial framework papers for countries.

He welcomed the progress to date on the development of policy framework papers and looked forward to the consideration by the Board of the initial framework papers for countries, Mr. Dallara said. During the recent Board discussion on the rate of charge for fiscal year 1986, Directors had held a preliminary discussion on provisioning. In that discussion, several questions had been raised by the Legal Department that had not been addressed in the paper provided to the Board; indeed, one rather fundamental point made by the Director of the Legal Department had troubled him in the sense that it could alter his views on provisioning. As he understood it, the indication was that the current Articles of Agreement might preclude making provision for losses of the sort discussed in the staff paper. Since the purpose of provisioning was related to probable loss, it would be difficult to hold a complete discussion of the matter in the absence of further staff analysis of what options were and were not available to the Fund. If a more comprehensive paper could not be prepared in time for the scheduled Board discussion on May 19, he would be prepared to view the May 19 discussion as a first round discussion, with further rounds to be scheduled when the appropriate analysis was available. On other operational matters, he wondered whether the paper on legal options available to the Fund following a declaration of ineligibility might not usefully be discussed at the same time as the Board discussed the paper on the six-monthly report on overdue obligations.

Remarking on administrative and related matters, Mr. Dallara said that he would have preferred postponing discussion of staff compensation issues until the work of the Joint Bank/Fund Committee on Staff Compensation was completed. However, he understood that the Chairman of that Committee had indicated that the Committee's report might not be ready for consideration by the Executive Boards of the two institutions until the time of the Annual Meetings. Of course, the overall timetable would depend upon the urgency with which the Board viewed the completion of the work of the Committee and the time that might be required for management to review the report. As for the paper on job grading, it was to be hoped that any provisions relating to an early retirement scheme for downgraded staff would not overly compensate individuals whose early retirement might be necessary because of the results of the job grading exercise.

Mr. Goos stated that he too was in broad agreement with the Managing Director's outline of the work program until the 1986 Annual Meetings. The Fund was obviously facing another period of heavy pressure on the staff and the Executive Board, and it was thus important in organizing the work to set clear priorities. While the work program outlined by the Managing Director generally appeared to meet that requirement, it was overly ambitious in the area of SDR matters. Clearly, the Interim Committee had suggested that SDR matters be kept under review, but there was nothing in the communiqué that required the Board to rush through all the issues mentioned in the program before the 1986 Annual Meetings. Also, he failed to see how the paper dealing with the issues arising from possible arrangements to permit the use of SDRs in exchange market intervention by central banks and to establish a clearing facility for SDR-denominated financial instruments could be reconciled with the Interim Committee's recommendation to study possible improvements in the monetary characteristics of the official SDR. As for the matter of allocation, he wondered whether it was necessary to go through the full process of writing a staff paper and holding another Board discussion of the Managing Director's bilateral contacts with Directors again showed that the necessary broad support for an SDR allocation could not be mobilized. He saw merit in Mr. Leonard's suggestion, raised during the previous discussion on SDRs, to pause for reflection for some period before again bringing the matter of SDR allocations to the Board. Such a pause would also appear quite logical as long as the papers aimed at overcoming the resistance to SDR allocations had not been discussed.

The proposed paper on indicators of economic policies and performance had assumed additional relevance with the decision at the recent Tokyo Economic Summit meeting to use such indicators as a means of policy coordination among the major industrial countries, Mr. Goos continued. Although the details of the Summit's understanding and their implications for the work of the Executive Board would have to be discussed later, it would certainly be helpful if the staff in its exploratory paper could include the indicators mentioned in the Economic Declaration of the Summit. He wondered like Mr. Dallara whether it might not be appropriate to broaden the scope of the paper to examine the use of such indicators in the context of surveillance of some developing countries whose economic performance had an important bearing on the international monetary system.

He considered it of paramount importance to maintain and even strengthen the momentum of the debt strategy that had been reaffirmed in the communiqué of the Economic Summit meeting in Tokyo, Mr. Goos continued. In that context, he welcomed the proposed extension of the forthcoming paper on international capital markets to include the lending activities of the multilateral development banks. Perhaps that paper should also review developments in foreign direct investment as well as the experience with mechanisms for debt/equity conversion and other means that might have been applied to strengthen the debt-servicing capacity of the major debtor countries. Moreover, he presumed that the problem of capital flight would be addressed also in that paper and not only in the world economic outlook exercise.

On operational matters, Mr. Goos said that he would welcome any additional information that might help to further clarify the issue of provisioning, particularly information relating to what was or was not consistent with the Articles of Agreement. He had some difficulty with the timetable proposed for the review of the Fund's income position and related subjects, particularly burden sharing and the annual comprehensive review of the remuneration coefficient. During the previous discussion of the Fund's income position, he had noted that burden sharing was closely linked to the underlying formula applicable to the remuneration coefficient. From that perspective, he could engage in a discussion of burden sharing only once the issue of the remuneration coefficient had been decided by the Board. Finally, as he had stressed in the previous discussion of the work program, an effort should be made to avoid any undue bunching of Board discussions and to allow for sufficient time between the circulation of papers and their consideration by the Executive Board.

Mr. Fujino, noting his general agreement with the work program, remarked that the Interim Committee at its previous meeting had rightly stressed that if better exchange rate performance were to be achieved, economic policies must be conducted in a sound and mutually consistent way. In that regard, the key role of Fund surveillance had been reconfirmed, and improvement in the multilateral setting for surveillance had been stressed, with particular reference to the exploration of "a set of objective indicators related to policy actions and economic performance, having regard to a medium-term framework." Reference had also been made to such indicators in the communiqué of the Economic Summit in Tokyo. The Board's discussion of the paper on those indicators, scheduled for July 14, should provide a good basis for the Fund's work on surveillance and the functioning of the exchange rate system.

Management's proposals on SDR matters were roughly in line with the guidance provided by the Interim Committee at its previous meeting, Mr. Fujino continued. However, what was needed in his view was a more basic study of the role of the SDR in changing circumstances, rather than too detailed an exploration of various side issues. The procedural approach suggested for dealing with the question of SDR allocations in the fourth basic period was acceptable.

Remarking on the role of the Fund, Mr. Fujino noted that the Executive Board decision on enlarged access should be reviewed annually, and he was in favor of holding a preliminary discussion on that subject before the 1986 Annual Meetings. Given the amount of work necessary for a full-scale quota review, preliminary discussions on the Ninth General Review of Quotas should be initiated soon, preferably in the second half of 1986, although the heavy work load of the Executive Board prior to the Annual Meetings meant that, from a practical standpoint, the review could probably not begin until after September. He would, however, welcome the views of his colleagues and the staff on that matter. Finally, on the structural adjustment facility, he was looking forward to reviewing the policy framework papers that were being prepared in conjunction with World Bank staff.

Mr. Schneider indicated that he too was in broad agreement with the work program outlined by the Managing Director. The topics proposed for further deliberations on the functioning of the international monetary system reflected the guidance given by the Interim Committee at its latest meeting; together with other items, dealing with the operational activities of the Fund, they formed a heavy work load for the staff and the Executive Board, and it might be difficult to avoid some congestion in the Board's schedule in the months ahead.

Lengthy discussions on surveillance and the exchange rate system at the beginning of the year had formed the basis for further work on those issues, with emphasis on strengthening multilateral surveillance and the possible formulation of objective indicators of performance aimed at improving the stability of the exchange rate system, Mr. Schneider continued. He had noted with interest that the ministers of finance of the seven major industrial countries had, at the recent Tokyo Summit, given themselves a mandate to engage in multilateral discussions on the mutual compatibility of their economic policies. Moreover, there appeared to be a broad understanding among the Group on the macroeconomic policy indicators that should be included in discussions on policy interactions among the major industrial countries.

On SDR matters, Mr. Schneider observed that several discussions had been scheduled on interesting aspects of the SDR that should allow the Fund to make progress toward a common understanding of the future role of the asset. Although those topics would add to an already heavy work load, their discussion seemed fully justified and would allow the Board to address problems currently perceived as major obstacles to a more general recognition of the role of the SDR. Those included possible arrangements to accompany SDR allocations and possible ways of making the SDR more usable in central bank operations. Another reason for intensifying Board work on the SDR was that the end of the fourth basic period was approaching, and it would be important in the coming months to clarify views on the role of the SDR before the next basic period began.

On the role of the Fund, Mr. Schneider considered that it would be preferable to organize the Fund's work on the enlarged access policy in such a way that the Interim Committee could provide guidance on the major aspects of that policy before the Board concluded its deliberations on the subject. Since the Interim Committee had already underlined the need for flexible application of the enlarged access policy in light of the Fund's role in the debt strategy, it would seem logical to refer the matter to the Committee for its further consideration before taking a decision on access policy for 1987. Finally, the discussion on developments and prospects in international capital markets in the context of the debt strategy had appropriately been scheduled for the weeks just preceeding the Interim Committee meeting, which would allow the Managing Director to reflect the essence of those discussions in his report to the Committee on the world economic outlook.

Mr. Ganjarerndee stated that his chair was in broad agreement with the proposed work program, and his comments would thus be limited to one or two specific areas. On the issues raised in the G-10 and G-24 reports on the international monetary system, he had noted the Managing Director's emphasis on Fund surveillance and the functioning of the exchange rate system as one of the broad subjects to be studied further. The G-10 and G-24 reports had suggested two approaches aimed at stabilizing exchange rates. One was to effect greater coordination of economic policies in the major industrial countries, a goal that could be achieved through a strengthening of surveillance and the formulation of a set of objective indicators which could signal the need for discussion of members' policies. The other approach was the use of target zones, a topic on which no further discussions were proposed in the work program. It seemed to him that individual industrial countries had some notion about the appropriate relationship of the exchange rates of major currencies and, at the same time, there was growing concern among market participants that official intervention in the exchange markets was likely to cause instability rather than stability, simply because there was no consensus among the major countries about what the appropriate exchange rate relationships should be. In the circumstances, his chair would welcome a short paper from the staff explaining the exchange rate objectives of the major industrial countries and the efficacy of the instruments being used to achieve them.

His chair strongly supported the idea of a preliminary discussion on access limits under the enlarged access policy as well as under the compensatory financing facility and the buffer stock financing facility, Mr. Ganjarerndee continued. On the debt strategy, he was disappointed in the slow progress in the implementation of the Baker initiative, which had received the endorsement of the Executive Boards of the World Bank and the Fund following the 1985 Annual Meetings. The Interim Committee had since reaffirmed that the Fund should play a central role in dealing with the debt problem, and he would thus welcome staff proposals on how the implementation of the Baker initiative could be expedited and on the role that the Fund must play in speeding up that implementation. Finally, on the world economic outlook, he noted that special attention was to be given to the indicators of policies and performance in the industrial countries and to the policy interaction among industrial countries. His chair would welcome a more detailed analysis of the consequences for developing countries of macroeconomic policies and trade protectionism in the industrial countries.

Mr. Zecchini considered the work program proposed by the Managing Director for the period until the 1986 Annual Meetings to be comprehensive, well focused, and consistent with the guidelines provided by the Interim Committee. It was evident that the program was a demanding one, especially in the period from early July until mid-September. During that particular time, it would perhaps not be advisable to schedule seminar discussions, for which more flexibility in timing existed. At the same time he considered that all the studies mentioned in paragraph 8 of the Managing Director's statement, including the one on Islamic Banking, deserved a Seminar discussion at an appropriate time.

With regard to the emphasis placed on the issues raised in the G-10 and G-24 reports, Mr. Zecchini said that priority should be given to the work aimed at strengthening multilateral surveillance over economic policies and at promoting exchange rate stability and consistency of economic policy approaches among major countries. In that respect, he looked forward to the discussion on the paper on economic policy indicators scheduled for July 14, a discussion that could pave the way for the implementation of an improved approach to surveillance. Intensified efforts in those areas appeared necessary, in light of the indications coming from the Interim Committee and other important international forums.

On the SDR, Mr. Zecchini welcomed the proposed SDR papers aimed at making the achievement of a consensus on allocations somewhat easier as well as those containing possible ways of enhancing the desirability of holding SDRs. He had noted that the paper on countries' reserve management practices--with particular attention to SDRs--was expected to be issued only after the Annual Meetings. Because that paper was closely related to the one outlining possible approaches to achieve a more balanced composition in members' holdings of SDRs and other reserve assets, he proposed discussing the two papers together by bringing forward the discussion of the latter paper.

Executive Board discussion on access limits and related policies was required before the next Interim Committee meeting, Mr. Zecchini observed. All relevant aspects of the issue should be examined, including the flexible use of the policy of enlarged access as specified in the most recent Interim Committee communiqué and its implications for the Fund's financing needs. In that context he would welcome some clarification of the sentence in the work program that seemed to suggest that a review of experience with enhanced surveillance could in some way be related to the papers on international capital markets and official debt. As he saw it, that review should be the subject of a separate discussion and not confused with other subjects.

He was well aware that the summer version of the world economic outlook exercise was essentially an update of the document prepared for the spring meetings, Mr. Zecchini commented. Recently, the Fund had embarked on an effort to strengthen multilateral surveillance through improved analysis of policy interaction and compatibility among industrial countries as well as the possible use of indicators of policies and performance. As the spring world economic outlook exercise had included for the first time a chapter on policy interactions, work in that area for the summer exercise should be viewed as more than an update of previous projections. In particular, it should further develop the indications that would emerge in other discussions, such as that on indicators.

On the area departments' work program, Mr. Zecchini noted that the Fund might receive several requests for drawings under the structural adjustment facility over the next few months. He would welcome such requests and would favor a rapid disbursement of available resources where warranted and feasible. Finally, noting that papers relating to the job evaluation exercise would soon be issued, he wondered whether, on occasion of the Board discussion on proposals for an early retirement scheme, some comments could be made on the appeals procedure as well.

Mr. Song stated that he too agreed with the thrust of the work program until the 1986 Annual Meetings. However, he wondered whether a thorough discussion on Fund surveillance and the functioning of the exchange rate system would be possible in only one day, as scheduled, especially against the background of the agreements reached among the Group of Seven at the recent Economic Summit in Tokyo on the problem of strengthening multilateral surveillance. It would seem to be important to clarify the relationship between Fund multilateral surveillance and that conducted by the Group of Seven, and it might thus be preferable to divide 1(a) of the Managing Director's statement on the work program into two separate topics: the role that Fund surveillance should play in the international monetary system in the context of the G-7 agreement; and the problem of the formulation of a set of objective indicators related to policy actions and economic performance as well as, perhaps, reconsideration of the feasibility of the target zone approach.

On SDR matters, Mr. Song considered that the emphasis should be placed on further exploration of the possibility of an early allocation of SDRs, which should be a focal point for all other SDR-related matters

He was pleased to note that in the discussion on the world economic outlook, special attention would be paid to the indicators of policy and performance in the industrial countries and to prospects for growth and adjustment in the heavily indebted countries, Mr. Song continued. Apparently, the discussion scheduled for September 3 on the staff's annual survey of developments and prospects in the international capital markets would also focus on the prospects for growth and adjustment in the heavily indebted countries. Given the importance of the debt situation of developing countries and the possible overlap in the two discussions, it might be preferable to combine the world economic outlook discussion and the capital markets discussion into one review of the debt situation. Finally, while he was certain that Islamic Banking was an interesting matter, he wondered whether the religious, political, and institutional complexities of the issue made it an appropriate topic for Board discussion. However, if his colleagues from the Islamic countries had no objections, he could go along with the proposal to discuss the matter in seminar.

Mr. Romuáldez observed that he could broadly endorse the proposed work program, which comprehensively covered the tasks set for the Board by the Interim Committee as well as the major operational and administrative matters that would need to be addressed in the coming months. On the work to be undertaken on the future role of the SDR, the next step was to consider the various suggestions put forward by Mr. de Groote, Mr. de Maulde, and Mr. Sengupta. His authorities considered that the Board would obviously need to review those suggestions in the context of the clear guidance given by the Interim Committee and, in particular, in the context of the importance that the Committee attached to "the monetary character of the SDR, which should not be a means of transferring resources." The proposed study dealing with countries' reserve management practices, particularly with respect to SDR assets and liabilities, was scheduled to be issued only after the 1986 Annual Meetings, although the material in that study might be relevant to the discussion on the potential use of the SDR in exchange market intervention by central banks, which he assumed would take place before the Annual Meetings. He wondered whether there was any possibility of the background material being made available in some form for the earlier discussion. On a related matter, it was not clear whether the proposed examination of possible arrangements to establish a clearing facility for SDR-denominated financial instruments was being framed in the context of official or private transactions in SDR instruments. He raised the question in light of the Executive Board's February 26 discussion on the potential contribution of the SDR to economic stability. At that meeting, a majority of Directors had expressed the view that the Fund should not actively support the private use of SDRs. The proposed paper on the growth of voluntary transfers of SDRs among participants and prescribed holders was one he looked forward to discussing.

On the role of the Fund, Mr. Romuáldez considered that it would be useful for the Executive Board to hold a preliminary discussion on access limits prior to the September meeting of the Interim Committee in order to gain that Committee's guidance. Like other Directors, he was interested in examining whether the Ninth Quota Review could be completed earlier than the March 31, 1988 deadline. As he saw it, there should be no question of the adequacy of the Fund's financial resources in relation to its activities, not least because of the potential risks such questions could have for the Fund's continuing ability to fulfill its catalytic role. While the most recent projections of Fund liquidity showed that the position would be reasonably comfortable through 1987, a number of uncertainties associated with those projections pointed to elements of potential weakness in the medium-term outlook. Given those uncertainties, the lags between the initiation of a quota review and the actual augmentation of the Fund's resources, and the fundamental importance of quotas for the very fabric of the institution, it would be prudent to initiate and complete the Ninth Quota Review as soon as possible.

He looked forward to the proposed papers on the design of Fund programs, noting that the review of enhanced surveillance, although it was to be associated with the annual review of capital markets and official debt developments, would be a subject for review in its own right, Mr. Romuáldez continued. It was not necessary to have a separate paper on enhanced surveillance; but that important aspect of Fund policy should not be lost sight of in the midst of an extensive discussion on the debt strategy. In that connection, he agreed with Mr. Pérez on the need to restructure the paper on capital markets in a manner that would enhance consideration of the debt problem and the strategy that should be employed to resolve it.

Remarking on the world economic outlook exercise, Mr. Romuáldez welcomed the proposed inclusion in the next two world economic outlook papers of sections dealing with prospects for commodity prices. It was to be hoped that at some stage that material would include an assessment of the effects on some agricultural commodity prices of agricultural protectionism and subsidies in industrial countries.

The work program showed that the Board was likely to be asked to consider no fewer than 100 country items over the next five months, Mr. Romuáldez observed. Given the Board's responsibility concerning the use of Fund resources, any lessening of the load would have to be concentrated on Article IV consultations, the number of which must be approaching the saturation point. It would be advisable in the circumstances to look, on a case-by-case basis, for those instances where it would be appropriate according to the guidelines to place countries on 18-month or two-year Article IV consultation cycles, a move that should be enhanced by a more focused surveillance effort. Finally, he found the staff paper on Islamic Banking a useful background account of Islamic banking practices. However, he remained anything but an expert on those practices and would feel poorly placed to participate in a Board discussion of the subject, although he was certain that he would benefit from the views of his colleagues who had had experience with Islamic banking.

Mrs. Ploix said that she too was in broad agreement with the work program, which reflected the guidance provided by the Interim Committee in April. The general outlines of the projected study on objective indicators seemed satisfactory. As she understood it, the aim was to formulate a pragmatic definition of some type of economic optimum and to provide instruments for analyzing policy compatibility among the industrial countries. That aim was all the more important since it had been expressly mentioned in the communiqué of the Tokyo Economic Summit that the Fund had an essential role to play in the analysis. She thus looked forward to the discussions scheduled for July 14 on objective indicators relating to policy actions and economic performance. It was to be hoped that the discussion would lead to significant progress in the definition of methods aimed at improving multilateral surveillance, which in some ways was the raison d'etre of the institution. It appeared that the Executive Board would need to examine different techniques for assessing equilibrium exchange rates, as the Managing Director had proposed in his introductory remarks to the Interim Committee in April. In fact, exchange rates were among the indicators of better coordination that had been enumerated in the Tokyo agreement.

On matters related to the SDR, Mrs. Ploix remarked that limiting the debate on international liquidity to the role of the SDR would prevent a full reflection of all the points raised during the Interim Committee's discussion on SDR matters. As for the paper on proposals regarding arrangements to accompany allocations, she noted that many around the table had put forward a number of ideas in the hope of advancing the search for a formula that would be as flexible as possible; she looked forward to seeing the staff's analysis of those ideas.

Like others, she could support the idea of initiating discussions on the Ninth General Review of Quotas as soon as feasible, Mrs. Ploix commented. Also, while she agreed with those who felt that it was important to update projections and provide a revised assessment of current policy issues in the context of the world economic outlook exercise, her authorities remained concerned that the world economic outlook papers had become rather bulky. Greater conciseness was called for.

The staff representative from the Legal Department, responding to questions from Mr. Dallara and Mr. Nimatallah, observed that the staff paper on legal options available to the Fund following a declaration of ineligibility was nearly ready for circulation to Executive Directors and could thus be discussed in the early part of June.

Mr. Dallara commented that if the paper in question was not unduly long or complex, he would be willing to waive the usual circulation period and add the paper to the Board's agenda for May 19, to be discussed in conjunction with the six-monthly report on overdue financial obligations.

Mr. Salehkhou remarked, that whatever the size of the paper, it touched upon a complicated legal question on which he preferred to seek the views of his authorities. He hoped that enough time would be given for that purpose.

Mr. Romuáldez said that, like Mr. Dallara, his chair would have preferred a discussion of the legal paper on May 19, but he too was concerned that sufficient time be given to Directors to review what was obviously an important subject.

The Chairman observed that, in the circumstances, the paper would be issued in time for the May 19 discussion but would be treated only as a background paper; later, it would be given a fuller discussion in its own right.

Mr. Nimatallah considered that the work program proposed by the Managing Director was a reasonable and manageable one. The issues related to Fund surveillance, the functioning of the exchange rate system and the SDR had been given appropriate impetus by the Tokyo Economic Summit, and he would thus focus his remarks on other matters. On the role of the Fund, he recognized the increased need for flexibility in the application of the policy on enlarged access, and he was open-minded on how best to proceed to achieve that flexibility. He looked forward to reviewing the paper on program design and performance criteria and hoped that ways and means could be found to improve performance tests to ensure that they were effective in safeguarding the revolving character of the Fund's resources.

His authorities had noted a growing problem with commodity prices and their impact on developing countries, Mr. Nimatallah continued. They hoped that the topic would be given attention in the world economic outlook exercise. As for the Annual Report, he was comfortable with the new approach that the Board had adopted. Finally, the long-awaited paper on Islamic Banking should provide the basis for a useful and interesting seminar. He had an open mind on the appropriate timing for the discussion, although consideration might be given to a July/August date, after the matter had been discussed in Teheran in mid-June.

Mr. Mawakani, noting that he was in agreement with the thrust of the proposed work program, wondered whether consideration should not be given to the exploration of subjects such as debt and transfer of resources among those raised in the G-10 and G-24 reports on the international monetary system. During the November 12, 1985 discussions of the work program, his chair had asked that the Executive Board's views on those issues be sought and submitted to the Interim Committee. He was reiterating that request in 1986, noting that most developing countries continued to experience great difficulty in servicing their debt, and outflows of resources from those countries often exceeded inflows. The particularly acute character of the external debt problem of African countries had prompted the governments of those countries to ask, through the Chairman of the Organization of African Unity (OAU) for the support of the industrial countries for the organization of an international conference on the debt of African countries. The Interim Committee, in paragraph 9 of its latest communiqué, had indicated its intention to examine further the issues raised in the G-10 and G-24 reports on the basis of the Executive Board's work. Although no specific instructions had been given on the issue of debt and resource transfer, he believed that they should be examined in the context of further work on the G-10 and G-24 reports because of the importance of the problem and the fact that the Interim Committee had not placed any topical restrictions on the follow-up matters. As he saw it, an examination of the debt problem in the context of the world economic outlook exercise would cloud the importance of that problem and the urgent need for effective measures to deal with it.

On Fund surveillance and the functioning of the exchange rate system, Mr. Mawakani welcomed the opportunity to examine the issue of objective indicators that might serve as a basis for medium-term policy actions by the industrial countries. On SDR issues, while he had no objection to the areas suggested for exploration, he wondered whether the Executive Board's schedule was sufficiently open to accommodate four papers on SDR matters before the September Annual Meetings. It might be noted in that regard that the usefulness of such studies in enhancing the multifaceted role that the SDR was intended to play would remain limited so long as most of the large industrial countries continued to oppose the resumption of new allocations.

Remarking on issues under the subheading "the Role of the Fund," Mr. Mawakani said he was not certain of the need to re-examine at present the guidelines governing the access limits applicable to purchases under the enlarged access policy and the special facilities. He was under the impression that the guidelines were already being applied quite flexibly, although he was prepared to support a review of the limits if his impression was incorrect. He was also looking forward to an examination of the paper on theoretical aspects of the design of Fund programs and its companion paper on program design and performance criteria, both of which should provide interesting insights into the development of Fund programs.

On the area departments' work program, the views of his chair had not changed, Mr. Mawakani commented. Efforts must be made to spread more evenly country missions in multicountry constituencies so as to reduce the bunching of country matters on the Executive Board's already crowded agenda. As he understood it, the Executive Board might be asked to consider Article XIV consultation and stand-by reports for nine countries in his constituency, and stand-by review reports for three others, by end-October 1986; and further Board discussions might be called for if negotiations for purchases under the structural adjustment facility--currently under way with some countries in his constituency--were completed in the near future. In order to alleviate the problem of bunching, his preference was for a more flexible application of the guidelines on scheduling of papers for consideration by the Executive Board.

During the Executive Board's November 1985 discussion of the work program, it had been proposed by Mr. Nebbia that the staff should explore, in a separate paper, the different aspects of external adjustment and the issue of economic growth in the developing countries, Mr. Mawakani recalled. The question of export growth had been touched upon in a paper circulated in March 1986 entitled "The Transmission of Economic Influences from Industrial to Developing Countries," which had been prepared by the staff as a supplement to the main paper in the world economic outlook exercise. However, the general problem of sustained and broad-based economic growth and, more particularly, the nexus between external adjustment and economic growth, had not been explored. For the latest work program, the Managing Director had made a brief reference to the topic by noting that attention would also be given "to updating the prospects for growth and adjustment in heavily indebted countries" and "to the problem of flight capital and to prospects for commodity prices." While welcoming the intention to emphasize growth and adjustment, he was concerned that the coverage should not be limited to heavily indebted countries but should extend to low-income countries as well.

In sum, Mr. Mawakani reiterated the call for a separate paper on external adjustment and economic growth in the low-income developing countries that would describe not only the theoretical relationships but past experience and prospects as well. The sample of countries explored in the paper should not be narrowly limited but more broadly representative of the spectrum of LDC's.

Mr. Nebbia commented that, like others, he could support the proposed work program. With regard to the consideration to be given to issues raised in the G-10 and G-24 reports on the international monetary system, his authorities felt that it was important to progress toward agreement on concrete programs of action for presentation to the Interim Committee at its September 1986 meeting. On Fund surveillance and the functioning of the exchange system, it had been proposed that the staff prepare an exploratory paper on indicators of economic policies and performance. His authorities had a number of questions about the role the Fund should play in determining the specific indicators for the industrial countries and about the monitoring of performance measured by them, particularly in light of the agreements reached at the Tokyo Economic Summit, agreements he hoped would be clarified in the near future.

On a related matter, Mr. Nebbia considered that it might be desirable to have the benefit of views from experts outside the Fund on certain of the issues in the work program. The Fund staff should of course prepare the studies for examination by the Board and the Interim Committee, but he was in favor of holding some meetings in seminar form, with papers prepared and delivered by outsiders. Welcoming the scheduled discussions on proposals regarding arrangements to accompany SDR allocations, he believed that the Board should be able to reach agreement on new procedures aimed at ensuring that allocations would not weaken the adjustment process in developing countries while at the same time maintaining the unconditional character of the SDR.

He could support a global paper on the role of the Fund that included Board discussion of various issues raised in the G-10 and G-24 reports, including closely related aspects such as conditionality and access policy, Mr. Nebbia continued. The global paper would link all the aspects related to the role of the Fund as overseer of the international monetary system. He was also in favor of holding a preliminary discussion before the 1986 Annual Meetings on guidelines on access limits under the policy on enlarged access. Studies on access limits should be related to the requirements for Fund financing, which themselves should be tied to the nature of Fund programs.

In preparation for the Ninth General Review of Quotas, the Executive Board should establish a Committee of the Whole before the end of 1986 to begin preliminary discussions on the quota review, Mr. Nebbia remarked. Quotas must remain the primary source of financing for the Fund, and the fact that the Eighth Review of Quotas had fallen short of current requirements underlined the need to advance the Ninth General Review.

The long awaited discussion on theoretical aspects of design of Fund programs had been scheduled for end-July, Mr. Nebbia observed. In the related staff paper on program design and performance criteria, the staff had indicated that it would "seek ways of improving performance tests to ensure that they are effective in safeguarding the revolving character of the Fund's resources." He would appreciate more detail on the staff's intentions and, specifically, whether there was any indication that greater conditionality in the use of Fund resources was implied.

On the debt strategy, his authorities concurred with the proposed studies but felt that even greater emphasis on the debt problem was needed, Mr. Nebbia said. As he had noted on other occasions, it was important for the staff to provide the Board with a paper dealing with the subject of growth in developing countries and outlining new strategies to make improvements in the external sector compatible with growth in the developing countries. On the structural adjustment facility, it was clear that some delays might arise in presenting policy framework papers to the Executive Board, and every effort should be made to ensure that disbursements under the facility were not improperly delayed.

He could support Mr. Sengupta's call for a staff study on possible mechanisms for recycling the large trade surpluses of Japan to developing countries, Mr. Nebbia remarked. Such a study could take on particular importance in light of the commitment of the United States to reduce its fiscal deficit. Finally, on other matters, he welcomed the various papers that would be circulated to the Board for information, particularly the study on forward exchange market arrangements, and he agreed that a seminar discussion of the proposed paper on Islamic Banking would be interesting, although he had an open mind about the appropriate date for such a discussion.

Mr. Massé, remarking first on the creation of the Group of Seven at the recent Economic Summit meeting in Tokyo and on the role of the Fund in the management of the world economy, stressed that in any discussions on multilateral surveillance, the Managing Director of the Fund must be included. His role was important, not only as spokesman for the Fund, which was charged with the management of the international monetary and financial system, but also as a link between the various players, especially the developing countries, which otherwise might have little input in the discussions.

Turning to the specifics of the Work Program, Mr. Masse endorsed the proposed study on ways of increasing the acceptability of SDRs. The chair representing his constituency at the Interim Committee meeting in April had indicated that great emphasis should be put upon such a study, although he tended to agree with Mr. Dallara that the work program of the Executive Board was such that there was a limit to the conclusions that could be reached before the 1986 Annual Meetings. On the role of the Fund, he could support calling a preliminary discussion before the Annual Meetings on the experience to date with the current access limits and on the potential need of members for Fund financial assistance in 1987. If that study could be extended, the Executive Board might be in a better position to evaluate the kind of role that the Fund should play in future in providing financial assistance to members. Like others, he was looking forward to discussion of the paper on the design of Fund programs and, particularly, the lessons that might be learned by working more closely with the World Bank on such programs. It might be that the programs would have to be adapted to reflect a longer time horizon or to be more consistent with the sectoral policies that would be recommended by the World Bank.

In the section of the work program on the world economic outlook, two questions were of paramount importance, Mr. Massé considered. The first had to do with the problem of flight capital, a study of which would be timely, especially if it was prepared from the point of view of the originating countries where the traditional argument had been that domestic policies must be adjusted to give a greater rate of return and lower risk to the capital that was invested. At the same time, it would be important to look at the policies of the receiving countries, which could also influence the flight of capital. The second issue of importance in the world economic outlook exercise concerned prospects for commodity prices. A study of that issue by the Fund would put the institution in a better position to make recommendations to countries from a global perspective on the production of, or investment in, certain commodities, given developments in the markets.

In the recent seminar discussion on social expenditures in the seven major industrial countries, it had become clear that a number of industrial economies were either already saving or would soon have to begin saving larger percentages of their GNP in order to adapt to aging populations, Mr. Massé recalled. A suggestion had been made at that meeting that flows of savings might well have to be invested in economies other than those making the savings. When that point had been raised, the counterargument had been put forward that some risk would be involved if industrial economies had to invest a large proportion of their savings in other economies in order to get future returns in 10-15 years. In that context, the paper prepared by Mr. Sengupta on the use of the Japanese surplus had been mentioned as covering ways in which savings could be used to yield the highest rate of return on the best investment opportunities world-wide, provided greater security of investment could be achieved. Since the Fund might well have to advise borrowers and lenders on such questions in future, it might be useful if those issues were raised in the context of the capital markets study. Finally, noting that the report of the Joint Bank/Fund Committee of Executive Directors on Staff Compensation would not be available until after the 1986 Annual Meetings, he asked for some preliminary indications of the work of the Committee in advance of the Board's discussion of the management's recommendations for the 1986 adjustment in staff compensation.

Mr. Parmena, indicating his agreement with the work program, noted that considerable ground work had been laid by the Interim Committee for the further consideration of issues raised in the G-10 and G-24 reports. In the circumstances, it was to be hoped that the staff papers on Fund surveillance, the functioning of the exchange rate system, SDR matters, and the role of the Fund would enable the Executive Board to ask the Interim Committee to reach conclusions on those issues in September. For example, in the exploratory paper on indicators of economic policy and performance, scheduled for discussion on July 14, he was looking forward to specific alternative approaches based on the consensus that had emerged in the Executive Board, the Interim Committee, and the recent Economic Summit Meeting of the Group of Seven in Tokyo. As for papers on the SDR, while he welcomed the management's proposals, he noted that much ground had already been covered on the SDR. In particular, the stabilizing role of an increase in the proportion of SDR holdings in the international monetary system was already established, as was the useful role the asset could play for debt-ridden countries as owned rather than borrowed reserve assets and as a safety net. Indeed, in summing up the discussion on the issue of an allocation of SDRs in March 1986, the Chairman had noted that those opposed to the allocation of SDRs were not keen on holding the asset but could possibly support an allocation if the holding of SDRs was made more attractive to hold. The logical conclusion was that the staff should look toward ways of making the SDR more attractive to hold. On the other paper dealing with possible arrangements to permit the use of SDRs in exchange market intervention by central banks and to establish a clearing facility for SDR-denominated financial instruments, he would be interested in a detailed comparison of the use of the ECU along those lines.

On the role of the Fund, Mr. Parmena said that he could support a preliminary discussion before the Annual Meetings on access limits under the policy on enlarged access as well as access limits applicable to the compensatory financing facility and the buffer stock financing facility. On the matter of debt strategy, his chair urged the staff to focus clearly on African countries in its review of international capital markets scheduled for Board discussion on September 3.

In connection with the effort to strengthen the multilateral setting for surveillance, the suggestion had been put forward in the past to include a separate chapter in the world economic outlook papers on the interactions and repercussions of policies of major countries, Mr. Parmena recalled. It was clear from the work program that the staff was being directed to bear in mind the increased emphasis to be given to policy interaction among industrial countries, but he would welcome some indication of how the staff intended to approach that matter.

It was clear that a number of Article IV consultations and requests for use of Fund resources would take up a considerable proportion of the Board's time in the next five months, Mr. Parmena said. During the same period, a number of requests for use of resources under the structural adjustment facility might well be brought to the Board. In that regard, and recalling that the structural adjustment facility had been designed as a quick-disbursing facility, he hoped that the policy framework papers currently being prepared would not take up too much of the Board's time.

The four papers mentioned under the heading "Other Matters" in the work program seemed to be of both intellectual and practical value, Mr. Parmena said. The paper on Islamic Banking was of particular interest, not only because it represented a new area about which many Directors knew very little but also because it was representative of the rapidly growing phenomenon of noninterest banking in many member countries. On the timing of the discussion of the paper, he could go along with Mr. Nimatallah's suggestion for a July seminar. The other three papers mentioned under "Other Matters" could also be discussed in seminar form when time was available.

Mr. Sengupta agreed with those who felt that the work program appropriately covered the extensive list of subjects that needed to be considered by the Board before the 1986 Annual Meetings. He was in general agreement with the proposal for dealing with the issues raised in the reports of the Group of Twenty-Four and Group of Ten, noting that it might be useful at the conclusion of the discussion of those subjects for the Managing Director to make a general report to the Interim Committee on the progress made toward the recommendations contained in those reports.

On Fund surveillance and the functioning of the exchange rate system, he agreed that the staff paper to be prepared for that subject should take account of the recommendations of the Interim Committee at its April 1986 meeting. In particular, attention should be paid to the ways in which the Fund's reviews of the world economic situation could be improved, including the formulation of a set of objective indicators relating to policy actions and economic performance in the major industrial countries. It was heartening in that context to note that at the recent Tokyo Summit meeting of the Group of Seven, agreement had been reached that "additional measures should be taken to ensure that procedures for effective coordination of international economic policy are strengthened." Toward the end of that meeting, the Ministers had agreed to review their individual economic objectives and forecasts collectively at least once a year, using certain indicators; and they had reaffirmed their undertaking to continue to cooperate with the Fund in strengthening multilateral surveillance, particularly among key currency countries. The Ministers had also agreed that in conducting such surveillance among themselves, individual country forecasts would be reviewed, taking into account a set of indicators. More significantly, the communiqué produced at the end of the Tokyo Summit invited Finance Ministers of the Group of Seven to "reach an understanding on appropriate remedial measures, whenever there are significant deviations from an intended course." That statement logically implied that the Ministers must also reach agreement about "the intended course." Finally, it was accepted that the Managing Director of the Fund would participate in their discussions.

The Group of Twenty-Four had made several recommendations to strengthen multilateral surveillance, Mr. Sengupta continued. In particular, the Group had recommended a two-stage approach, pointing to the need to develop indicators for conducting multilateral surveillance as well as to the need to reach agreement about the behavior of those indicators and the set of policies to be applied if actual developments deviated from the desired outcomes. The Group of Twenty-Four had also suggested a second stage of bilateral surveillance of industrial countries' policies. The proposals of the Group of Seven fell short of the recommendations of the Group of Twenty-Four, but they could be considered as a move in the proper direction. The next step was for the staff to clearly examine the question of the development of indicators so that the Fund could review, perhaps in the context of the world economic outlook exercise, the various policy objectives that should be pursued by the industrial countries to yield a desired set of indicators. As he had noted earlier, the Group of Seven had expressed its resolve to cooperate with the Fund and to work in conjunction with the Managing Director toward that end. As he understood it, the Managing Director would be a participant in the annual discussions of the Finance Ministers of the Group of Seven and would convey the views of the International Monetary Fund at those meetings on the importance of various indicators that needed to be developed. The proposed staff paper should outline, first, the set of indicators and the target course of the variables they were intended to measure as well as the appropriate policies that would produce those outcomes. In addition, the staff should look at the manner in which the policies of individual industrial countries could be monitored to make them "compatible" with one another.

With regard to the role of the Fund, the Group of Twenty-Four had made several important recommendations, Mr. Sengupta recalled. At its Seoul meeting, the Interim Committee had asked the Executive Board to study all the issues raised in the G-10 and G-24 reports and to bring them back to the Interim Committee for their "substantive consideration." In April 1986, the Managing Director had indicated in his report to the Interim Committee that the subject of the role of the Fund had not been discussed by the Executive Board as a separate subject because it had not been on the agenda of the April meeting of the Interim Committee. Now that the Board was prepared to discuss the role of the Fund, it was important for Directors to examine all the recommendations made in the G-24 and G-10 reports on that subject. The G-24 report covered extensive ground, which included, inter alia, the nature of Fund programs, their design, the need for growth orientation in adjustment policies, access limits, quotas and concessionality in Fund lending. Only some of those issues had been included in the latest work program; he proposed that the Board should examine all of them. Moreover, in examining those topics, it was important to ensure that the link between various subjects was not lost. For that purpose, he suggested a global paper on the role of the Fund that would indicate the links between topics as well as the manner in which it was proposed to discuss them. Papers on individual subjects could then be discussed separately within that overall framework.

He was happy to note that the Board would be discussing the theoretical aspects of the design of Fund programs as well as a paper on program design and performance criteria in late July, Mr. Sengupta said. The Group of Twenty-Four had made several suggestions on those matters in its report, and he had put forward a number of proposals in Board discussions in January and February of 1986. He hoped that all the suggestions would be considered in the two papers. Of particular concern was the manner in which the emphasis on growth would be reflected in the theoretical paper as well as in the actual design and implementation of Fund programs.

The Group of Twenty-Four had in its report indicated that the size of quotas had a bearing on the effective functioning of the Fund and that "quotas must remain the primary source of financial resources for the Fund's operations," Mr. Sengupta went on. In preparing papers for the Ninth General Review of Quotas, the staff should clearly indicate the rationale for making the Fund essentially a quota-based institution, unlike the World Bank or other institutions. The Fund's attitude toward quotas must be guided by those fundamental considerations. Given the uncertainties facing most developing countries--particularly the debtor countries in Africa and Asia that were suffering from a steep decline in their terms of trade and other adverse external circumstances--the Fund must be equipped with adequate resources to play the central role it was being assigned to ensure orderly adjustment in those countries. It would be unrealistic to expect countries to follow Fund advice and to adopt Fund programs in the absence of adequate resources to finance them. For that reason, the Group of Twenty-Four had pressed for advancing the Ninth Quota Review, along the lines suggested by Mr. Arias.

Welcoming the proposed studies on international capital markets and on developments in official debt rescheduling, Mr. Sengupta wondered whether the debt problem should not be subjected to further analysis in a separate staff paper with a view to helping other countries avoid the problem. What he had in mind was a general policy framework that would ensure that developing countries--especially the low-income countries--grew as rapidly as possible without an increase in their debt burden. In that context, the observations made in the report of the Group of Twenty-Four were pertinent. The report stated that the "lesson learned from the recent experience with the debt crisis is that heavy reliance on medium- and short-term borrowing for development financing is bound to give rise to liquidity problems, even if such financing were to be directed toward sound and viable projects." In playing its central role in the international adjustment process, the Fund should examine how the twin objectives of growth and prudent debt levels could be achieved in developing countries. Such an examination could also throw light on the level of viable interest rates, the terms and conditions of loans that could be absorbed by countries without creating problems, and the desirable directions of international capital flows.

He was in general agreement with the remainder of the work program, and could support Mr. Salehkhou's suggestion that the paper on Islamic Banking could best be discussed in seminar form, Mr. Sengupta remarked. Finally, he believed that the Fund should examine the issue of recycling the Japanese surplus, although it might be better for the staff to look at the problem in more general terms than had been mentioned by Mr. Massé by using the Japanese case only as an illustration of the problem of recycling structural savings from surplus to deficit countries.

Mr. Fujino remarked that while he had different views on the approach suggested by Mr. Sengupta, he agreed it would be worthwhile for the Fund to look into the problem of recycling structural savings from surplus to deficit countries.

The Executive Board agreed to continue its discussion of the work program at 3:00 p.m.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/77 (5/6/86) and EBM/86/78 (5/9/86).

3. COTE D'IVOIRE - TECHNICAL ASSISTANCE

In response to a request from the authorities of Côte d'Ivoire for technical assistance in the customs and tax fields, the Executive Board approves the proposal set forth in EBD/86/132 (5/5/86).

Adopted May 8, 1986

4. ZAMBIA - TECHNICAL ASSISTANCE

In response to a request from the Zambian authorities for technical assistance in the area of tax policy, the Executive Board approves the proposal set forth in EBD/86/133 (5/6/86).

Adopted May 8, 1986

5. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 85/122 through 85/124 are approved. (EBD/86/129, 4/30/86)

Adopted May 6, 1986

b. The minutes of Executive Board Meetings 85/125 and 85/126 are approved. (EBD/86/130, 5/2/86)

Adopted May 8, 1986

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/104 (5/5/86), EBAP/86/105 (5/6/86), and EBAP/86/106 (5/7/86), and by Advisors to Executive Directors as set forth EBAP/86/104 (5/5/86) and EBAP/86/105 (5/6/86) is approved.

APPROVED: January 23, 1987

LEO VAN HOUTVEN
Secretary