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Minutes of Executive Board Meeting 86/191

3:00 p.m., December 3, 1986

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

| Executive Directors | Alternate Executive Directors |
|---|---|
| A. Abdallah | E. T. El Kogali |
| Dai Q. | |
| | D. C. Templeman, Temporary |
| | L. Hubloue, Temporary |
| | J. J. Dreizzen |
| | M. Z. M. Qureshi, Temporary |
| | M. Sugita |
| G. Grosche | |
| J. E. Ismael | J. Reddy |
| A. Kafka | |
| T. P. Lankester | M. Foot |
| H. Lundstrom | |
| M. Massé | |
| Mawakani Samba | C. V. Santos |
| Y. A. Nimatallah | I. Al-Assaf |
| G. Ortiz | L. Filardo |
| H. Ploix | S. de Forges |
| | J. de Beaufort Wijnholds |
| | C.-Y Lim |
| G. Salehkhou | |
| A. K. Sengupta | |
| | F. Di Mauro, Temporary |

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: S. N. Kimaro, A. Tahari. Asian Department: L. de Wulf. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; M. Guitian, Deputy Director; J. Berengaut, J. T. Boorman, D. Burton, J. Hicklin, G. G. Johnson, P. Neuhaus, M. Nowak, C. Puckahtikom External Relations Department: M. Goldstein, B. Nowzad, H. P. Puentes. Fiscal Affairs Department: A. A. Tait, Deputy Director; A. Cheasty, E. S. Kreis. Legal Department: F. P. Gianviti, Director; A. O. Liuksila, J. M. Ogoola, S. A. Silard. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; W. M. Corden, J. A. Frenkel, P. Isard, N. M. Kaibni, M. D. Knight, A. Lanyi, J. J. Soladay. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; D. N. Lachman. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. A. Agah, E. Ayales, A. Bertuch-Samuels, S. M. Hassan, G. D. Hodgson, J. Hospedales, K. Murakami, J.-C. Obame, G. Pineau, I. Puro, Song G., A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, J. de la Herrân, V. Govindarajan, G. K. Hodges, J. M. Jones, S. King, T. Morita, C. Noriega, J. K. Orleans-Lindsay, S. Rebecchini, V. Rousset, G. Seyler, B. Tamami, H. van der Burg, Wang X., Yang W.

1. PROGRAM DESIGN AND PERFORMANCE CRITERIA

The Executive Directors continued from the previous meeting (EBM/86/190, 12/3/86) their consideration of a staff paper on program design and performance criteria (EBS/86/211, 9/8/86), a staff paper summarizing experience with the specification of performance criteria in stand-by and extended arrangements approved since 1979 (EBS/86/211, Sup. 1, 9/11/86), and a staff paper containing a general review of the issues involved in the oil price and growth contingencies in Mexico's stand-by arrangement (EBS/86/211, Sup. 2, 11/11/86).

Mr. Sengupta made the following statement:

The issues that are covered in the staff papers need to be discussed thoroughly before we can come to any definitive conclusions, because they have an impact on not only the design and implementation of programs for countries, but also the general question of the role of the Fund. At its most recent meeting the Interim Committee asked us to study the role of the Fund in detail and to report on our views. Our discussion on this subject, along with the discussion on the theoretical aspects of the design of Fund programs, should form a good beginning toward meeting this objective.

I wish to make several general observations. The design of performance criteria will be influenced considerably by the approach to the theoretical underpinning of the design of Fund programs. Our discussion of the theoretical aspects was somewhat inconclusive. Questions on several aspects of design need further examination, and we should come to some understanding on them before definitive views can be expressed on the questions concerning performance criteria. In saying this I do not wish to detract from today's discussion, but I would underscore that our conclusions must be tentative and would need to be considered further by the Executive Board after the next discussion on the theoretical aspects of the design of Fund programs.

One of the important questions that was posed during the previous discussion on program design was the manner in which both growth and adjustment can be incorporated into the design of programs. The Chairman agreed in his summing up that we need to reflect on this issue further. The role of finance and the appropriate speed of adjustment need to be discussed, as they have a bearing on the role of the future evolution of the Fund. The present paper, apart from noting the need for the staff to stress in its discussion with members the advantages of a growth-oriented approach, does not include specific suggestions on how such a growth-orientation would be incorporated in the monitoring techniques or in the design of programs.

The proliferation of performance criteria in the recent past is clearly described in EBS/86/211, Supplement 1. There has been a doubling in the average number of performance criteria in the previous year or so in comparison with a decade ago. This raises certain important issues. One needs to analyze whether this development has contributed to the success of Fund programs in these countries, the improvement of the relationship between the Fund and the borrowing members, and the Fund's role in ensuring symmetry in adjustment between surplus and deficit countries. There has been little discussion on these important issues in the staff paper. In his opening statement Mr. Kafka referred to a Canadian proposal to introduce reverse stand-by arrangements for surplus countries, involving commitments to provide resources to the Fund. This proposal clearly merits further examination not only because of its symmetry, but also because it would increase the chances of success of adjustment programs and would enhance the ability of adjusting countries to meet performance criteria. It should be stressed that adjustment is a global process; deficit countries cannot adjust if the surplus countries do not adjust simultaneously.

Like Mr. Kafka, I am unhappy with the statement by the staff at the beginning of the first paragraph on page 26 that the general principles underlying Fund programs "remain appropriate." It is not clear how the staff has come to this conclusion at a time when our discussion on the theoretical aspects of the design of Fund programs remains inclusive. In any event, the question of the effectiveness of Fund programs is also in considerable doubt, a fact that even the staff seems to recognize. Nor can I agree with the staff's assumption that recent concerns about the relative priority to be attached to economic policy objectives such as growth do not involve "fundamental questions" about the "appropriateness" of Fund program design. In his summing up on the discussion of the theoretical aspects of design the Chairman observed that "although consultations and other activities have enabled the Fund to accumulate a wealth of knowledge and experience concerning individual countries and policies that is unmatched in the world, we need to undertake further empirical analysis of the way in which the Fund programs have worked or not worked well in individual countries; this should be a major priority of the Research Department's future work in cooperation with the area and functional departments." At this stage of our discussion, there seems to be no room to assert that Fund program design is generally appropriate.

I also have some difficulty in understanding the undue emphasis given by the staff on the "degree of commitment of the member" as a factor that is a "fundamental limit to the efficacy" of the program. While no one can quarrel with the idea that a member needs to be committed to the program that it accepts, it is not clear whether the staff is implying that programs have often failed because of a lack of commitment by the member. If this is the assertion, it raises a number of questions. First, one needs to know how many programs, according to the staff, have suffered because of this lack of commitment. Second, what are the views of the countries on this matter? Do they feel that their programs broke down because of faulty design? Do they have alternative approaches to suggest? What alternatives have the Fund suggested to them, and what were the reactions of the countries? I wonder whether the staff will be able to elaborate on this aspect of their experience. I am also not certain whether the commitment of the authorities can be substituted for or improved by close monitoring, as the suggestion by the staff on the bottom of page 26 seems to imply. It is important to remember that most of the countries that approach the Fund generally face serious problems, and it is difficult to presume that in such a situation they would not try to make every effort to solve those problems. If in any particular case a country has been unable to introduce the required policies, it would be necessary to examine what went wrong, including the appropriateness of the design of the country's program in the light of the country's particular circumstances.

While simplicity of performance criteria is a laudable objective, comprehensiveness of performance criteria may not always be practicable, and I would not wish to see a widening of the scope of performance criteria merely for this purpose. Performance criteria should have direct relevance for the assessment of progress of the program in some specific critical areas. Comprehensive criteria may at times not serve the purpose and could send wrong and conflicting signals. Reliable data for such criteria may often not be available.

The same reasoning argues against the concrete specification of intermediate variables underlying the formulation of performance criteria. There should not be any rigid rule regarding the monitoring of these variables or deviations from targets that trigger a consultation. We should avoid such procedures, since they not only limit the choices that are available to the authorities, but could also be seen as an unnecessary intrusion into their sovereign authority, even if they do not interrupt purchases. This is also inconsistent with the staff's conclusion on page 16--with which I fully agree--that the desirable features of performance criteria favor a "small, rather than a large, number of performance criteria, and the need to avoid unnecessary proliferation of performance criteria should always be kept in mind."

In the monetary and credit policy areas the staff has shown its preference for the broader concept of net domestic assets over the concept of domestic credit and has suggested that "a more prudent approach would be to combine a performance criterion on net domestic assets with supplementary monitoring of other items, in which case unexpected behavior of the latter could trigger a consultation that, if necessary, could result in appropriate modification of the performance criteria." The monitoring of other items net has been suggested with a view to controlling greater than planned expansion of expenditure on other items that are in fact the counterpart of increases in domestic liquidity. However, the clearly identifiable and relevant aggregates are M1, broad money, domestic credit of the banking system, and net foreign assets. Other items net is a residual category the movement of which cannot therefore be fully explained and which is not under the control of the authorities. The present practice under which, as the staff states on page 7 of EBS/86/211, Supplement 1, "the most common form of credit ceiling remains that of domestic credit of the banking system," should not be changed. In the fiscal policy area the staff has observed that "a broad definition of the public sector borrowing requirement would normally be preferable to one limited to net bank credit to the government." This has been suggested with a view to covering the net borrowing requirement from all sources, particularly the nonbank sources of domestic financing.

The public and private sectors resort to nonbank financing mainly with a view to utilizing the savings of the household sector, which has a surplus of savings over investment. Furthermore, the nongovernment public sector is part of the commercial sector, which needs credit for its normal commercial activities. Borrowing from the nonbanking sector is on a different footing compared with bank financing. While banks can create credit, nonbank financing institutions cannot. What needs to be controlled, if anything, is the government's undue reliance on bank credit. Moreover, timely and reliable data on nonbank borrowing at many stages of the year are not available in many countries. As the staff itself admits, "the typical fiscal performance test since the late 1960s has taken the form of a subceiling on net bank credit to the government or to the public sector. I see no merit in the staff's suggestion that a broad definition of the public sector borrowing requirement should be preferred over net bank credit to the government.

I generally agree with the staff that reviews should be reviewed flexibly in the event of unforeseen developments but should not be used to change the basic process of policy-planning and program implementation, except, perhaps, in cases in which it is unavoidable owing to a lack of information or of an understanding on the nature of the difficulty at the beginning of a program. Guideline 10 clearly states that in programs extending beyond one year or in circumstances in which a member is unable to establish a performance criterion or performance criteria in advance, "provision will be made for a review in order to reach the necessary understandings with the member for the remaining period." In addition, in those exceptional cases "in which an essential feature of a program cannot be formulated as a performance criterion" at the outset because of uncertainties in economic trends, "provision will be made for a review by the Fund to evaluate the current macroeconomic policies of the member and to reach new understandings if necessary." The provision is for one review, even in exceptional cases or in programs extending beyond one year. As Table 15 in EBS/86/211, Supplement 1, shows there was more than one review in many arrangements covering just 12 months. The provision for a review only if an essential feature of the program cannot be formulated beforehand has often not been adhered to; staff papers on arrangements rarely include a justification that an essential feature of a program cannot be formulated at the beginning of the program year. In the exceptional case specified by the Guideline, the intended review should not cover any sectoral problem such as public enterprises, but should cover current macroeconomic policies and should be designed to "reach new understandings if necessary."The authors of this Guideline perhaps did not think that such a provision was necessary for programs covering only one year.

The staff contends that automatic adjustments of performance criteria may be appropriate for dealing with minor deviations in exogenous variables that are clearly reversible over a relatively short period and that can be anticipated with some certainty, such as a debt rescheduling. The staff said that such fluctuations in other exogenous variables, such as key commodity prices, could be too large and not reversible in a short time, and that automatic adjustments in such cases may not be effective. According to the staff, this is a particularly important point, as one of the difficult judgments that is to be made about exogenous developments concerns their temporariness, on the validity of which ex ante automatic adjustment hinges.

While I understand the point that the staff is making, it should be recognized that one of the strong points in favor of an automatic adjustment system is that it gives sufficient confidence to the member to go ahead with a program without undue worry, hesitation, or uncertainty that a midyear review would cause. It would therefore be more desirable to include automatic adjustments to the extent possible. If there are any strong reasons to review them in a particular case, they can always be taken up at the time of the routine midyear review after consultation with the member.

On the question of major deviations from understandings on supporting policies, the staff has stated that "the strongest response to clear evidence of major policy deviations would be to cancel the arrangement and require an immediate repurchase of any drawings made. A lesser response would be to interrupt drawings under the arrangement until new understandings are reached with the member and necessary corrective action has been taken. If the member did in fact make any purchases after the policy action had been taken, a requirement of immediate repurchase akin to that which applies to noncomplying purchases could be established." I have difficulty in accepting these recommendations. I do not support recalling any drawings that are made if there is no clear evidence of willful or deliberate deviation from the understandings reached with the Fund. The present phasing of drawings suggests that they are linked with policy actions already taken by the authorities. The more appropriate response in the event of major policy deviations may be an interruption of drawings. In any event, there should be a full consultation with the member. As to ceilings on external debt, I see no merit in placing a ceiling on contracted debt. If such debt is excessive, it could always be canceled. Otherwise, it acts as insurance for the undertaking of development plans. Furthermore, ceilings on contracted debt have been resorted to by the Fund in some cases because timely data on disbursements were not available. Therefore, no case can be made for having ceilings on both disbursed and contracted debt; the ceilings should be restricted to disbursed debt.

The contingency mechanisms that have been used in the Mexican case are welcome but do not go far enough. They need to be applicable to other cases, as the modifications are in the right direction and take into account the uncertainties and developments in international prices of commodities and with respect to economic growth prospects. In fact, as this chair stated earlier, the uncertainties about the international environment and growth need to be taken more fully into account in designing and monitoring programs.

Adequate and appropriate financing is essential for time-bound adjustment. If the international environment deteriorates, greater financing and a lengthening of the time frame of adjustment are required. In the real world, forcing a country to adhere to a program within the originally anticipated financing framework, whatever the developments in the international situation might be, would surely lead to the failure of the program. The need of flexibility has to be built into programs.

Contingency financing would undoubtedly increase the external debt of a country. The debt-servicing burden arising from this should be minimized through various measures if the existing debt burden is excessive. If the international situation deteriorates, thereby increasing the burden of adjustment on deficit countries, the international community will have to find ways in which to see that the time frame of adjustment is lengthened and that the sacrifices that are to be made by the adjusting deficit countries are tolerable. Under a commodity price contingency mechanism a member should receive financing from the Fund that it would otherwise have received under a normal program owing to the deterioration in its balance of payments caused by the commodity price decline. Even after such a provision is used, if the prices were to decline to a lower than assumed level, further financing should be provided.

One of the major objectives of the Fund is to provide balance of payments assistance to its members. Against the desire of a large segment of its membership the Fund decided to limit severely its balance of payments assistance and to play a role as a catalyst. Through a substantial augmentation of its resources the Fund could meet the balance of payments needs of its members arising from the contingency features of programs that need to be generalized and avoid the difficulties in negotiations with banks that are alluded to on page 17 of EBS/86/211, Supplement 2.

As to the Fund's role in avoiding exchange restrictions by members, I agree with Mr. Kafka that the Articles do not fully forbid restrictions. They can be imposed in certain circumstances, with the approval of the Fund as provided in Article VIII, Section 2. Similarly, Article XIV, Section 2 also provides for the maintenance and adaptation of restrictions by a member under the transitional arrangements and enables a member to withdraw them "as soon as they are satisfied that they will be able, in the absence of restrictions, to settle this balance of payments in a manner that will not unduly encumber their access to the general resources of the Fund. It would therefore be wrong to say that the Fund programs should always "eschew" the use of restrictions, as the staff said on page 12. The very fact that the Articles provide for the use of restrictions with the permission of the Fund implies that under certain circumstances the Fund would be well justified in permitting the use of restrictions.

Mr. Sugita made the following statement:

The discussion on program design and performance criteria comes at a time when members' attention is focused increasingly on the growth aspect of adjustment and when the financing constraint, particularly financing from private sources, is becoming increasingly evident. It is in the commercial banks' own interest to help to expedite the adjustment process by providing the necessary financing to developing countries. While the case-by-case approach should be adhered to, stronger efforts have to be made to secure financial flows for countries in need. Of course, this does not reduce the primary importance of the adjustment efforts by the debtor countries themselves and of successful demonstrations of progress in these efforts as a precondition for the flow of credit from the commercial banks.

After several years of low or even negative growth, an increasing number of countries have come to realize that an improvement in their growth prospects is needed to maintain and strengthen their adjustment efforts. While I have difficulty in accepting the notion that growth is a precondition for adjustment, growth and adjustment certainly are not mutually exclusive, particularly if growth is achieved through structural reform that could also have a positive effect on adjustment. If structural reform can be considered to be an important link between growth and adjustment, this may have to be reflected in the monitoring techniques of Fund arrangements as well as in the design of programs. While Guideline 4 on conditionality, which stresses the importance of avoiding undue interference in members' decision-making process, has to be respected as much as possible, if the expressed wish of the member is to aim at a higher rate of economic growth, policy measures of a structural nature need to be specified at the outset, after close consultation with the Fund and the World Bank, and progress needs to be monitored through the use of reviews. Emphasis on growth may necessitate the inclusion of structural reform in performance criteria, and in this connection the appropriateness of Guideline 9 may have to be reviewed during the coming discussion of conditionality.

At the same time, I would stress that I attach particular importance to the preservation of the monetary character of the Fund. What I have said about growth and structural reform should not be taken as advocating a modification of this basic character of the institution or as favoring an encroachment by the Fund on the domain of the World Bank.

I broadly endorse the points that the staff has made in its papers, and I would like to emphasize certain aspects of them. First, as to responses to delays in completing reviews, while I can go along with the suggestion to maintain the current flexibility, it is important that the Executive Directors should remain fully informed of the causes of a delay in completing a review and of the current status of the negotiations with the authorities. Informal Executive Board meetings have provided good opportunities for such briefings, and such practices have to be continued, preferably with somewhat more detailed information than in the past. In order to respond effectively to cases in which policy actions have been taken that are inconsistent with understandings, it is important to have procedures to deal with such situations, and the staff should begin working on them.

Two contingency schemes were adopted for the program with Mexico, which is in a difficult situation and has a viable adjustment program. There could be cases in which the adoption of an appropriate contingency scheme contributes to a member's adjustment efforts. However, such an advantage has to be balanced against the risk of further debt accumulation and a subsequent increase in the debt service burden; such considerations seem to argue for a cautious and case-by-case approach to this matter. In particular, growth contingency mechanisms should be used only in very exceptional circumstances and should always be linked to the completion of review. In using commodity contingencies, it is important to set realistic price ranges, to maintain symmetry with respect to additional financing and repayment, and to strengthen adjustment as and when the lower price level becomes persistent. Given the general reluctance shown by commercial banks to provide contingency financing to Mexico, the Fund has to be realistic about the extent to which such financing can be obtained from commercial sources in future cases.

Mr. Kyriazidis made the following statement:

The staff paper touches on important issues that have been at the core of the operations of this institution. I will make three general comments. I am satisfied with the description of the evolution of the performance criteria and other monitoring techniques and with the treatment by the staff of the major characteristics and features of the criteria. The staff's presentation is well organized and complete. The presentation of the theoretical underpinnings of each of the performance criteria is somewhat less satisfactory. Our understanding of the evolution of the system of criteria would have greatly benefited from the analysis of the theoretical issues that are to be faced in choosing the most appropriate criteria. In the case of credit ceilings or fiscal performance, the choices between alternative available instruments are only briefly mentioned and are not properly related to the policy mix in a Fund program.

A second general comment concerns the development over recent years of the range, the number, and the variety of performance criteria. I would have preferred a more in-depth review of the factors underlying this phenomenon than the one provided in the supplementary paper, as well as a tentative assessment of its implications in terms of the effectiveness of the Fund's adjustment policies and program design. The proliferation of criteria may indicate that the specifications of adjustment programs have become so detailed as to restrict unduly a government's ability to govern. Consider for instance developments in the fiscal policy domain. The use of subceilings or supplementary ceilings in Fund arrangements affecting the composition of expenditures increased significantly in 1983-84 and is now back to the 1979-82 levels. Such an increasing involvement on the part of the Fund in members' fiscal management needs to be carefully assessed in the light of the very wise principle in Guideline 4 on the use of the Fund's resources that "the Fund will pay due regard to the domestic, social, and political objectives, the economic priorities and the circumstances of members." In this connection, it might also be useful to recall that in 1968, when addressing the issue of the use of fiscal targets among the performance criteria, the staff warned in SM/68/128 that "if [the fiscal targets] are made performance criteria and included in a performance clause, the impression may be created that the Fund is making a judgment on the priorities of the member." This is particularly relevant in cases in which the composition of expenditure is affected by the performance clauses.

I recognize that some expansion of performance criteria might be warranted by the greater involvement of the Fund with structural adjustment and growth issues. However, a substantial degree of flexibility is still preferable in the setting of performance criteria, given our knowledge of economic relationships and the instability that affects the behavioral equations. Furthermore, performance criteria should be few and should be aimed at the medium-term viability of the balance of payments and of the balance of aggregate supply and demand, and they should be applied to policy variables. Even if important elements of the adjustment program require careful specification, they need not be spelled out in the form of performance criteria or performance clauses.

My third general comment is that the paper lacks an overall assessment of the combined effects of the monitoring techniques used. Although I might agree with the staff's evaluation of developments concerning performance criteria, prior actions, and reviews, I still need to assess the global evolution of the Fund's monitoring techniques. By looking at each single tree we may miss the forest. How have the Fund's monitoring and program design policies been evolving over time? How appropriate are these policies in order to face the threats and opportunities determined by the changing environment in which this institution operates?

For instance, the fundamental issue that Mr. Kafka raised in his opening statement, concerning the essential distinction between the degree of control that the Fund can justifiably exercise and involvement in the governing of those countries, can only be considered at such a level of analysis. I am concerned that the combination of an increasing number and variety of performance criteria, the proliferation of reviews, and the use of prior actions might be sending a signal of excessive involvement of the Fund's programs beyond their macroeconomic objectives as well as a reduction in the "certainty" of access to Fund financing by members.

Those issues can be properly addressed only in the context of the forthcoming review of the success of Fund programs. It might perhaps be desirable to return to the discussion of performance criteria in order to properly assess their likely effectiveness for future Fund policy.

As for the more specific points raised by the paper, the increasing use of automatic adjustments needs to be closely scrutinized. I would welcome from the staff additional information on the number of cases in which the automatic adjustment clause was effectively utilized. As a general principle, I agree with the staff that automatic adjustments of performance criteria may be appropriate for dealing with minor and reversible deviations of exogenous variables. On the basis of this principle, the scope for the use of automatic adjustments appears to be rather limited. Therefore, in order to improve the flexibility of the Fund's programs, given the large degree of uncertainty characterizing some exogenous variables, a wider use of reviews--rather than automatic adjustment clauses--would be more appropriate.

I welcome the increasing attention to issues pertaining to structural policies. As is recalled in the paper, the Fund has for many years explicitly embodied structural objectives in its adjustment programs. At this stage, however, given the recent emphasis on growth aspects, a careful examination might be required to determine the structural policy objectives that the Fund can effectively address. This should be done bearing in mind the revolving nature of the Fund's resources and drawing on the particular instruments and skills that the Fund has developed in its operations over time. Therefore, I agree with the staff that many structural issues that are part of a more growth-oriented approach fall largely within the domain of the World Bank. I envisage the role of the Fund in fostering structural adjustment being mostly in the fiscal area, concentrating on the structure and efficiency of taxation, budgeting, and expenditure control, or in the financial sector, concentrating on the rationalization of the exchange rate system, or in the banking system and the development of capital and money markets.

As for the techniques to be applied in monitoring such policies, the approach should be derived from the Guidelines on Conditionality. Guideline 9 restricts the use of performance criteria in monitoring structural policy developments, as it provides that "performance criteria will normally be confined to macroeconomic variables and those necessary to implement specific provisions of the Articles or policies adopted under them." Moreover, I would stress that performance criteria should be objective in nature and relate to policies that can be expressed in quantitative or precise terms. Therefore, I agree with the staff's suggestion that most structural policies can best be dealt with through prior actions and reviews.

Turning to the contingency mechanisms adopted for Mexico, I welcome the opportunity to give some further thought on the issue of the broader context of the evolution of the Fund's adjustment strategies. The innovative character of the Mexican program is a logical consequence of the involvement of the Fund in growth-oriented adjustment programs, the increase in the collaboration with the World Bank, and the growing catalytic role of the Fund.

I am not ready to express a definite opinion on these issues--only some general thoughts. I have some doubt whether the Mexican program, including its technical innovations, represents "the" approach that should be generalized to other member countries to comply with the new objectives that the Fund is setting for its future actions.

The reasons for this skepticism are twofold. First, the nature of the Mexican case, which led to the conception of the two well-known specific contingency mechanisms, is very particular. Mexico faced, in addition to a very deep recession associated with a difficult debt problem, a highly volatile price of its major source of exports and fiscal revenue. Moreover, this volatility was particularly dangerous for the stability of the economic system in the aftermath of a drastic price fall. Therefore, the introduction of some innovation in the Fund's adjustment program for Mexico was strictly connected with the conditions of that country. Second, while the intended smoothing of the effects of adjustment efforts, which is a major task of the Mexican program, would be a welcome feature for various member countries, one should not overlook the possible drawbacks of the contingency clauses with respect to existing financing facilities both for Fund policy and for the adjustment process in individual countries.

Furthermore, the interaction of the two contingency mechanisms adopted for Mexico poses some puzzling questions. A drastic deterioration in the terms of trade affects growth negatively over a period of time beyond the initial shock. The two mechanisms might conceivably be triggered following a single shock, generating a sort of "double counting" of that shock. The Mexican economy has already suffered a serious shock from this source, the effects of which are still working themselves out. The purpose of the oil contingency mechanism is to smooth out the immediate balance of payments and revenue effects of an additional shock from the same source. But given the additional negative growth effects of an eventual further decline of oil prices, it would appear virtually certain that the growth contingency mechanism would also be triggered by the same shock, as it would be very difficult to disentangle the eventual cumulative reduction in the rate of growth due to the terms of trade deterioration from the effect of other factors already in operation. If this reasoning is taken out of the Mexican context, it would lead to the conclusion that the two mechanisms might well be considered as complementary and should be established together in growth-oriented programs that attempt to deal with problems arising from the instability of major commodity prices. I am not opposed in principle to such a prospect, but some further study is needed if commodity price and growth contingencies are to become standard features of Fund-supported programs.

Beyond these general points, I will comment on each of the two contingency mechanisms separately. As far as the commodity price contingency mechanism is concerned, I would like to make two points. First, the choice of the commodity whose price swing one wants to neutralize is crucial. Automatic adjustment of performance criteria and financing provisions might be appropriate if the price of the commodity in question is subject to excessive volatility, due for instance to speculative pressures or exogenous policy decisions over which the country has no control. On the contrary, I would not find justifiable an automatic adjustment mechanism applied, say, to agricultural goods the price variations in which are mostly supply based.

Second, the revolving character of the Fund's resources suggests the need to assess the presumed length of the price swing. It would be inappropriate for the Fund to engage in insulating large once-and-for-all shifts in commodity prices, which could be of a nontemporary nature. The financing of a clearly mistaken supply strategy pursued by a country would entail further external debt accumulation that would push the economy farther away from its optimal adjustment path. I must admit that the logic of the compensatory financing facility, which we will have the opportunity to discuss in another meeting, is most appealing because it requires explicitly that the Fund take a view of future commodity price developments. By the same token, I disagree with the staff's assertion on page 14 that "contingency mechanisms of this nature need not pose major issues for Fund policies." On the contrary, I am convinced that an important change in philosophy is implied, so that the implications for Fund's policies should be carefully evaluated.

I welcome the growth contingency mechanism, which is a practical manifestation of the Fund's increasing commitment to the support of growth within the framework of its programs. However, the specific technical way that was chosen to address the growth question in the Mexican case requires further scrutiny before being generalized. We have to examine the potential consequences and uncertainties connected with the consideration of the rate of growth, i.e., a final objective, as a sort of a sui generis reverse "performance criterion" triggering additional action on the part of official creditors and/or multilateral financing institutions. Furthermore, like Mr. Foot, I feel uneasy about the implication in the Mexican arrangement that the rate of growth can be managed chiefly through public investment expenditure. As we all know, this issue is much more complicated, not least because of the need to correct fiscal imbalances. I feel that not enough emphasis has been placed on the conditions that would make the achievement of the growth objective possible--conditions to which the contingency mechanism should be organically related.

I also feel that an explicit consideration of the different time span in which growth-oriented adjustment programs have to be considered with respect to other Fund programs should have been taken into account. In this respect, I would have preferred to see the contingency mechanism in question be associated with an extended arrangement rather than with a stand-by arrangement.

Mr. Dai made the following statement:

I fully agree with many of the comments that Mr. Kafka made in his opening statement.

In the area of performance criteria, it is understandable that there are differences in attitude and understanding between the Fund and member countries that use the Fund's resources. On page 1 of the main paper the staff states "from the member country's point of view, they are sometime seen as imposing undue constraints on their policy choices; from the Fund's point of view, they give rise to continuing questions regarding their effectiveness in safeguarding the revolving character of the Fund's resources." This conclusion is clearly correct.

Unfortunately, the staff papers do not contain either an analysis of the causes and effects of these contested views or an examination of their merits. In general, program design and performance criteria are aimed at curing the maladies of economies of member countries that use the Fund's resources. In this sense, the objective of the Fund should be precisely that of its member countries, and both parties have a common interest. Ironically, however, member countries are usually reluctant to accept the prescriptions given by the Fund, and the question naturally arises why member countries in difficulty are unwilling to accept the Fund's advice if that advice is good and helpful to their economies. Therefore, this basic difference is a key issue and might affect the success of program design and the selection and use of performance criteria; this difference needs to be further explored.

Member countries and the Fund staff are familiar with the fundamental principles underlying the Fund's inception, and discussions about the Fund commonly include references to such well-known phrases as "to promote international monetary cooperation" and "provides the machinery for consultation and collaboration on international monetary problems." However, the Fund is very different from any commercial financial institution in its philosophy toward member countries. Its cooperative nature--the most important and basic characteristic of the Fund--should be reflected much more consistently in the organization's operations, particularly in the Fund's financial assistance to its members. The spirit of international cooperation should be the starting point and basis on which Fund-supported programs are designed. We should not forget that, at any given time, this international cooperative character outweighs the revolving character of the Fund's resources. In saying this I do not wish to underestimate the importance of safeguarding the revolving character of the Fund's resources. No one would deny the need for such a safeguard, but it should be used in a way that is different from that of a money lender. In addition, we need to review the safeguard in the context of the purposes of the Fund. In this connection, Article I, Section (v) is especially relevant, as it stipulates that the Fund is to "give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments." As this text shows, the temporary availability of Fund resources under adequate safeguards is not in itself the ultimate aim but rather a means by which to achieve that aim, namely, of giving confidence to members and of helping to tide them over periods of balance of payments difficulties.

Too much emphasis has been placed in EBS/86/211 on safeguarding the revolving character of the Fund's resources to the detriment of the very countries that need the Fund's assistance. There is an abundance of suggestions aimed at restricting the use of Fund resources and at tightening the terms and conditions of their use at a time when many developing countries are in urgent need of the Fund's help to deal with their external payments difficulties. Many of these difficulties are caused by exogenous factors beyond the control of the country's authorities; it seems that the terms and conditions in the arrangements of recent years have been excessively harsh. These terms and conditions are becoming increasingly tight with respect to number, content, and incidence of reviews, and they appear to be increasingly in conflict with the cooperative nature of the Fund.

The time is ripe to conduct an overall review based on the experience of 1979-86 in order to assess the effectiveness and appropriateness of performance clauses in Fund arrangements. According to EBS/86/211, Supplement 1, the average number of performance criteria for an arrangement increased from 5.7 in 1969-April 1977 to 9.4 in January 1985-June 1986. Since 1982, the content of performance criteria has been extended to include such policy areas as budget components, trade, interest rates, and pricing--which were rarely touched upon before 1979--and arrangements with midyear reviews increased from 25 percent in 1979 to 100 percent in 1986.

It is interesting to note that even after such a tightening of and increase in criteria, there are only limited answers to questions about the outcome of adjustment programs. One such view by the staff--that the "outcomes have sometimes proved disappointing"--is mentioned on page 26 of EBS/86/211. Although we cannot attribute these disappointments to the increasingly tighter performance clauses, we can at least be sure that increasingly tight performance clauses have not resulted in more positive outcomes and that they have certainly not resulted in the expected outcomes. Therefore, the main purpose of an overall review of performance clauses should be to explore the proper scope, content, and instruments of the performance criteria in Fund arrangements. This should be based on the appraisal of their effectiveness and appropriateness in the context of the difficult global economic environment that many member countries have to contend with. In addition, it should be recognized that balance of payments adjustment is now a longer and more arduous process than in the past, as the staff has noted on page 25. The staff should comment on how successful the design of Fund-supported programs has been over the previous five years in terms of achieving program objectives and on some of the causes of the disappointing outcomes of programs. Could these disappointing outcomes be attributed mainly to the determination of the authorities to implement policies? Since external factors have made program implementation difficult, could some of these disappointing outcomes be the result of faulty design of Fund-supported programs or improper performance clauses in Fund arrangements?

A key issue in the area of program implementation and monitoring techniques is how to deal with a situation in which the design and implementation of policies have fallen short of the ideal. In certain circumstances, the commitment of the authorities to program implementation is often affected by domestic political difficulties as well as by exogenous developments. This kind of situation is referred to by the staff in its paper, and to tackle such difficult problems the staff suggests on page 26 that it is when such pressures are strongest that close monitoring can be crucial, because it can help encourage members to persist and follow through with policy implementation. This statement disturbs me, and I greatly doubt whether such a suggestion will work. Obviously, in order for it to work the member country concerned has to be placed under heavy pressure by the Fund through close monitoring and most likely would face political and social embarassment. Hence, an economic issue may be transformed into a political and social one. It is imperative for the Fund to move very cautiously in exercising its monitoring mandate.

It is recognized that the Fund's main role is to provide policy advice on the formulation and design of Fund-supported programs, on the selection of the policy mix, and on the process of monitoring implementation. Consultation and collaboration should be the principal means by which the Fund plays its essential role, and any kind of extreme measures taken by the Fund must be avoided to the extent possible. The staff has made an inappropriate suggestion on page 35, namely, that in the case of major deviations from policy understandings, the response by the Fund would be either to cancel the arrangement concerned and to require an immediate repurchase of any drawings made, or to interrupt drawings under the arrangement until new understandings are reached and corrective action has been taken. Such a suggestion could well be a plea for proliferation under a different name, as Mr. Kafka rightly noted, and the possible adverse consequences of such action by the Fund should not be overlooked.

Some of the staff's suggestions in the final part of the main paper are aimed at further restricting the flexibility of programs and at tightening the terms and conditions of access to the Fund's resources. These are not appropriate in the present economic environment. Any action that would result in improperly tightening the performance criteria must be handled with great care.

In the present changing circumstances, predetermined targets or performance criteria cannot always be accurate or fully met, and the resultant noncompliance might be due to various factors: the original design or performance criteria might not have been reasonably realistic or suitable to the actual situation; the situation or economic fundamentals upon which the program design was based might have changed; unforeseen domestic or exogenous developments might have occurred; and policy slippages or mismanagement might have taken place. Given the variety of situations, there appears to be a need for flexibility in dealing with this matter, and it is inappropriate to rely mainly on increasing pressure on the member countries concerned.

I noted with interest the new model of program design and performance criteria in the recent stand-by arrangement with Mexico. Much of the useful information contained in EBS/86/211, Supplement 1, was not incorporated in the staff paper itself. This stand-by arrangement represents a new development in the evolution of practices and procedures concerning performance criteria. The arrangement is the first one to include a growth-oriented adjustment program. The staff should comment on the implications of this development for the design of future Fund-supported programs. Given present realities, since members using Fund resources are without exception from the developing world, performance criteria are naturally a major concern of the developing countries, and the correct handling of program design and performance criteria is essential to maintaining an appropriate and proper relationship between the Fund and developing country members. The relationship between the Fund and those countries using Fund resources should not be limited to a creditor/debtor one. In this connection, it is essential that the Fund's image should be far different from that of commercial banks. Mutual trust is important. It seems that the further tightening and added complications of monitoring and similar techniques are derived not from actual need but, to a certain extent, from a distrust of the conscientiousness and capability of the member concerned with respect to the implementation of a program and the meeting of performance criteria. Greater emphasis should be placed on giving the service that best matches the member's needs while taking appropriate measures to safeguard the revolving character of the Fund's resources. In sum, what I am deeply concerned about and what we must not lose sight of when we consider the roles and operations of the Fund in the face of the difficult and rapidly changing world is the international cooperative character of this institution.

Mr. Mawakani made the following statement:

The staff paper raised fundamental issues, namely, how the Fund should monitor members' economic programs and how the increasing uncertainty surrounding the evolution of key exogenous variables should be taken into account in the design of Fund-supported programs and in developing appropriate techniques for monitoring such programs.

When a country undertakes such an adjustment program, there is a need to monitor the progress being made in its implementation regardless of whether or not the program is supported by Fund financing. From this standpoint, I would endorse some form of monitoring. However, any techniques that are considered appropriate for monitoring should enhance the likelihood of successful implementation of the program without unduly constraining the ability of a government to continue to formulate appropriate policies in response to unforeseen events. The criticism that is generally made of the Fund's monitoring techniques is their lack of flexibility. In many instances, performance criteria, the most widely used form of monitoring, are seen as being too rigid and as failing to take into account developments that are attributable to exogenous factors. This rigidity explains why performance criteria are contested, despite their role in ensuring member countries of the conditions under which drawings on Fund resources would be allowed in order to reduce internal and external imbalances.

Timeliness of data relating to performance criteria is of paramount importance, because the earlier the data are available, the sooner remedial actions can be taken to avoid major deviations of program targets. As the staff has stated, it is occasionally very difficult to collect comprehensive data in a timely fashion. This problem is particularly acute in countries in my constituency. For example, the time lag that is associated with the collection of statistical information by the monetary authorities is much shorter than that for the banking sector. Similarly, data on the central government are more readily available than data on the public sector, including state enterprises. Because of this inherent difficulty associated with the compilation of statistical data, there is a need to strike a balance between timeliness and comprehensiveness of the data used to establish performance criteria. In addition, it is important to note that in some instances the behavior of some components of the variables for which performance criteria are established are beyond the control of the authorities. In this connection, the practical approach adopted by the staff, which is to choose, at times, less comprehensive performance criteria, is welcome and should be continued.

One cannot a priori limit the number of performance criteria either by requiring that a comprehensive definition be adopted or by imposing the introduction of new performance criteria if warranted by more recent developments. However, the increase in the number of performance criteria is constraining and could appear to increase the involvement of the Fund in the implementation of the program. In that connection, I favor a flexible approach that takes into account the particular institutional and statistical conditions of a country.

The use of prior actions should be limited, and clear guidelines for their use should be established. For example, prior actions should be considered when, under a past arrangement, the country concerned fails to implement key measures, and/or when the measures under consideration have a favorable impact on the program objective with a lag. I agree with Mr. Kafka that under any circumstances prior actions could be perceived as a sign of distrust.

Because of the need to assess the incidence of some discrete actions, including prior actions, reviews should remain an essential feature of program monitoring. This performance clause is helpful in increasing the flexibility in program design. During a review, performance criteria could be set in light of the likely behavior of key exogenous variables. In addition, reviews should be consistent with the medium-term framework and should provide the opportunity to reassess the key assumptions underlying the program and to adapt the program to changing circumstances. This chair will continue to endorse the use of review clauses in program design. However, their frequency during an arrangement should be reduced to a reasonable number.

The internal and external imbalances facing most countries are caused by either internal factors or external shocks. At present, the cause of disequilibrium does not seem to matter in the design of programs. In fact, existing monitoring techniques, particularly performance criteria, assume that in all instances expansionary demand-management policies are the culprit, and that to restore economic and financial balance more restrictive and monetary policies should be implemented. This chair has contested this approach and has urged the staff to examine and assess a country's problems in a more imaginative way. It is in that context that I welcome the contingency schemes combined with automatic adjustments in the performance criteria that have been included in the program for Mexico. The contingency features of this program should become an integral part of Fund programs. Unlike the staff, I believe that, whenever necessary, the increasing use of automatic adjustments in performance criteria together with contingency clauses similar to those used for Mexico would strengthen Fund programs. These features also give member countries the necessary courage to undertake timely economic reforms.

Mr. Abdallah made the following statement:

Performance criteria are of crucial interest to the members of my constituency. Fund support for adjustment programs by and large hinges upon the observance of performance criteria, and it is widely known that this support is the seal of approval for satisfactory performance not only for donor countries but also for commercial banks. A Fund-supported program is a precondition for debt rescheduling under the Paris Club, which, in turn, sets the stage for rescheduling with commercial creditors. Therefore, the use of performance criteria must be given serious attention; the interests of debtor countries as well as the credibility of the Fund are at stake.

The title of the main paper is a misnomer. The paper is informative about the historical evolution of performance criteria, although in Mr. Kafka's opening statement--with which I wish to associate myself--it is clearly shown that the narrative part is incomplete. The staff paper is also lacking in analytical content with respect to the relationship between program design and performance criteria. An apparent difficulty in defining the role of performance criteria in Fund-supported programs might explain this shortcoming. It is stated on page 2 that although performance criteria are related to the design of adjustment programs, they are not a part of those programs but are rather a part of the financial arrangements by which the Fund supports members' adjustment efforts. It is not clear what is meant by this, and the question arises as to whether it makes sense to separate the two. Many would agree that an adjustment program can be successful only if it reflects the economic and institutional characteristics of a given country and takes full account of all the constraints. Should the terms of the Fund's financial commitment not also reflect this reality? The answer must be in the affirmative, especially since the performance criteria are used to pass judgment on the validity of a member's economic policies, as is mentioned on pages 2 and 3 of the staff paper. There should therefore be no question that the mechanism that provides the link between the implementation of the program and disbursements under a given arrangement with the Fund should be determined as an integral part of the program rather than as a mechanical device governing transactions.

The failure to deal fully with the subject of performance criteria in the context of program design has caused the paper to be narrow in scope: it merely advocates proposals to limit the flexibility of programs and to tighten conditionality. To follow the theme of the paper is to become emmeshed in operational details while running the risk of losing sight of the pertinent issues surrounding the use of performance criteria, including their relation to the achievement of program targets. This is disappointing, given the lively debate during the seminar on the theoretical underpinning of Fund-supported programs.

The staff took too much for granted in putting the present paper together. This is glaringly reflected in the assertion on page 26 that "the general principles underlining the design of Fund-supported adjustment programs are by now well established, and by and large the experience with those programs indicates that they remain appropriate to the attainment of their objectives." Any one familar with the literature on this subject knows that this is hardly the case, and the Fund cannot ignore this fact by a simple assertion to the contrary. Perhaps it is relevant to recall here that if there was a lesson to be learned from the recent seminar it is that there is much room for improvement in translating economic analysis into economic policy. I would go further to say that performance criteria are an attempt to form a link between analysis and policy. In that connection, one cannot but conclude that the lesson of humility would also be applicable.

Performance criteria arouse considerable debate, which is not surprising. After all, they are the means by which the Fund implements the principle of conditionality, and they are at the heart of the monitoring of Fund-supported programs. However, the debate on performance criteria usually does not center on the appropriateness of the criteria. Most would agree, including countries that use the Fund's resources, that there is a role for quantifiable indicators within a given program period to monitor the implementation of policies. I agree with this, but there are the legitimate complaints about the terms of Fund lending. Performance criteria that might appear to be reasonable can be interpreted in a rigid, legalistic fashion. In sum, the issue has to do with the flexibility--or lack of it--in Fund-supported programs, and there is a need to make a genuine effort to see how the modus operandi of Fund lending can meet the legitimate concern of a large majority of the membership. This is of immediate importance because debtor countries cannot make much progress in mobilizing external financing without the Fund's blessing, usually in the form of a stand-by arrangement. The issues involved are highly complex, and the failure of Fund-supported programs should not be automatically blamed on borrowing countries.

There has been increased use of performance criteria in the 1980s; the average number has been increased from 5.8 in the period 1969-77 to 9.4 in the period 1985-June 1986. It is important to consider whether this trend has improved program performance. A cursory review of the evidence suggests that it has not. However, the tenor of the staff paper appears to be that when the situation in a country's economy becomes difficult, as it has been in recent years in many countries, the appropriate approach is to increase the number of performance criteria. What needs to be emphasized is that each time performance criteria are increased, the room in which the government can maneuver to improvise in order to cope with changing circumstances becomes more circumscribed. As Mr. Kafka noted, the Fund cannot and should not run a world government through the disbursement of the resources that it makes available to members. It is impossible to prescribe in both scope and content how a country's policies should respond to every facet of change in the world economy. In any event, it becomes difficult for the Fund to exculpate itself from the failure of adjustment programs after being perceived to be the prime architect and monitoring agent of the policies underlying such programs.

This leads to two fundamental issues. First, how should we view a Fund-supported program? Second, what should be the focus of performance criteria? Adjustment is clearly a process, but in the context of a specific program the penchant for exactitude tends to lead us to consider programs as finite products. However, a longer view gives room for flexibility, and targets need not be necessarily seen as being rigid; instead, they may be seen as magnitudes to aim at under normal conditions. In partial recognition of this, Fund rules allow waivers and modifications under certain conditions. But the granting of such waivers is treated as something very exceptional, while the history of the previous five years suggests that they should have been used more often instead of permitting many arrangements to become inoperative.

Some observers have argued for flexibility by calling on the Fund to make greater use of contingency clauses--for example, there should be one target if the price of a country's principal commodity increases, and there should be another target if there is a decline. The staff has begun to see some merit in this, as evidenced by the case of Mexico, which is discussed in EBS/86/211, Supplement 2. I would like to see more such contingency clauses in other programs, particularly with a view to preventing a decline, if not ensuring an increase, in per capita income in the least developed countries. In this connection, it is worth mentioning that the background against which the Mexican program was developed was not unique. Many countries faced comparable circumstances, and some face even more adverse situations.

The adoption of contingency clauses will not weaken Fund-supported programs, and such clauses might be useful in adjustment programs for three reasons. First, contingency contracts highlight the economic function of performance criteria and minimize their mechanical role; they tend to establish a more explicit link between performance criteria and program design. Second, they tend to focus attention more directly on the link between adjustment with economic growth and financing. Third, there is a more explicit awareness of the need to consider the impact of exogenous forces on economic management, since these forces are always outside a government's control.

There will of course be a need for caution in striking some balance in the use of automatic adjustments. Such adjustments would increase the importance of reviews which should provide a better perspective on the nature of the constraints facing the country and on what is feasible in terms of formulating appropriate policies. These need not be necessarily time consuming, nor do they necessarily have to be considered as performance clauses. This matter cannot be dealt with as an either/or situation--i.e., require either automatic adjustment or review clauses. This is an area where judgment must be exercised, and the key point to keep in mind is that Fund assistance is to lighten the burden of adjustment, not to make it more cumbersome. I will reserve my judgment on the issues concerning the relationship between access to resources in the credit tranches and access to resources under the compensatory financing facility until the coming review of that facility. For the moment, I would say only that the role of automatic adjustment that might lead to augmentation of access in connection with a Fund-supported program and the role of the compensatory financing facility should not be confused. Each mechanism is important in its own right.

The introduction of the structural adjustment facility in the Fund has created a further need to take a broader view of performance criteria. In this connection, the issue is not primarily the appropriateness of automatic adjustment mechanisms, but rather the importance of focusing attention in the broad thrust of economic policy in countries that use the new kind of arrangement. The staff paper seems to be biased toward a policy framework that is formulated in quantitative terms. I would emphasize that in order to be effective structural adjustment arrangements will have to be built around agreed margins of deviations, even in cases in which efforts are made to quantify key targets. We should not lose sight of the fact that structural adjustment programs should aim at systemic adjustment and growth; excessive emphasis on quantitative indicators would not be compatible with this approach, particularly in the case of low-income countries that are not only highly vulnerable to adverse exogenous developments but also lack an adequate statistical base. In taking this position I am aware of the use of benchmarks under structural adjustment arrangements. But the meaning of such benchmarks is still unclear, given the increased use of prior actions--which some consider to be a sign of mistrust, since performance criteria are not directly used in structural adjustment arrangements--and what appears to be the linkage of structural adjustment arrangements and stand-by arrangements under one umbrella. There has been only one exception to the linking of structural adjustment arrangements with stand-by arrangements, but the discussion on that country showed that the concern about the tightening of conditionality remains.

Another fundamental issue is the appropriate focus of performance criteria. Under traditional stand-by arrangements the emphasis should be on targets that monitor a country's progress toward eliminating essential imbalances. This would tend to keep performance criteria to the minimum necessary, as was intended under the guidelines on conditionality. In this respect, ceilings on domestic credit expansion have an important role to play, as do targets for the real exchange rate. Whether subceilings should be set on credit to the government sector is another issue. It can be argued that since infrastructural investment is generally the domain of the public sector the need for such investment as a part of structural adjustment could run counter to the prescription of severe limits on public sector borrowing. Furthermore, in the context of monetary expansion within the basic Fund model, unless we are prepared to assume suboptimal efficiency of the public sector in all cases, it is the overall growth of domestic credit, and not its subsectors, that should be relevant.

In setting subceilings on public sector borrowing requirements and in reaching detailed understandings on interest rates, inflation and other variables the Fund begins to tread on uncharted territory because, while there is considerable analytical agreement on the "external balance," there is less agreement on the precise meaning of "internal balance," something that concerns interest rates, inflation, unemployment, and other variables. Of course, as steps are taken to eliminate payments imbalances, these variables will have to be considered in determining the pace at which the disequilibrium might be eliminated.

The increased use of performance criteria seems to be designed to encourage economic fine-tuning. The same concerns expressed about the difficulty in fine-tuning in connection with the establishment of performance indicators to strengthen surveillance over industrial economies are applicable to the imposition of too many performance criteria on developing countries. Such fine-tuning starts from an optimization view of the world, which assumes perfect knowledge. If such knowledge does not exist in developed countries, it is certainly less likely to be present in developing countries. Attempts to manipulate economic performance through an elaborate set of performance criteria might be counterproductive. Some observers believe that there might be a connection between stringent and numerous performance criteria and the derailment of a number of arrangements in the very difficult environment of the 1980s. The lesson in all this is that in the final analysis it is the firm determination of borrowing governments--not a proliferation of performance criteria--that guarantees program implementation. Ways must be found in which to generate the essential commitment as well as to sustain it, and one approach would be to modify the Fund's negotiating procedures as Mr. Kafka has suggested.

In concluding, I would refer to the advice that Mr. Templeman gave at the previous meeting, namely, that the staff should show more flexibility and innovation. I support this suggestion, although my views on the direction and scope in which greater movement is required differ from those of Mr. Templeman.

Mr. Lundstrom made the following statement:

This paper reflects the considerable degree of flexibility that was demonstrated by the Fund in gradually adapting program design to prevailing conditions and circumstances. Therefore, I agree with the staff that the general principles governing program design continue to be adequate. They have allowed the Fund to pay due regard to the specific problems facing, and the conditions in, individual countries. One indication of this is the large number of different performance criteria that have been applied. Some may have doubts about the design of programs that heavily emphasize structural adjustment. This is obviously a field in which much remains to be done--in cooperation with the World Bank--but I still feel that the material reviewed might have been more complete. As Mr. Massé mentioned, this is a matter to which we will have to return.

I support the trend toward broader, more comprehensive definitions of performance criteria, which has been facilitated by improved statistics and can be expected to provide more direct--and thereby more effective--monitoring of relevant variables. The use of more comprehensive performance criteria also has the advantage of giving the governments concerned more room in which to frame their economic policies. Furthermore, the broadening implies that the number of performance criteria within the traditional, stabilization-oriented subject areas can be reduced. However, it should be noted that this trend has been counteracted by the rising number of performance criteria resulting from the increased orientation toward structural adjustment.

I agree that is it more desirable to use certain key intermediate variables in the way in which the staff has suggested.

The more extensive use of program reviews is a reflection partially of the fact that adjustment problems have become more complex and long term in nature. Furthermore, exogenous developments have become more difficult to predict. In those circumstances, and for practical reasons, reviews may in certain cases be preferable to quantitative performance criteria, especially if the necessary data base is deficient, as is often the case with programs that attach great importance to structural adjustment. One reason for caution in using review clauses, however, is the risk of an ad hoc approach under which too much attention would be paid to short-term adjustment of programs and too little to the long-term targets. There is also a risk that planned adjustment measures for different--namely, political--reasons will not be implemented, or will not be implemented in accordance with plans unless they are implemented at the outset of the program. This occurs because, in contrast to quantitative performance criteria, reviews lead to an increased degree of uncertainty about the conditions for subsequent drawings. My conclusion is that reviews are an important surveillance technique, but that the use of them should be as limited as possible. I, too, am attracted by Mr. Wijnholds's suggestion that certain program reviews might not necessarily require discussion by the Executive Board but could be dealt with instead on a lapse of time basis. I agree that there should be a possibility of extending the use of prior actions as the staff suggests.

Flexibility should be exercised in dealing with delays in completing reviews. If a program is on track and can be expected to remain on track despite a delay, or if a program that is temporarily off track can realistically be expected to be brought back on track in a somewhat longer perspective, a waiver should be granted. Countries that deliberately delay reviews--probably as a result of deficient fulfillment of commitments--should be treated less favorably than others in the sense that they run the risk that their programs will be considered to be impossible to implement and that their drawings under the arrangement would be terminated. The fact that drawings are not permitted during the period in which the review is delayed may also provide an incentive for corrective action. In cases of delays, it is of course important for the Executive Board to be kept informed of developments in the country concerned. It should be possible to distribute such information informally and in a simple manner--for example, orally--if quick, written reporting is considered to be difficult.

Another issue concerns the choice between reviews and automatic adjustments in determining the need to modify performance criteria owing, for example, to unexpected exogenous disturbances. In general, I prefer reviews because they provide an opportunity to take the entire program into account. The main risk of automatic adjustments is that changes in assumptions--which eventually trigger such adjustments--may affect the foundations of the program, which, of course, requires a more comprehensive adjustment of policies. In order to reduce this risk, it is important to consider automatic adjustments only in cases in which prospects are especially uncertain within a clearly defined part of an economy, and if the program is strong and the record of cooperation with the Fund is satisfactory. In such specific cases, automatic adjustments may be a flexible way in which to adjust performance criteria to changes in assumptions, thereby securing better continuity in program implementation.

In assessing the role of program monitoring in promoting structural adjustment it is important to remember that structural measures often are not of a traditional macroeconomic character. Furthermore, they may involve institutional and other changes that could take considerable time to implement and which, therefore, can be difficult to incorporate more directly in an adjustment program. In general, the monitoring of such structural adjustment measures should be uncertaken in close cooperation with the World Bank. This type of program monitoring should take the form of reviews--possibly complemented by "supplementary monitoring"--rather than quantified performance criteria. In general, the Fund should exert restraint in imposing microeconomic structural conditions that could be seen as interference in a member's domestic affairs. Such conditions may also interfere with the functions of the World Bank. Hence, the Fund's approach in this area must be circumspect.

However, this does not mean that attention should not be paid to macroeconomic and social implications of structural adjustment. In this connection, I would associate myself with much of what Mr. Ismael said at the previous meeting about the desirability of avoiding to the extent possible the brunt of demand compression being borne by the poorest part of the population. In addition, I would reiterate the view of this chair that the Fund, upon the request of a member, should stand ready to help to formulate alternative forms of adjustment that would lead to the attainment of the desired general macroeconomic goals.

In his opening address at the 1986 Annual Meetings, the Managing Director referred to the Fund's readiness to "help members make more informed choices about the growth and income-distribution implications of alternative forms of adjustment." In addition, in his press conference at the end of the 1986 Annual Meetings the Managing Director emphasized that in designing a program the Fund should pay attention to the effects of different alternatives for public sector spending cuts. However, for the Fund to provide assistance in formulating the options, it has to be called upon to do so. I hope that the indications that the Managing Director has given will receive a positive response in the countries concerned. The Executive Board should be informed in the relevant staff documents of any adjustment options that are considered during program discussions.

The use of waivers is an excellent method for treating deviations--for example, deviations caused by exogenous factors--that do not place the implementation of a program at risk. However, I agree that lighthearted approval of too many exceptions should be avoided. One problem with waivers is that the focus generally is on individual performance criteria, thereby creating the risk that due consideration is not given to interactions between different variables and sectors in an economy. Slippage vis-à-vis a single performance criterion can be an indication of imbalances in other areas. If in such a case a waiver is granted, it may be the beginning of a vicious circle that over time could undermine the entire program. Therefore, the present restraint in granting waivers should be continued.

There should be a relatively strict attitude toward major deviations from policy understandings. But the main concern should be to maintain a working relationship between the Fund and the member as long as possible and, if feasible, to save the current adjustment program. Therefore, I prefer the so-called lesser response, namely, interruption of drawings under an arrangement without waiting for a formal confirmation in the form of nonobservance of performance criteria. Contacts should then be made to bring the program back on track through corrective action. Should this not succeed, a demand to repurchase previous drawings may become necessary.

In the absence of data permitting the definition of performance criteria, the Fund should be flexible and make increasing use of other mechanisms, particularly reviews, to substitute for the lack of satisfactory data. Presumably this would apply primarily to small, relatively underdeveloped countries that have perhaps only recently become independent. At the same time, uniform treatment implies that countries should have neither softer nor harder adjustment programs because of a lack of data. In the design of programs the same consideration should be shown to countries with deficient institutional resources for program implementation. The Fund should stand ready to grant technical assistance to help to deal with such deficiencies.

Like Mr. Kafka, I missed in the staff paper an analysis of the need for the increase in the number of performance criteria that occurred in the 1980s. I also share Mr. Kafka's concern that performance clauses that are too many and too rigid may prejudice a government's ability to adapt its policies quickly. This raises the question whether obtaining waivers could not be speeded up.

Mr. Kafka rightly stressed the importance of the availability of external resources for program design and performance criteria and he correctly insisted that very poor countries should obtain concessional loans or debt relief rather than loans on concessional terms.

Without denying that the public sector has become disproportionately large in certain countries, I agree with Mr. Kafka that one cannot justify a public sector ceiling simply because of a fear of crowding out the private sector. The question has to be asked whether such a ceiling would increase the overall productivity of the economy concerned.

It should be possible for the Fund to be flexible by using innovations in order to be able to take into account the specific circumstances that have caused the member to undertake a Fund-supported adjustment program. In the initial phase, when such innovations must be regarded as experiments, they should not be considered to be precedents.

My basic attitude toward growth-oriented adjustment programs is positive. I am aware that the growth orientation involves an increased emphasis on structural adjustment measures, which calls for a different program design. This, in turn, may make short-term adjustment more difficult. The Mexican program is generally within the limits of flexibility that are envisaged under the present guidelines for conditionality. However, I do not think that the growth contingency mechanism in the Mexican program could be used in its present form as a pattern for similar cases. I agree with the staff's general remarks on this issue. The growth-promoting element of Fund-supported programs should be an integral part of the economic policies underlying the program.

From the Fund's point of view the foundation of sustainable growth in the medium term is a viable balance of payments position. My basic attitude toward contingency mechanisms follows from my comments concerning my preference for reducing reviews and for using automatic adjustments only in exceptional circumstances. In the case of Mexico, the risks of automatic adjustment may have been reduced by combining it with reviews, but, as a rule, I would favor the use of reviews only. A full discussion of the interesting issue of compensating for fluctuations in commodity export earnings through the compensatory financing facility or stand-by arrangements has to be deferred until the coming review of the compensatory financing facility. In the case of Mexico, the oil contingency mechanism has the advantage of implying a comprehensive economic evaluation, including the important petroleum sector, within the framework of one arrangement.

In sum, I broadly agree with Mrs. Ploix's opening statement, although I might not be prepared to go as far as she in accepting automatic adjustments linked to developments in international commodity prices.

Mr. Dreizzen made the following statement:

I welcome this discussion, as there has been a strong demand both in and beyond the Fund for an analysis of the theoretical basis of Fund-supported programs as well as their design and the use of performance criteria. The failure of some member countries to implement fully funded adjustment programs can be explained in some cases by a failure to pursue appropriate policies, but in many other cases the reason has been a lack of flexibility in program design and in performance criteria needed to face a difficult external environment characterized by marked shifts in the prevailing market conditions of key export commodities, as well as in the availability of external financial resources.

The Fund plays two important roles, namely, as a provider of financial assistance and as an advisor on a broad spectrum of economic policies. As a provider of financial assistance, the Fund needs to safeguard the revolving character of its resources. Therefore, performance criteria are included in all stand-by and extended arrangements, which are aimed at seeking a viable balance of payments position that will enable a member to meet its scheduled repurchases. The set of performance criteria that is the most efficient to ensure repurchases might not necessarily be the most efficient for attaining a country's economic program targets. For example, in the monetary area, the Fund chooses net domestic assets as the performance criterion to attain the external targets--consistent with the monetary approach to the balance of payments--while a comprehensive concept of money might be more appropriate to deal with inflation. In the external sector, a real effective exchange rate performance criterion will contribute to achieving the external targets but will certainly be counterproductive if inflation needs to be reduced. It is not clear to me what the priorities for the staff are when performance criteria are set and a trade-off arises between the need to preserve the revolving character of the Fund's resources and the country's economic stabilization targets.

The staff paper shows that the staff uses at least five different monitoring techniques, some of which are beyond the control of the Executive Board. The techniques include prior actions; supplementary monitoring of developments in the components of the overall variables included in performance clauses as well as the use of shorter periods, such as months, to monitor the indicators; supplementary policy understandings; reviews; and performance criteria, the average number of which per program has increased steadily over time.

Although the Fund has adopted this broad set of monitoring procedures, it has not been shown that a large number of performance criteria or other monitoring techniques has increased the success of programs. I agree with previous speakers that the critical issue is to ensure the right design of a program in terms of policy measures and financial assistance as well as with respect to its robustness and flexibility to face changes in exogenous variables.

Given the uncertainty of forecasts in the unstable external environment in which member countries have had to live in recent years, it is important to preserve a government's flexibility in managing its economy and to avoid reducing its efficiency by imposing an excessive number of constraints on the implementation of economic policies. The Fund's negative image in some developing countries cannot be explained only by the inevitable effects that adjustment programs often have on living standards in the short run; the belief that the Fund is able to compel a government to adopt an adjustment program and that some sort of intervention might occur in these situations is also an important factor.

The staff suggests some proposals that, as I understand it, will not help to provide Fund programs with the needed flexibility to which I have referred. These proposals focus on three major issues. First, the staff advocates a good measure of caution in extending waivers or in accepting modifications of performance criteria, since the departure from a single performance criterion could affect an entire program. I agree that the evaluation of each component and the potential deviations should be related to the whole program. However, this evaluation should not lead to an increase in the rigidity of the Fund's assessment when deviations occur. On the contrary, a country might have pursued the necessary adjustment efforts but there could have been errors in the program design or the circumstances might have changed dramatically since the program was approved. A global assessment may be useful to avoid interruptions to a program caused by a minor deviation from one performance criterion. In this connection, it is important to remember that the Fund has often dealt with programs in which external sector targets were exceeded while deviations occurred in domestic performance criteria owing to major errors in the forecast rate of inflation. Could it be said of those cases that the revolving character of the Fund's resources was at stake and that the drawings had to be interrupted?

A second proposal by the staff is to interrupt drawings or to require repurchases when a country adopts policy actions that the staff considers to be contrary to understandings reached between the Fund and the member even though performance criteria are met. This proposal would add an element of arbitrariness to the relations between the Fund and the member and would impose on the country a high level of uncertainty about the availability of financial resources even when all performance criteria are met. The most appropriate response to policy deviations is to seek a comprehensive dialogue in order to understand the reason for the deviations; unilateral measures should be considered as a last resort and should require, as in the case of waivers, approval by the Executive Board.

A third issue related to the problem of flexibility is the period in which reviews are to be completed by the Executive Board. I favor continuing the current, pragmatic approach. By avoiding setting a strict maximum period for the completion of reviews, the Fund would allow the necessary flexibility in response to each member country's particular circumstances. In addition, the Fund should not create conditions under which it sends on-off signals to the international financial community about decisions to continue providing resources to a country where there have been delays in the envisaged review process. As in other areas, flexibility and pragmatism are needed to deal with delays.

The staff paper on automatic adjustment and contingency clauses admits that the outcome of adjustment programs that have been undertaken with Fund support has sometimes been disappointing. The difficult external environment, with marked shifts in the terms of trade, variations in the access to external capital flows and other similar factors require adaptation of the design of Fund programs. In some cases, the program design and performance clauses have not proven to be flexible enough to reflect these developments in the external environment. The difficulty in forecasting with sufficient precision key exogenous variables that are beyond the control of the authorities, such as the prices of major export goods, has led to the need to use automatic adjustments and contingency clauses. These clauses may play an important role in supporting the continuity of the adjustment program during the whole period of the arrangement, when negative external shocks may occur. They also constitute important incentives for a member country under a stand-by or extended arrangement to continue adjustment efforts to which it committed itself at the beginning of a program period. On the financial side, the availability of contingent financing provides a breathing space for policy adaptation and, by avoiding the delays that are often associated with the organization of concerted financial packages, prevents a program from being interrupted owing to a lack of timely external financing.

According to the period in which deviations of exogenous variables are forecast to last, a distinction can be made between temporary and permanent deviations; at the same time, on the basis of their size, a distinction can be made between small deviations and large ones. Contingency clauses are useful for temporary deviations of exogenous variables, but they can also be applied in cases involving permanent deviations when time is needed before adaptation measures are fully implemented. The contingency clauses and financing may provide a breathing space for the formulation of the appropriate policy responses. The Fund cannot have a restrictive approach to the size of deviations, since it is precisely when deviations are larger that the probability of program interruption is higher and contingency clauses will have more useful results.

In its paper, the staff explains that reviews have not substituted for performance criteria because of the objective way in which performance criteria operate compared to the uncertainty involved in a review clause that makes continued access to the Fund's resources contingent upon a discretionary judgment by the Fund that a member's performance has been satisfactory. For similar reasons, reviews are not efficient substitutes for automatic adjustments to performance criteria. These adjustments avoid discretionary judgment and uncertainties about access to the Fund's resources in the event that a member has to face a negative change in some key exogenous variable that is beyond the country's control. Automatic adjustments to performance criteria provide the member country with clear assurance of the circumstances and conditions under which it will be able to make purchases, given the different probable scenarios for key external variables.

As to the relationship between contingent access to Fund resources and the compensatory financing facility, I fully agree that the Fund should use a mechanism that ensures that the same shortfall will not be compensated twice. This restriction means that if the country has used contingency financing during the period of an arrangement, the amount purchased should count against the amount that is potentially available under the compensatory financing facility with respect to the period of the program. However, there is no rationale for the second restriction, namely, that any purchase under the compensatory financing facility during the period of a program, even with respect to a period before the program starts, would count against the contingent augmentation. The second restriction does not prevent the country from demanding double compensation for the same shortfall but does prevent it from making purchases under the compensatory financing facility for a shortfall that has already occurred. For example, assume that a country without a program suffers an export shortfall during 1986 and makes a purchase under the compensatory financing facility in April 1987. Assume also that the country has a new shortfall in 1987 and makes a second purchase under the compensatory financing facility in April 1988. If the country had a program during 1987 with contingency clauses and had used the augmented financing triggered by the shortfall of 1987, it would have lost the right to request compensation for the shortfall of 1986. This means that, with contingency clauses, the country would have had the right to ask for one shortfall compensation, and without the clauses it would have had the right to ask for two instances of compensation.

Most of the reasons that have been given to justify the use of adjustment and contingency clauses in a recent arrangement with a major member country are similar to those that I have given thus far and are not necessarily unique to that country. Therefore, the principle of uniformity of treatment of members facing similar circumstances seems to be appropriate in this area. The contingency mechanism fosters continuity of adjustment efforts in the event of negative external developments, saves unnecessary adjustment costs when an external shock is transitory in nature, and permits an orderly adjustment path when the shock turns out to be permanent. In addition, when positive external developments take place, the contingency mechanism's symmetrical character ensures a more rapid pace of adjustment.

The growth contingency mechanism seems to be consistent with the Fund's current approach to the debt problem, under which growth is considered to be an explicit target of adjustment programs and is not a residual variable, once the external targeted change in international reserves has been achieved.

Mr. Salehkhou made the following statement:

I fully agree with the findings in the opening statements by Mr. Kafka and Mrs. Ploix. I was struck by the way in which conditionality in the form of performance criteria and review clauses has evolved from its virtual absence in the 1960s to the proliferation of the 1980s. Like Mr. Kafka, I am wary of the Fund, which, in its consulting position vis-à-vis member countries, has multiplied the checks and controls over adjustment programs to the extent that it runs the risk of sharing the responsibilities of governments, a development that is rightly resented by these countries.

As a general proposition, I wish to stress that performance criteria and review clauses should be applied in a symmetrical manner, with due respect being paid to the sacrosanct principle of uniformity of treatment. They should also be flexible in order to preserve some automaticity for drawings. In this connection, I do not understand the staff's reluctance in its main paper, as well as in its paper on the Mexican program, to introduce some automatic viability, which, in my view, is quite feasible. The Fund should in general pay more attention to, and have more respect for, the political and social settings of member countries.

As to the issues raised by the staff in EBS/86/211, the idea of comprehensiveness in the definition of quantitative performance criteria seems to be attractive at first glance. However, I doubt whether it could in itself constitute a way in which to avoid the distorting effects of unforeseen developments in those components that may be excluded from narrower definitions. The magnitude of the unforeseen developments that have occurred in the recent past has been such that simply changing the definitions would not have changed the results. In fact, there have been cases in which these broader concepts were used but the programs still went off track because of unforeseen developments. In addition, for statistical or managerial reasons this broader coverage is not always possible and recourse to it would only intensify the pressure on the authorities. The argument that comprehensive definitions would reduce the number of performance criteria needed for program monitoring is surprising, since I am certain that the staff's ingenuity would lead it to set subceilings that would ultimately result in the same effect.

I have difficulty in appreciating the supposed novelty of the suggestion to have a clear specification of the path envisaged for the key intermediate variables that underlie the formulation of quantitative performance criteria. After all, this is what is already being done. I fear that with this statement the staff is trying to transform targets and objectives of programs into de facto performance criteria. Any clarification of this matter by the staff would be helpful, as such an approach justifies the concern that was expressed by Mr. Kafka that the Fund could become part of the government of member countries.

As to the role of program reviews in relation to prior actions and performance criteria, I would like to stress first that I am concerned about the multiplication of the number of reviews, which were initially supposed to be confined only to mid year reviews of programs. At present, there are early reviews, reviews sometimes of specific problems before a mid term review, and more recently, reviews prior to the latest drawing period. The case that the staff is trying to make in favor of prior actions and more stringent performance criteria as opposed to less, or less comprehensive, reviews is not convincing, since we have been witnessing a proliferation of reviews of prior actions and of performance criteria. As to prior actions, I wish to stress the necessity for the staff to show more sensitivity to socioeconomic problems and to take into account the views of the authorities on the timing of some measures, particularly those affecting the prices of staple foods.

In the area of the completion of reviews, the tendency of the staff has been, even when the scope of a review is well defined in a stand-by arrangement, to try to cover everything. This is particularly burdensome and time consuming for authorities and casts doubt on the obligations of the Fund toward member countries with respect to drawings, especially as these drawings are increasingly back-loaded. Given the generally tight foreign reserve position of borrowing countries, this leads to accumulation of arrears, including those to the Fund. This in turn compounds the problems with the Fund and indirectly with other creditors. It also explains the disruption of many arrangements that have been canceled before their normal expiration dates.

This obliges me to strongly oppose the proposed use of reviews rather than automatic adjustments in determining the need to modify performance criteria in the light of unexpected developments. This approach is inconsistent with the desirability of reducing the number and scope of reviews by the staff. It is indeed difficult to understand why, in the case of commodities, for example, automatic adjustments would not be adopted beforehand if the commodity in question is of vital importance to the country and if, as is normally the case, its effects on the main aggregates are well known. After all, this is what was justifiably adopted in the case of Mexico. A number of other countries have commodities that are of considerable significance to their economy, given their importance in their GDP or exports. Therefore, it follows that it is only fair for the Fund to work toward generalizing this approach, which will help to improve its image in borrowing member countries. Another reason for preferring automatic adjustments of performance criteria over reviews is the shortfalls in foreign flows. These flows are usually well defined and individualized in Fund programs. In such cases, it is advisable to have automatic adjustments instead of having to wait for reviews for a member to be eligible to draw on the Fund. The irony is that in the reverse situation--when the external flows are higher than expected--automatic adjustments on the minus side are generally introduced. I also strongly oppose the introduction of techniques such as performance criteria in monitoring the implementation of structural measures. Most such measures are highly sensitive in nature and are in the domain and under the sovereignty of the member countries. Trying to monitor them in a quantitative manner would be counterproductive. Legislative bodies are usually involved, and it is of the utmost importance that governments keep some kind of flexibility in dealing with these problems. If delays occur, they should be dealt with on the occasion of reviews, and the Fund should be understanding of the particular circumstances surrounding such delays.

Similarly, the introduction of sanctions in response to possible deviations from policy understandings that are not directly subject to any of the Fund's current monitoring techniques is another example of the staff's arrogant attitude in dealing with borrowing members. The goodwill of authorities is not to be questioned by the staff. The authorities should in turn be encouraged to cooperate in order not to disrupt programs.

My impression from the staff papers--and I sincerely hope that my impression is wrong--is that in making the proposals that I have commented upon the staff is not cognizant of the grave situation of the world economy and of the plight of the developing countries in particular. The staff appears often to presume that member countries are always trying to evade their responsibilities. The staff's proposals ignore the severe circumstances that these countries are dealing with, including collapsing world prices for primary commodities, the sharp reduction of financial flows from all sources including the Fund, and the heavy burden of debt obligations that is increasingly being identified as the main source of their problems. The staff also appears to ignore the necessity of growth--a notion that is gaining increasing prominence--as a vital element of the effort to contain the debt problem. It is surprising that no proposal is made to establish a performance criterion to monitor growth. This restrictive and short-sighted approach is indeed frightening, and I would once again request that the Fund establish an outside independent unit within the institution that would report directly to the Executive Board and provide an ex post evaluation of programs. This would certainly help us to design programs with more realistic performance criteria and would certainly lead to the adoption of less dogmatic and more successful approaches to adjustment in member countries.

Mr. Templeman said that there seemed to be a general assumption that only prior actions or reviews could be used as ways in which to introduce structural actions into Fund-supported programs. He saw no reason to make such an assumption. There were a variety of ways in which such kinds of actions could be embodied in Fund-supported programs, namely, prior actions, performance criteria, or review clauses--the choice would depend upon the type of structural action that was involved. For example, in cases involving relative prices, quick and discrete action would be possible. Reforms of institutions and markets might well involve more complex efforts. Such reforms often took place in stages. For example, the effort might begin with a study of the question concerned followed by an outline of the basic actions that should be taken, the presentation of legislation, and the implementation of regulations. Those steps could be followed by an assessment of the progress under a program. The type of procedure that the Fund might wish to use would depend upon the stage of a member's reform effort. For example, there could be a specific commitment and deadline related to the completion of a study of tax reform or the presentation to parliament of a banking law. Similarly, there could be a specific date and even quantitative variables with respect to the phased introduction of an import liberalization plan, or there could be a review of the implementation of a reorganization of the public enterprise sector. The kind of procedure that would be used should not be prejudged.

He sympathized with Mr. Wijnholds, who had suggested that in some cases it might be possible to complete a review with a decision on a lapse-of-time basis rather than in a discussion in the Executive Board, Mr. Templeman commented. It was of course conceivable that in some cases a program would be clearly on track and, therefore, the Executive Board would merely need an assurance to that effect plus an update showing current developments in the economy. Unfortunately, such cases were likely to be rare. A formal discussion by the Executive Board would certainly be expected in cases involving the setting of new performance criteria.

Mr. Nimatallah said that he did not agree with Mr. Salehkhou's criticism of the staff. After all, the staff worked on the basis of directives issued by the Executive Board.

The Director of the Exchange and Trade Relations Department remarked that the staff's wording of its conclusion on page 26 that the principles concerned were well established was not ideal. The staff had not intended to imply that program design was firmly established and was not being questioned, but rather that there was broad experience with the principles governing conditionality. The staff intended to present and discuss as completely as possible the issues involved in the general principles underlying the monitoring of programs, so that it could receive Executive Directors' guidance on how to proceed in the next stage. The staff would study Executive Directors' views and consider carefully how to apply them in specific cases that would arise in the future and in writing subsequent papers.

Some of the comments by Mr. Salehkhou and Mr. Abdallah were disturbing, the Director continued. The staff agreed with Mr. Dai that the issue of the Fund working with members was one of cooperation between the institution and countries to achieve the necessary objectives. Accordingly, the term "monitoring" seemed more paternalistic or prescriptive than was intended. The use of the term "surveillance" raised similar problems. Performance clauses and other techniques were designed to facilitate the task of finance ministers and central banks, as they encouraged governments to adopt necessary policy decisions. In many cases, the reaching of an understanding between the Fund and a country permitted such decisions to be adopted. The Fund was not trying to encourage spurious precision or to place officials in a policy straitjacket. The Fund endeavored to work with treasuries and central banks to ensure that needed policies were adopted and that day-to-day decisions were taken with a sense of purpose and direction. Financial authorities were responsible for instilling a sense of confidence in external and internal sources of capital by showing that problems facing an economy were being dealt with. The authorities concerned often operated with relatively fine margins in the absence of fairly firm assurances that sources of capital were likely to make their funds available. It was therefore crucial that a government's policies be clearly understood, and that financial authorities instill the needed confidence by providing fairly precise descriptions of their policy intentions. The understandings with the Fund must not be one-sided; the authorities and the Fund must have a shared attitude toward tackling the problems facing an economy as part of their attempt to restore balance to the economy. The adjustment effort should not be seen as policy prescriptions mandated by outsiders.

The present staff papers were meant to be a part of an ongoing process of the consideration of the various issues concerned, the Director commented. In analyzing program design, the staff had thought that it was crucial also to look at the way in which certain aspects of design were dealt with through performance clauses. Such matters were normally dealt with during the annual reviews of conditionality, but they unfortunately sometimes were overlooked in the general reaction to the description of the success and failure of various adjustment programs. Those discussions often tended to concentrate on whether the Fund was sufficiently flexible in providing financing and failed to take a close look at the techniques involved, which, in the staff's view, deserved a separate discussion. The present and previous discussions on program design would be helpful for the review of conditionality, the staff's presentation for which would include a number of basic facts concerning actual cases.

It had been implied by some speakers that the staff was complacent about the way in which program design and performance criteria had been developing and seemed to favor essentially the status quo, the Director said. In fact, that did not accurately describe the staff's approach as reflected in the present paper. The particular emphasis in that paper was to provide a clear description of the staff's view on where things had gone wrong in order to receive the Executive Board's guidance on the way in which the problems should be dealt with. The same approach would be applied in the papers for the forthcoming conditionality review and the discussion on the debt strategy, both of which would involve some of the issues that had been raised during the present discussion. The issue of symmetrical adjustment by surplus and deficit countries could be dealt with again during the discussion on surveillance. The staff would also be preparing a separate paper containing a broad description of the structural measures that might be included in programs with a view to receiving the Executive Board's guidance concerning how such measures should be monitored. The review of the structural adjustment facility would also involve some of the issues that had been raised during the present discussion.

The staff had not meant to suggest that growth involved merely deregulation or the transfer of public enterprises to the private sector, the Director of the Exchange and Trade Relations Department commented. Major aspects of growth were firmly within the Fund's tradition, although growth had not been achieved in all cases. Mr. Massé's comments on the matter brought to mind the fact that, despite the Fund's long association with Jamaica, there had not been significant economic growth in that country in recent years. The areas that Mr. Templeman had mentioned, such as the price structure, relative incentives to broaden the range of exports, and the creation of government savings to support a broad range of investments, were crucial to growth, and the staff would certainly continue to bring developments in those areas to the attention of the Executive Board. However, there were also other questions to consider on which the staff would need more guidance from the Executive Board, including the distribution of responsibilities with the World Bank.

The Deputy Director of the Exchange and Trade Relations Department remarked that some of the questions that had been raised dealt with subjects that, although related, were outside the scope of the staff papers. For example, the question had been raised whether the discussion in the staff paper had adequately covered the issue of access. In addition, questions had been raised about the phasing of drawings. The Executive Board had issued guidelines on those subjects that were reviewed periodically; accordingly, they had not been addressed specifically in the present papers.

The general thrust of the main staff paper was based on the notion that the authorities should have a plan of action based on the adoption of certain needed measures, the Deputy Director continued. After reviewing a number of programs, the staff had concluded that a well-quantified plan covering a reasonable period--typically the policy period of a government--was a valuable instrument not only for ex post measurement of developments, but also for ex ante determination of the actions that were needed to reach the desired objectives. It was against that background that the discussion on the mix of quantified performance criteria and reviews was based. Reviews were thought to be useful for policy areas that were not easily amenable to quantification or when there were unexpected exogenous developments or changes in assumptions. In that connection, reviews were a valuable instrument but they could not provide a substitute for a quantified plan of action covering an appropriate period.

The staff paper was not intended to give the impression that the staff felt hesitation about the appropriateness of monitoring structural measures, the Deputy Director remarked. The staff had stressed the difficulty in monitoring such structural measures and had wanted to underline the need for an efficient division of labor in that area between the Fund and the World Bank. Accordingly, in the discussion of structural adjustment the staff had meant to indicate the feasible instruments of action within a program and to pose the question of how far the Fund should go in that direction.

In his statement Mr. Ortiz had mentioned the important subject of the trade-off between the intensity and the quality of fiscal measures or any other kind of adjustment actions, the Deputy Director recalled. The staff had always been mindful of such a trade-off and of the constraints that it imposed. For example, in the case of a reduction in a public sector deficit, the issue was not only the size of the reduction, but also the efficiency--or the quality--with which it was achieved. However, it had to be stressed that the scope for attaining both of those objectives was bound by the constraint of the availability of financing.

The question had been raised why the staff paper did not discuss the operational deficit as a possible performance criterion, the Deputy Director said. On previous occasions the staff had been asked whether it intended to apply the criterion of the operational deficit more generally to members. The staff had replied that it had hoped that there would not be a great demand for such a criterion, since its general applicability extended mainly to countries experiencing very high rates of inflation. In any event, the operational deficit as a performance criterion posed a number of practical problems because although it could serve as a policy indicator, it was also an outcome of a policy effort. In that connection, Mr. Ortiz had mentioned the issue of the degree of control that a government had over certain variables, especially inflation. He himself tended to agree with Mr. Foot that the issue of control was a matter of degree; instruments should be broadly, but not necessarily totally, within the control of the authorities. In the context of an operational deficit, inflation was one reflection of accumulated imbalances, which inevitably reduced the freedom for policy maneuver available to the authorities in the future. The question of control should not be considered statically; inflation was a means for economies to adjust imbalances, and like excessive indebtedness accumulated over time, it limited the scope for maneuver in the future.

Unexpected developments could of course occur at any time within a program, and the incidence of requests for waivers and modifications when governments had undertaken a concrete and quantified adjustment policy path for a reasonably long period could conceivably increase in the future, the Deputy Director remarked. At the same time, the staff felt that a significant measure of caution would continue to be called for in granting waivers and modifications. In the recent past, along with the increase in the number of reviews, there had been an increase in the number of requests for waivers and modifications. Reviews, waivers, and modifications had as a common element the signal of changes in a policy path, and, therefore, some degree of caution to limit their frequency seemed to be desirable.

It had been noted that there had been an increase in the use of short-term debt ceilings in recent years, the Deputy Director recalled. In earlier periods, such ceilings usually had not been included among the performance criteria, but during a discussion on external debt policies in the Executive Board in 1983, the staff had been encouraged to include short-term debt limits among the performance criteria partly in recognition of the debt problem. The discussion had also underscored the advisability of setting debt ceilings on disbursements of debt rather than on debt contracts; the tone of the discussion at that time had emphasized disbursements, but the staff had been asked to be flexible and to approach each debt situation on a case-by-case basis.

Mr. Wijnholds said that the developments that the staff had described with respect to the use of short-term debt ceilings were fully warranted. Those developments suggested that the language of the relevant guidelines should perhaps be re-examined.

The Deputy Director of the Exchange and Trade Relations Department remarked that, as Mr. Kafka had noted in his opening statement, restrictions were permitted under the Articles. However, it was one thing to permit existing restrictions and another to contemplate or to treat the use of restrictions as an appropriate instrument for balance of payments adjustment. In its paper the staff had stated that "programs will eschew the use of restrictions as a means of reaching the desired balance of payments outcome." The staff recognized that restrictions might be needed; indeed, restrictions were, when appropriate, approved by the Executive Board, but such approval required the restrictions to be both needed and temporary; it did not mean that they were considered as appropriate policy instruments to deal with balance of payments difficulties.

With regard to a question raised by Mr. Nimatallah, the calculation of the shortfall under the oil price contingency for Mexico was to be based precisely on a given volume of production and on deviations between the reference price of oil, as stated in an appendix of the relevant staff paper, and the actual price that materialized, the Deputy Director went on. All the other assumptions relating to the contingency had also been described in the staff papers on Mexico. The operational aspects of the growth contingency were still under discussion with the Mexican authorities. The only aspects of that contingency that were established when the program for Mexico was presented to the Executive Board were that during the first review under the arrangement the evolution of activity in the economy measured on the basis of a commonly agreed index would be examimed; the World Bank would have assessed the Government's planned investment projects; and, of course, the various targets and performance criteria under the stand-by arrangement would have to be observed.

The baseline scenario for the oil contingency included a price of oil between $9 per barrel and $14 per barrel, the Deputy Director of the Exchange and Trade Relations Department remarked. Within that specific range, the package of external financing would not change; policy adjustments in response to fluctuations in the oil price within that range would have to be made if sufficient reserves were not available to finance the shortfall.

The Director of the Exchange and Trade Relations Department, responding to a further question by Mr. Govindarajan, said that there was no practice of denying access to use of Fund resources to members maintaining exchange restrictions. In fact many members that maintained restrictions were using the Fund's resources. The staff paper meant to say that, given the Fund's objective of maintaining open world trade, adjustment programs should not involve new restrictions except on a temporary basis. Fund financing was designed to enable members to solve their balance of payments problems without resorting to restrictions.

Mr. Govindarajan remarked that he had not understood Mr. Kafka and Mr. Sengupta to have said in their opening statements that restrictions were a means of solving balance of payments problems. Rather, they had stressed that the Articles permitted restrictions in certain circumstances, and they were worried that the staff paper had implied that restrictions were not acceptable in any circumstances.

Mr. Templeman commented that one of the major purposes of the Fund was to encourage free trade. While restrictions might have to be introduced in difficult situations, the Fund should not assume that such restrictions were a permanent and acceptable part of an effort to reach a sustainable balance of payments position. It was for that reason that the Executive Board needed to examine a member's exchange regime in deciding whether or not a member's program was adequate. The Executive Board could not judge whether an exchange rate was satisfactory without examining whether a member's restrictions might be suppressing a balance of payments problem. That was one of the reasons why his authorities were concerned about import liberalization, import licensing, and other elements of exchange systems; it was sometimes easy to overlook the fact that a long-standing exchange regime was suppressing a balance of payments problem, thereby making it difficult to discern that a balance of payments position was in fact unsustainable in a worldwide trade system that was basically free of restrictions.

The staff representative from the Exchange and Trade Relations Department remarked that in considering the increase in the number of performance criteria, it was useful to compare the experience in recent years with that of earlier years. Between 1969-77 and 1985--mid-1986, the average number of performance criteria had risen from less than six to more than nine. A major factor in the increase was that midyear reviews were virtually nonexistent before 1978 but had been included in nearly all arrangements since then. In addition, under the guideline on performance criteria on foreign borrowing all arrangements included such ceilings, which had been included in only a minority of arrangements in 1969-77. In recent years, arrangements had also included a performance criterion on short-term borrowing. A third factor in the increase in performance criteria was the increasing incidence of arrears: domestic arrears had rarely been a factor in the earlier period, but at present they were covered in about half of all arrangements. Similarly, while external arrears had been covered in about a third of arrangements in the earlier period, they were covered in approximately half of all present arrangements. Another factor was the more active exchange rate policies that were involved in programs in recent years; performance criteria on exchange rate policies had been relatively rare in earlier years, but they were included in approximately a third of all arrangements in recent years. Structural performance criteria were concentrated on the fiscal side and included criteria mainly on expenditure, revenue, and interest rates. All these factors together easily accounted for the increase in the average number of performance criteria over the years.

Prior actions could have some of the features of a monitoring technique, the staff representative noted. Certain actions could be taken before a program was implemented, and others could be taken during the program period. The latter would normally be covered by a performance criterion or a review clause, and in that sense a requirement that actions be taken prior to a program's approval by the Executive Board also involved a kind of monitoring. There was typically a gap between the negotiation of a program and consideration of the program by the Executive Board. In that period, members often adopted new measures. Before the Executive Board could consider a member's request for an arrangement, the staff had to determine whether or not certain desirable actions had been taken. That kind of monitoring was a necessary aspect of the process of considering a member's request for an arrangement. A complicating factor was that prior actions had some ambiguous aspects. For example, the position in time of prior actions was often somewhat vague; such actions could be taken well before an arrangement was presented to the Executive Board or just before the arrangement was to be discussed. Another aspect was the motivation for prior actions. They could be taken in the context of a response by the authorities to comments by staff and Executive Directors during a previous consultation. Alternatively, they could be taken purely at the initiative of the member. Prior actions taken in response to a serious concern expressed by the Fund, however, could be seen as preconditions for the consideration and approval of an arrangement. In many cases it was not possible to specify whether prior actions were taken at the insistence of the Fund or at the initiative of the member, and the member was given full credit for measures taken prior to a request for a stand-by arrangement. The staff typically reported that such measures were taken without attempting to elaborate on the process behind the adoption of the measures. As Mr. Wijnholds had implied, it was difficult to be very specific about prior actions in requests for arrangements with the Fund.

Prior actions had been most frequently used in three areas, namely, the exchange rate, key domestic prices--including producer or administered consumer prices--and changes in the tax system, the staff representative went on. Measures affecting budget expenditures and interest rate adjustments also were often taken prior to the effective date of an adjustment program.

The staff planned to continue to review regularly the experience with Fund-supported adjustment programs, the staff representative said. The latest staff paper to review factors that had affected the outcomes of programs had covered the experience of 22 countries that had entered into arrangements in a particularly difficult period, namely, in 1982. The extremely adverse external developments had clearly been the most important factor in the weak performance of many of the programs that were undertaken in 1982. Six of the countries covered by that review had managed to make some progress toward achieving balance of payments viability; most of the others had made little or no progress. The more successful cases had been characterized by a sense of continuity and determination in the implementation of the adjustment programs. On balance, the authorities concerned had responded flexibly in response to deterioration in domestic and external conditions. Experience clearly showed that members must be flexible and that the Fund must assume that a member was committed to the program that it intended to implement. Ex post evidence of commitment was a country's success in implementing its program, although other factors were certainly taken into account, as implementation sometimes was not possible even when the authorities had remained committed to their adjustment program. There were a number of issues involved in that area, and the staff would address them in the next review of the experience with Fund-supported programs.

In the coming period the staff would be examining in greater detail the Fund's experience with program monitoring, the staff representative noted. Many of the issues that had been raised at the present discussion about the design of programs would be followed up during the examination of the implementation of programs. The experience with reviews might cast some light on the circumstances in which it would be appropriate to conclude reviews on a lapse-of-time basis in line with Mr. Wijnhold's suggestion. One of the key issues that would be addressed in the coming period would be growth and structural adjustment; the staff would assess the ways in which such adjustment had been approached in the past. Those assessments would attempt to answer some of the questions that had been raised by Executive Directors about the Fund's approach to growth and structural adjustment under Fund-supported programs--including, for example, the need to monitor structural adjustment measures. Finally, the staff would wish to discuss with Mr. Nimatallah on a bilateral basis the issue that he had raised concerning the apparent differential treatment of countries with arrears.

The Chairman made the following summing up:

Today's discussion has dealt with the subject of how to monitor the implementation of adjustment programs to ensure the success of members' adjustment actions and the revolving character of the Fund's resources. It has been a very interesting follow-up to the discussions we had in October and November this year on the theoretical aspects of program design.

At the outset of these concluding remarks it is appropriate to recall a fundamental point made by several Directors, particularly Mr. Sengupta, namely, that while the paper under discussion today presents in a precise and operationally directive manner the ways in which performance criteria could be applied in Fund programs, our recent seminar discussions on the theoretical aspects of the design of Fund programs clearly pointed to the need for further analytical work in this broad area, especially by the Research Department. These Directors thus consider that it is important not to build an overly rigid and overly precise structure of monitoring on what they consider is a less than firm foundation of program design. I would like to assure all Executive Directors--those who share that view as well as others--that you will have additional opportunities to come back to these matters during the scheduled discussions in the Board on such subjects as the experience with Fund programs as well during the symposium on growth-oriented adjustment programs.

Also, by its very nature, today's subject matter has produced a wide variety of views. As some Directors said, this is normal in view of the different vantage points of countries that are using Fund resources and countries that are not. While my summing up should, as usual, reflect the broad thrust of the discussion, I would like to express my appreciation for the critical but always thought-provoking comments that were made by several of you today, and I would mention in particular Mr. Kafka's very interesting opening statement.

1. <u>General considerations</u>

Let me first say a few words about certain aspects of the discussion that focused on what I might call the philosophy of program monitoring. Mrs. Ploix, among other Directors, stressed in her very thoughtful statement the fundamental point that Fund programming and monitoring are designed to give mutual assurances--i.e., on the part of the member that it will fulfill the program as agreed with the Fund, and on the part of the Fund that the member will have assured access to Fund resources under the program if it observes the performance criteria. Directors agreed that effective monitoring can only be expected when the program contains policies that are well understood--Mr. Ismael in particular stressed that point--and to which the member is fully committed. They also agreed that monitoring should not be seen as constraining the members' policy choices unduly or as getting the Fund involved in great detail in the member's policy planning and implementation, although the Fund must, of course, be responsive to requests for policy advice--that often require the staff to go into the details--on the one hand, and must seek adequate safeguards for its resources, on the other; the latter is a statutory obligation.

I think that everyone agreed that monitoring must remain limited to what is strictly necessary to ensure that the Fund's financial assistance is used in support of appropriate external adjustment. That being said, there were nonetheless differences in views on whether the Fund's current monitoring practices in fact met that criterion. Several Directors believed that our current monitoring practices constrain members' policy choices excessively and in some cases create severe problems with respect to what I would call the image of this institution in member countries. In their view, what they see as the proliferation of performance criteria and test dates has not been demonstrated to be conducive to the attainment of program objectives. Directors who held that view generally considered that performance criteria should be kept to an absolute minimum; that automatic adjustments, modifications, and waivers should be utilized flexibly, in particular to respond to unforeseen circumstances or changes in assumptions about exogenous variables; and that reviews should be emphasized as an important monitoring technique. This, however, was not the majority view. Most Directors, while emphasizing the need for trust and to limit the number of performance criteria as much as possible, and while recognizing that program monitoring could never replace the member's own commitment to orderly adjustment as the main guarantee of the effectiveness of the program, considered nonetheless that the Fund needed to ensure that the use of its resources was appropriate, and that the process of monitoring must therefore be precise and objective. These Directors thought that it was important that where policy intentions were not followed through, disbursements of Fund resources should not continue until policies were once again consistent with achieving the agreed external adjustment.

2. Issues in the selection and mix of monitoring techniques

Many Directors underscored the importance of comprehensiveness in the definition of quantitative performance criteria as a means of better covering the phenomena that are to be addressed; as a means of avoiding the distorting effects of the achievement of program objectives resulting from unforeseen developments in some components excluded from narrower definitions; and as a means of minimizing the number of performance criteria needed for program monitoring, although there was some skepticism about the latter on the part of some Directors. Most Directors encouraged the use, where feasible--and I would underline the words "where feasible"--of a broad definition of the public sector borrowing requirement, while allowing some flexibility in light of timely availability of data and the different institutional settings of members.

Directors noted that in the recent past, midyear reviews had been featured as a performance clause in almost all stand-by arrangements. This contrasted with the practice in the years immediately following the adoption of the guidelines on conditionality, during which such reviews figured in a minority of arrangements; and it contrasted even more sharply with the virtual absence of such clauses prior to 1979. Most Directors observed that the highly uncertain world in which we have been living in the 1980s--resulting particularly from the increased constraints on the availability of external financing, the complexities of the problems facing countries, and the growing need for structural adjustment policies that were generally not amenable to monitoring through specific quantitative performance criteria--accounted for much of the increased incidence of reviews. While several Directors thought that the use of reviews as substitutes for prior actions or quantitative performance criteria could be expanded, most Directors stressed that prior actions were often critical to the success of programs, and that performance criteria provided both the member and the Fund with a clear understanding of the nature and the direction envisaged for adjustment policies. It is also fair to say that a number of Directors stressed that reviews should not be open ended or tantamount to the negotiation of a new program; on the contrary, the scope of program reviews should be defined with precision before reviews took place. It is, indeed, important that reviews not be permitted to result in occasions for short-term, ad hoc policy planning and thus contribute perhaps to an erosion of the policy decision-making process. Most Directors reiterated the view that performance criteria should normally be specified in advance for the whole of a member's basic policy period, normally a year. Proliferation of reviews, moreover, adds to the work load of the Board, the management, and the staff, and I have noted the view expressed by some that program reviews could perhaps be handled by the Board on a lapse of time basis if they do not involve new performance criteria and provide only a simple updating that does not require a Board discussion. We will come back to this suggestion on another occasion.

A number of Directors addressed issues involved in delays in the completion of reviews. On the question of whether a fixed time limit for completion of reviews should be established, and whether there should be formal reporting to the Board of reasons for delays in reviews, Directors on the whole felt that the current case-by-case approach on time limits and our present informal methods of reporting to Executive Directors provided desirable flexibility.

On the use of automatic adjustments, most Directors who spoke on this issue believed that the use of this technique should normally be limited to minor and reversible exogenous developments that would not involve basic policy adjustments. As Mr. Dreizzen stressed, this was not the unanimous view of Directors.

Regarding the issue of growth and structural adjustment, a wide variety of opinions was expressed about the extent to which policy actions in these areas needed to be precisely specified and monitored in our stand-by arrangements. A number of Directors believed that structural policy actions needed to figure more largely in Fund programs, particularly in areas that the Fund could effectively address, such as tax reform, financial markets, mobilization of savings, and reforms of trade and exchange regimes. Many Directors advocated an experimental, case-bycase approach to monitoring these structural actions. It was noted that insofar as policy actions involve discrete, qualitative institutional steps, quantified performance criteria might well prove inadequate for monitoring in many cases. A number of Directors noted that the nature of structural reform suggested that in a number of cases structural actions should be taken before the start of a Fund arrangement, at the initiative of the member; but it was also suggested that such actions could be staggered over the period of the arrangement. In addition, the timing of any supplementary actions should be, as far as possible, well specified at the outset, and any further monitoring considered necessary should take place either through reviews or through clear indications of deadlines in the programs themselves. Other Directors considered that these matters were not appropriate for monitoring because they involved in many cases legislative actions that were sensitive to political conditions. I believe that, in the light of today's discussion, the staff should work on possible ways in which structural adjustments could be encompassed in our monitoring arrangements.

Several Directors suggested that the issue of waivers and modifications could have been discussed at greater length in the staff paper. However, as the staff paper noted, these issues will be examined in the forthcoming review of the experience with Fund programs, and I will refrain from further comment on the subject.

Directors noted that the data bases of some member countries are so deficient that monitoring through quantitative performance criteria was problematic. In such cases, technical assistance provided by the Fund in particular was crucial. If there were to be Fund programs in such cases, the relevant magnitudes should still be quantified as performance criteria, but with purchases being subject to reviews. Such a procedure would ensure that the discussions would retain a quantitative focus and would help to promote the development of better statistics.

3. Contingency mechanisms

I now turn to contingency mechanisms, particularly the special features of the arrangement with Mexico. Directors considered that such new contingency mechanisms reflected a flexible response to very difficult circumstances. Most Directors were not ready to consider any generalized use of such schemes at this time and emphasized the need to approach this matter with caution and on a case-by-case basis.

Most Directors expressed firm reservations about "growth" contingencies in particular, since in their view the activation of such contingencies would imply by definition an increase in external debt without necessarily providing for a strengthening of policies of external adjustment. As speakers rightly stressed, a particular economic growth rate cannot be guaranteed by the Fund; and, as Mr. Foot put it, growth could not result automatically from turning on the tap of public expenditures. Policies for growth need to be built into a program from the beginning, and growth-oriented policies need to be given time to have their effects. Moreover, attempts at "fine-tuning" in response to short-run fluctuations in growth rates were not likely to promote the achievement of a program's overall objectives.

Incidentally, in considering the appropriateness of the so-called growth contingency for other countries, I feel that it is important to bear in mind the fact that the "growth" contingency in the arrangement for Mexico was not designed to fine-tune economic growth or guarantee a particular economic growth rate. The policies for growth had been built into the program as a whole. The Mexican contingency could perhaps more appropriately have been called a "public investment" contingency.

Other Directors--who did not, however, constitute a majority--had more positive views on such mechanisms. They stressed that a "growth" contingency was a positive means of encouraging a member that might otherwise be most reluctant--or might refuse--to do so to undertake an adjustment program based on stringent policies recommended by the Fund that were very difficult to implement for social and political reasons.

Directors noted that one of the key aspects of both contingencies in Mexico's arrangement was that clear provision was made for financing their external consequences through additional foreign borrowing and/or the use of reserves. It was further noted that constraints that limit foreign borrowing and the use of reserves are also constraints on the use of such contingencies. Directors thought that the integration of the commodity contingency mechanism into the Mexican program and that contingency's symmetrical characteristics were positive elements. Many Directors considered, however, that contingency mechanisms of that type should be brought within the framework of the compensatory financing facility, although several Directors thought that the financing of commodity contingencies could remain independent--alongside, as some of you said--of the CFF mechanism. In any event, it is clear that Fund policy on financing commodity contingencies cannot be considered in isolation from Fund policies on the compensatory financing facility, and we will return to this question early next year during the review of the facility.

With respect to the concerted lending, or catalytic, aspects of the contingency mechanisms, some Directors noted the reluctance of other lenders--particularly commercial banks--to participate in such contingency schemes, which suggested to those Directors that, practically speaking, the scope for extension to other cases of such mechanisms might well prove to be limited.

4. Concluding comments

I think that we all agree that performance criteria are tools; they are not ends. It is the attainment of the general objectives of a program that marks the success of corrective policies. But if performance criteria are tools and not ends in themselves, they are, in my view, crucial to showing the desirable adjustment path and to checking that developments are unfolding in line with the agreed path. The path can appropriately be adapted--and it must be adapted in many cases--as long as the basic agreed direction is preserved. That is of course a very general conclusion, with which everyone could agree. It is the way in which that conclusion is applied that is critical and difficult.

I think that it is fair to say that the thrust of the general guidelines on conditionality has not been questioned today. We must now prepare for the discussions on the various related issues in the coming months. We have scheduled the review of the compensatory financing facility, and we will have our regular review of the experience with Fund-supported adjustment programs as well as a conference on growth-oriented adjustments, which I hope will provide new and thought-provoking ideas. I would urge the staff to note very carefully the views that were expressed today in developing the analysis in the forthcoming papers, which will provide you and my successor with opportunities for early involvement in these critical issues.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/190 (12/3/86) and EBM/86/191 (12/3/86).

2. MAURITANIA - STAND-BY ARRANGEMENT - MODIFICATION

Paragraph 2(a) of the stand-by arrangement for Mauritania (EBS/86/70, Sup. 1, 4/23/86), is hereby amended as follows:

a. Replace "December 15, 1986" by "December 3, 1986, the effective date of Executive Board Decision No. 8461-(86/191)";

b. Replace "March 15, 1987" by "February 27, 1987."
(EBS/86/270, 11/26/86)

Decision No. 8461-(86/191), adopted
December 3, 1986

APPROVED: July 29, 1987

LEO VAN HOUTVEN
Secretary