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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/100

10:00 a.m., June 26, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. R. Ismael, Temporary
C. H. Dallara	
J. de Groote	
	X. Blandin
M. Finaish	T. Alhaimus
	M. Sugita
	B. Goos
J. E. Ismael	
	G. D. Hodgson, Temporary
	H. A. Arias
H. Lundstrom	
E. I. M. Mtei	
	M. A. Weitz, Temporary
	J. E. Suraisry
P. Pérez	G. Ortiz
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
	A. A. Agah, Temporary
A. K. Sengupta	A. S. Jayawardena
N. Wicks	T. A. Clark
	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
K. Baer, Assistant

Also Present

European Department: B. Rose, Deputy Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. T. Boorman, E. H. Brau. External Relations Department: H. O. Hartmann. IMF Institute: S. El-Khouri, M. R. Rached. Legal Department: J. G. Evans, Jr., Deputy General Counsel; J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; F. Drees, Z. Iqbal, B. A. Karamali, D. B. Noursi, S. M. Thakur, G. Tomasson, M. Yaqub. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell, M. D. Knight, A. Lanyi, D. J. Mathieson. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. Wright, Deputy Secretary. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, J. Hospedales, H.-S. Lee, G. Nguyen, M. Z. M. Qureshi, T. Sirivedhin, A. Steinberg, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, W.-R. Bengs, Chen J., C. Flamant, R. Fox, V. Govindarajan, L. Hubloue, H. Kobayashi, A. K. Diaby, G. Ercel, S. Geadah, M. Lundsager, R. Msadek, K. Murakami, A. Mustafa, E. Olsen, W. K. Parmena, M. Rasyid, J. E. Rodríguez, M. Sarenac, A. A. Scholten, L. Tornetta, E. L. Walker, B. D. White, Yang W.

1. GROUP OF TEN - REPORT BY MANAGING DIRECTOR

The Managing Director said that he welcomed the occasion of the meeting of the Ministers of the Group of Ten (G-10) held in Tokyo on June 21, and the opportunity to comment on the report of the G-10 Deputies on the functioning of the international monetary system. Nearly ten years had passed since the formal introduction of a more flexible exchange rate system, which had been agreed upon by the Interim Committee in Jamaica in 1976. Since then, there had been both positive and negative developments in the system's functioning, and it was timely to reflect upon the lessons to be drawn from experience and improvements that could be made in the functioning of the system.

The report by the G-10 Deputies had made many detailed suggestions, and he had informed the Ministers that the Fund management and staff, and the Executive Board, would examine them carefully, the Managing Director continued. He had added that Ministers and Governors would appreciate that his own remarks would be personal at the present preliminary stage, before the Interim Committee and the Executive Board had considered the G-10 report. He also understood that the Group of Twenty-Four was preparing a parallel report on the same subject.

He had considered it appropriate to make some general remarks on the international monetary system, the Managing Director continued. He had noted that, in his view, no system could provide complete protection against disruptions in international monetary and payments relations. The Bretton Woods system of fixed or stable parities had not prevented the accumulation of large and persistent balance of payments imbalances or sharp distortions in exchange rates. Eventually, the exchange rate system had collapsed because it had been out of line with the economic fundamentals and because it had been unable to adapt itself to the new realities of international economic and financial relations.

The floating-rate system supported by Article IV surveillance had also failed to prevent two significantly unfavorable developments from emerging in recent years, the Managing Director remarked. First, a number of countries, developing and developed, had resorted to massive overborrowing in the second half of the 1970s and in the early 1980s, reflecting a systematic bias in favor of financing instead of adjustment. Borrowing on such a large scale had been made possible, among other factors, by the growth of financial markets, which had realized too late that indebtedness was assuming crisis proportions. Second, the present international monetary system had not prevented the development of large payments imbalances among industrial countries, nor had it prevented large movements in real exchange rates. The exchange rate patterns that had emerged did not seem to be in line with economic fundamentals. As a result, countries were faced with difficult problems in the real sectors of their domestic economies, compounded by the ensuing risk of protectionism and of further disruptions in the system associated with possible reversals in the pattern of exchange rate movements.

In his remarks to the Group of Ten, he had suggested that the nature of the formal international monetary system was perhaps less important than the way in which national economies were managed, especially those of large countries having the greatest impact on the functioning of the international system, the Managing Director observed. Without financial discipline and internationally consistent policies, no system could provide the stability and the conditions necessary for lasting growth. It was gratifying that the G-10 report had reached the same conclusion, thereby providing support for the idea of more effective surveillance.

He had also drawn attention to the increasingly dominant role of capital movements in exchange markets, the Managing Director stated. Market views on exchange rates had always reflected a host of factors and assessments going far beyond the narrower concept of economic fundamentals based on price and cost relationships and competitiveness; the existence of large and free capital movements had amplified those unquantifiable factors in exchange markets, making stable exchange rates all the more difficult to achieve.

As the G-10 report had explicitly recognized, there was no support for international capital controls, and the scope of official intervention by central banks was limited, the Managing Director continued. Therefore, the exchange rate system would have to be flexible enough to allow market forces to operate smoothly, but that very freedom and flexibility would have to be backed by sound and consistent economic policies. In a world of large capital flows, the more flexible the system, the greater the need for discipline. Thus, the notion of improved surveillance had become the common thread of the whole G-10 report.

In referring to the different proposals set forth in the report, the Managing Director said, he had mentioned two negative developments over the past few years that had prompted him to touch on those proposals that concerned the role of the Fund. First, there had been insufficient adjustment by borrowing countries; second, there had been large payments imbalances among industrial countries and excessive shifts in the exchange rates for those countries' currencies.

For the sake of clarity, he had made a distinction between adjustment and financing on the one hand and surveillance on the other in describing the role of the Fund, although he realized that adjustment and conditionality both formed part of the Fund's surveillance function, the Managing Director commented.

The debt crisis had proved to be an important lesson for countries--creditors and debtors--and for the Fund; the Executive Board itself had been considering the Fund's role in adjustment and financing, the Managing Director remarked. As he had said, adjustment should ideally strive to avoid balance of payments crises through an effective use of the preventive function of surveillance. When balance of payments problems did arise, adequate adjustment measures would have to be taken at the earliest possible stage. The Fund could help either through the regular consultation process or through programs supported by Fund resources and backed by other creditors if necessary. Countries' adjustment programs would have to be comprehensive and strong enough to help restore the medium-term balance of payments viability that the Fund had been created to promote. The Fund could also be helpful, once crises had been overcome, in supporting continuous adjustment through enhanced surveillance in appropriate cases, thereby permitting a better assessment by creditors of the performance of adjusting countries and facilitating their return to more normal market access and conditions.

Close collaboration with the World Bank in moving toward adjustment would be of critical importance, and in his presentation to the Ministers, he had noted that the issue of cooperation had been examined in depth by the Fund's Executive Board in November 1984 and the Bank's Executive Board in March 1985, the Managing Director continued. He had cited in particular closer contacts between the Fund and the Bank at management and staff levels; attendance and, where relevant, participation of staff members of one institution in Board meetings of the other during discussions on countries in which both had programs; participation of the staff of one institution in the missions of the other; continuous exchange of information on country analysis; and joint seminars. As a result, he had been pleased to note that most of the recommendations in the G-10 report concerning collaboration had been considered by the Board and either had been adopted or were in the process of being introduced or considered further. In addition, he had noted with interest the somewhat novel proposal in the G-10 report calling for greater coordination of the financial support provided by the two institutions, a proposal that would no doubt be taken up at a later stage.

In his remarks on financing by the Fund, he had noted the importance attached by the Group of Ten in its report to quotas as a basic source of Fund financing along with the suggestion that the Fund embark on a study of alternative techniques, other than quotas or borrowing, to acquire resources in exceptional circumstances, the Managing Director said. Further thought would have to be given to that suggestion at a later stage. In responding to the suggestion in the G-10 report that Fund credit should be available on a sufficient scale to provide meaningful support to countries embarking on adjustment programs, thereby also enhancing the Fund's catalytic role, he had drawn attention to the considerable expansion of that aspect of the Fund's activities since 1981-82.

As for the concern in the G-10 report regarding the prolonged use of Fund resources and arrears to the Fund, the Managing Director continued, he had assured Ministers that management and the Executive Board had been working on the matter seriously, and that important steps had been taken over the past year to deal with overdue obligations to the Fund.

Mention had been made in the report of the need to phase down enlarged access to Fund resources, the Managing Director observed, and he had drawn attention to what Ministers had no doubt noted, namely, the cautious application of the policy on enlarged access, which would of course be taken up at the next Interim Committee meeting in Seoul. Meanwhile, the Executive Board would be examining the issue as it made preparations for the Seoul meetings.

There was no disagreement about the need for more effective surveillance in present world economic conditions, as the issuance of the G-10 report itself confirmed, the Managing Director noted. He had therefore welcomed the emphasis placed in the report on the importance of the Fund's role in the exercise of surveillance. The role of the Managing Director in the surveillance process had been mentioned in the report, among the more detailed suggestions for strengthening surveillance. It had been suggested that the Managing Director and the Minister of Finance exchange confidential views at the conclusion of a consultation with a country whose economy had an important bearing on the functioning of the system. While he had recalled that such exchanges of views were already occurring, he had indicated that he would be willing to carry such an approach to surveillance further, within the limits of available time.

A number of other suggestions on surveillance contained in the G-10 report had already been subjects of discussions in the Executive Board, the Managing Director commented. In some cases, the discussions had led to action; in others, the matter would still be subject to further review. For instance, in Article IV consultations, the action already taken had included paying more attention in staff reports to capital account developments, trade, restrictive measures, and medium-term prospects as well as a better identification and analysis of data and relationships underlying the Board's judgments. Steps had been taken to ensure that key economic policymakers in national capitals were aware of the substance of consultation discussions and reports, which were being followed up more actively. The development of enhanced surveillance was another innovation. Coordination with the World Bank on matters of analysis and operations had been improved, although there was still room for improvement.

On other suggestions put forward in the G-10 report, no action had yet been taken by the Board, the Managing Director said. In particular, he had noted the call for a special report after a consultation outlining the measures introduced to deal with problems identified by the Fund and responding to specific policy suggestions. The report had also called for heavier reliance to be placed on the supplementary consultations provided for under the procedures for surveillance, clearer identification of differences of views between the staff and the authorities of the country during a consultation, and precise suggestions by the Fund for policy changes in such cases.

One of the most important suggestions set forth in the G-10 report had been the emphasis on multilateral surveillance as a way of integrating precise information obtained under bilateral surveillance, the Managing Director noted. The idea would be to consider in a more systematic way the repercussions of large industrial countries' national policies on the international system, and on the interaction of those national policies on exchange rate developments and international adjustment. Much had already been done in the World Economic Outlook exercises to establish a more effective framework for such a focus, which he agreed was appropriate. Without necessarily changing the detailed format of the World Economic Outlook, the Fund could develop additional analytical tools to help countries, and itself, to sharpen analyses of the interrelationship between national policies and developments.

The passage in the G-10 communiqué and in the report on international liquidity and the SDR had been read no doubt with great interest by the Board, the Managing Director said. In reviewing the role of the SDR, Ministers had recognized that the international monetary system had changed considerably since the creation of the SDR scheme, and the changes, in their view, affected the rationale for the existence of the SDR. The Group of Ten had, however, recognized that that reserve asset would still have a useful role to play in meeting the long-term global need for reserves and in providing a safety net for future contingencies, a particularly interesting feature of the report in his view. Thus, the G-10 Ministers had supported the intention of the Executive Directors to carry out a comprehensive review of the future role of the SDR in the international monetary system.

In paragraph 10 of their communiqué, the Ministers of the Group of Ten had requested their Chairman to transmit the G-10 Deputies' report to the Chairman of the Interim Committee, with the suggestion that the report receive preliminary consideration at the meeting in Seoul on October 6, 1985, the Managing Director concluded.

The Executive Directors took note of the report by the Managing Director.

2. JORDAN - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Jordan (SM/85/159, 6/3/85). They also had before them a report on recent economic developments in Jordan (SM/85/161, 6/6/85).

Mr. Finaish made the following statement:

> The East Bank of Jordan has limited natural resources and a narrow agricultural base; the more fertile West Bank has been occupied since 1967. The uncertainty arising from sensitivity to external economic developments and an unsettled regional environment have further complicated Jordan's development efforts. Despite these contraints, the Jordanian economy has performed quite well over a long period in terms of economic growth and diversification in conditions of financial stability. In the decade through 1981, output growth averaged 9 percent, the share of commodity-producing sectors in GDP almost doubled,

and inflation on average remained moderate. A major stimulus for the rapid economic expansion was a large inflow of foreign exchange receipts from exports, workers' remittances, and external assistance, all reflecting the then buoyant economic conditions in Arab oil exporting countries. Another important contributory factor was sound economic management within the framework of medium-term development planning and a set of well-coordinated policies that were conducive to the maintenance of financial stability, the encouragement of private sector initiative, a prudent use of foreign exchange inflows, and the generation of complementary domestic financial resources.

In the more recent past--more specifically, since early 1982--Jordan's previously impressive economic performance began to weaken due to a number of adverse developments, necessitating significant policy adjustments. The inflow of foreign exchange receipts from exports, remittances, and grants was significantly reduced owing to the effects of the world recession and the slowdown in economic activity in Arab oil exporting countries. A sharp drop in exports to Iraq in 1983 and a drought in 1984 contributed further to a slowdown of growth and an increase in financial pressures. Under these circumstances, the authorities allowed a drawdown of reserves along with an increase in external borrowing in order to ease the pressure that emerged on the external payments position and to cushion the economy from too sharp an adjustment to the reduced level of financial inflows. At the same time, they began putting in place adjustment policies as part of an orderly process of adjustment to the changed circumstances with a view to stabilizing foreign exchange reserves and bringing external borrowing back to normal levels. During this period of adjustment, growth has been maintained at a positive, albeit much reduced, level, inflation has been reduced to below 4 percent, and the impact of the reduced financial inflows on domestic and external financial positions has been contained.

Jordan's development strategy has placed particular emphasis on the promotion of commodity-producing sectors in an effort to diversify and broaden the productive base of the country's service-oriented economy. Within this context, a number of measures were taken in the past two years to assist these sectors with their particular problems during a difficult period. In the agricultural sector, measures were introduced in 1984 to affect the cropping pattern in 1985 so as to eliminate the recent surpluses of some crops due to shrinking export markets and to promote the production of crops in greater demand. The policy package included the licensing of acreage for a few food crops in surplus, the introduction of incentive prices for several crops, and demonstration projects to encourage the cultivation of field crops. The measures relating to manufacturing and mining emphasized the expansion of export markets, particularly in view of the coming on stream since 1982 of some major production facilities for phosphates, potash, fertilizers, and cement. The industrial policy package included the establishment and expansion of trade and credit arrangements with Iraq, the conclusion of two commercial protocols (with Egypt and Ethiopia), tariff restructuring for the protection of some infant industries, and a closer examination of dumping by foreign producers. Consideration is also being given to the establishment of a new institution for export guarantees. The new agricultural and industrial policy measures are consistent by and large with Jordan's traditional pursuit of liberal and market-oriented policies. The few measures that appear to deviate from this general policy stance are of limited scope and temporary. These measures are intended to tackle certain rigidities in agriculture, afford a temporary period of adjustment to certain newly established industries, and explore new areas of comparative advantage.

Jordan's domestic energy requirements are met mostly through imported oil, which amounts to about 20 percent of the import bill. To encourage conservation in the use of energy, domestic petroleum prices and electricity rates were substantially raised during 1983-84. Significant progress has been made toward eliminating the energy subsidy funded by the budget. Exploration efforts for oil have also been stepped up with the recent discovery of an oil field. There are now three oil producing wells, which are expectd to meet up to 10 percent of domestic requirements in the near future.

The brunt of domestic financial adjustment has been borne by central government operations in the form of expenditure cuts and domestic revenue increases in an effort to adjust to the significantly reduced amounts of external budgetary assistance. On the expenditure side, spending was kept essentially unchanged over the two years 1983-84 owing in part to a substantial reduction in the energy subsidy and economies in administrative expenditures. At the same time, as external budgetary assistance continued to fall short of expected levels, the authorities made substantial cuts in capital outlays by postponing lower-priority investment projects. On the revenue side, new tax measures and improved tax collection raised domestic revenues at substantially higher rates than national income. The revenue measures included higher import duties for luxury goods, a capital gains tax on real estate sales, and administrative improvements relating to income taxes and customs duties. Consequently, while the overall budget deficit relative to GDP increased in 1983, the declining trend of the previous three years was restored in 1984. Considerable progress has been made toward the objective of meeting current expenditure requirements from domestic revenue sources, with the corresponding ratio reaching 95 percent in 1984. The budgetary position for 1985 is subject to some uncertainty, particularly regarding the level of foreign grants. However, the authorities have indicated their determination to maintain and, if needed, strengthen the policy of fiscal adjustment.

Monetary policy in recent years has been assigned the role of striking a balance between meeting the requirements of financial adjustment to shrinking flows of external finance and partly compensating for the reduced external stimulus to economic growth. Accordingly, while the declining trend of domestic liquidity expansion since 1980 continued, with the rate of expansion dropping by one half over the two years 1983-84, the overall monetary policy stance remained mildly expansionary. Within this context, credit policy is being rationalized in an effort to meet genuine credit needs while restraining credit for unessential purposes. The Bank Markazi has made active use of its credit control instruments and passed measures to encourage and assist commercial banks and financial institutions to syndicate loans for domestic industries, purchase corporate equities, and hold government debt instruments. The interest rate policy operates on the basis of ceilings on deposit and lending rates which the Bank Markazi adjusts when needed to maintain adequate real rates of return on domestic savings and avoid excessive increases or fluctuations in the cost of credit. The current interest rate ceilings yield a significantly positive real rate of return. The authorities intend to maintain due flexibility in interest rates.

Jordan's external position in 1983-84 reflected both the pressure of external financial developments and the ongoing domestic adjustment efforts. The balance of payments outcome showed a weakening in exports and workers' remittances in 1983 followed by a recovery in 1984, moderately declining imports, substantially lower external grants, and higher commercial borrowing. The authorities' adjustment efforts aimed at both restraining imports and promoting exports. These efforts comprised tighter demand management policies as well as specific price and trade measures to raise domestic production, rationalize imports, and open up markets for exports. The real effective exchange rate for the Jordan dinar, which is peggged to the SDR, held steady over the two years 1983-84, showing a slight depreciation on balance. The debt service ratio remains relatively low, estimated at under 8 percent at end-1984. Nevertheless, the authorities are determined to reverse the rising trend of external borrowing since 1982, while also seeking to replenish foreign exchange reserves.

Jordan's medium-term economic prospects are difficult to assess in view of the uncertain regional outlook. The level of domestic economic activity and, in particular, the balance of payments outcome are closely linked to the level of economic activity in Arab oil exporting countries through exports, workers'

> remittances, and external grants. The continuation of active export promotion policies and the expansion of capacity in export industries could sustain the recovery of exports that took place in 1984. The strong recovery in workers' remittances in 1984 is less likely to continue, since it could have been due to a larger flow of workers returning home with their savings. The prospects for a recovery in external assistance are more uncertain. The authorities have demonstrated their willingness and ability to undertake necessary adjustments to the reduced availability of financial resources from abroad and to contain the impact of adverse external developments on the domestic economy and the external payments position. However, while these adjustment policies could help to stabilize growth and the balance of payments, it is difficult to foresee a return to the buoyant economic conditions of the decade through 1981 without the restoration of an adequate external stimulus.

Mr. Suraisry said that he was in general agreement with the staff analysis and supported the proposed decision. Jordan had traditionally pursued sound economic and financial policies that had greatly contributed to the economy's good performance. Until recently, output had grown rapidly, the productive base of the economy had been diversified, and inflation had remained low. Both the budget and the balance of payments positions had been strong, but both had been weakened by recent changes in Jordan's external environment that had led to a contraction in its foreign exchange receipts.

The Jordanian authorities had responded to those adverse developments by introducing strong adjustment measures, Mr. Suraisry observed. Fiscal expenditures had remained essentially the same in 1983 and 1984 in nominal terms but had fallen in real terms, while the growth in domestic revenues had exceeded the growth in national income. However, despite the authorities' efforts, based on discipline and sound management, Jordan's public finances had remained vulnerable to external developments owing mainly to the occupation of the West Bank. Development outlays were financed totally from external sources, and domestic resources were used only to finance current expenditures.

For 1985, outlays on capital spending were being increased significantly on the assumption that external grants were to recover sharply, Mr. Suraisry commented. At the same time, the authorities had made a contingency plan to reduce capital spending in case actual receipts were less than expected. As a safeguard against the uncertainties surrounding international aid, it was important for the authorities to continue expanding the domestic resource base in order to finance capital expenditures in the future. Reduced use of external grants to finance capital expenditures would be necessary to facilitate the long-term development of Jordan's economy and to ensure its continued diversification.

Jordan's monetary policy had been consistent with its overall economic policies for several years, Mr. Suraisry remarked. Recently, the growth of credit had been mildly expansionary; the authorities were aware of the need to guard against inflation, and they should be ready to restrict credit growth if the forecast budgetary receipts were not forthcoming.

A strengthening of domestic financial policies would help to increase Jordan's external reserves and improve the balance of payments, Mr. Suraisry suggested. Considering the limited scope for a further reduction in reserves and the undesirability of additional external borrowing on a large scale, he advised the authorities to maintain a cautious stance. As far as possible, short-term remedies that might impair the fulfillment of the economy's long-term growth potential should be avoided.

Mr. Dallara recalled that when the Executive Board had last discussed economic developments in Jordan (EBM/85/8, 1/18/85), he had been concerned about considering the authorities' request for a drawing in the upper tranche of the compensatory financing facility in the absence of comprehensive information and data on Jordan's policies. Such information could have been usefully presented at the time in the context of an Article IV consultation, especially as Jordan had not been required to have a program supported by an arrangement with the Fund in order to draw. Unfortunately, subsequent economic developments in Jordan had been worse than expected, and there had been a large fall in external reserves. The lack of a comprehensive approach to reversing the deterioration strengthened the concern that he had voiced during the January 1985 discussion.

There was a need for economic adjustment in several areas, Mr. Dallara continued. First of all, a much stronger fiscal effort would be required, given that revenue shortfalls and expenditure overruns had led to a larger than expected deficit in 1984, of 8.2 percent of GDP. By contrast, the 1985 budget was based on estimates that growth in revenue would exceed growth in expenditure, narrowing the deficit to 5.4 percent of GDP. However, the staff considered the 1985 budget estimates to be somewhat optimistic and had warned that the overall deficit could be double the official estimate. A budget deficit in excess of 10 percent of GDP could lead rapidly to an unsustainable external position. Indeed, as of April 1985, official reserves had declined substantially.

Among its specific recommendations, the staff had suggested a reduction in the petroleum subsidy, and the Jordanian authorities had considered raising the price of some petroleum products, Mr. Dallara remarked. Several other recommendations had been outlined, including budgetary reforms, pricing adjustments to eliminate subsidies, and assigning an order of priority to items in the capital budget. Improved tax collection could ensure a more equitable distribution of the burden of financing fiscal operations. In that regard, he had been surprised to learn that only 3 percent of public sector employees paid income taxes.

Monetary policy could also be tightened more easily if fiscal policy were less expansionary, Mr. Dallara observed. While real interest rates were positive in Jordan, interest rate ceilings might not have been high enough to encourage larger flows of remittances. The decline in official reserves was an indication of the strength of the dinar, and higher interest rates might encourage local currency deposits, thus easing pressure on the balance of payments. The errors and omissions item had been largely negative in 1984; the outflows were expected to diminish in 1985 but might remain negative into the medium term.

Because of Jordan's dependence on external trade in both goods and services, the exchange rate peg to the SDR should be monitored continually and adjusted in order to maintain competitiveness, Mr. Dallara emphasized. Combining a flexible rate with a more rational producer incentive scheme could permit the economy to develop those sectors in which Jordan clearly had a comparative advantage, instead of relying on various government incentive schemes, such as those being applied in the agricultural sector. A more rational approach to producer incentives was particularly important in view of the medium-term outlook presented in the staff report. Balance of payments deficits were projected for the remainder of the decade; Jordan had access to international capital markets, but, if it had to borrow at commercial rates to finance payments deficits, it could encounter debt servicing difficulties in the 1990s.

The adjustment effort so far had not been sufficient to stem or reverse the deterioration in Jordan's external position, Mr. Dallara considered. During the consultations, the staff had made numerous suggestions, but he was not convinced that the Jordanian authorities had acted on them. He therefore encouraged the authorities to reassess their policies and take the measures necessary to ensure a viable payments position in the medium term, thus providing a framework for growth in the economy.

On the periodicity of Article IV consultations with Jordan, his chair had been somewhat concerned that the authorities had chosen to remain on an 18-month cycle despite the staff's recommendation that Jordan be placed on a 12-month cycle, Mr. Dallara said. In the light of recent economic developments, a 12-month cycle would be more appropriate.

Mr. Goos remarked that it was astonishing to note how fast the situation had changed since the Board had had the opportunity to discuss Jordan's economic performance and policies in the context of its request for a compensatory financing drawing in January 1985. At that time, it had been the staff's view that the authorities were continuing to implement generally appropriate policies in support of balance of payments adjustment. By comparison, from its appraisal in the report for the present Article IV consultation, the staff appeared quite concerned about the balance of payments prospects; it found that credit policy over the past two years had been "unbalanced and expansionary" and that "both fiscal and credit policy would need to be strengthened." He was inclined to agree with that assessment but its apparent inconsistency with the earlier view of the staff raised a number of questions.

The first and probably most serious question was whether the Board should have concluded in January that the cooperation requirement for upper credit tranche drawing had been met, Mr. Goos said. Second, he wondered why the staff had not drawn attention to the change in its assessment of Jordan's economic policies and to the reasons for such a change. He recognized the great uncertainty affecting the level of foreign assistance and the considerable weakness in statistical data that made economic forecasting particularly difficult. However, while such problems could have explained the signficant changes in the budgetary figures, the shift of the staff's assessment of monetary policies to a more critical tone had occurred despite the fact that monetary growth had decelerated at a faster pace than had been assumed earlier in the year. As a matter of general policy, Article IV consultation reports should contain a reference not only to the Board's main findings at the conclusion of the previous Article IV consultation, but also to its findings on requests for the use of Fund resources in the intervening periods.

A strengthening of both fiscal and credit policies would improve the country's balance of payments prospects and, if accompanied by structural adjustment measures, would eliminate the need for government intervention in the economy, which had increased at a worrying pace in the recent past, Mr. Goos remarked. A permanent reversal of the authorities' traditional liberal and market-oriented policy stance was bound to be counterproductive in the longer term.

Unfortunately, there were several indications of a more basic change in the authorities' underlying economic philosophy, Mr. Goos observed, the most conspicuous one being the Bank Markazi's desire to ensure "that the use of [bank] deposits was in the interest of the country" by imposing mandatory investment regulations. Equally worrying was the statement that "it was important that any adjustment not be at the expense of growth," which could easily be used to justify the general introduction of administrative controls. Such statements seemed to reveal considerable mistrust about the effectiveness of market forces, and an overestimation of the effectiveness of economic policy in postponing and alleviating the overall adjustment burden. The latter was also supported by the conduct of monetary policy, which over the past two years "has been expansionary in response to economic conditions." Without dwelling further on the potential drawbacks of interventionist economic policies, he urged the authorities to adopt the policies recommended in the staff appraisal.

While the authorities had executed the 1984 budget flexibly in response to lower than expected revenues, it was unfortunate that expenditure cuts had affected capital outlays exclusively, Mr. Goos said. At the same time, considerable overruns in current expenditure had led to an overall deficit that had been almost double the budget target. Thus, it was surprising that the 1985 budget estimates incorporated the same assumptions regarding external grants and capital outlays that had been made in the 1984 budget estimates, which had proved overoptimistic. The contingency plan drawn up by the authorities to meet renewed shortfalls in revenues, while welcome, apparently covered only capital expenditures.

Accordingly, the prospect of unchecked current expenditure growth and hence of another large overrun in the overall deficit was not ruled out. The fact that the authorities appeared to be prepared to accept such an outcome from the outset without considering further corrective action was cause for concern. Such a policy stance would be inconsistent with the staff's considered advice to strengthen fiscal policy. Therefore, the authorities would be well advised to adopt a comprehensive contingency plan covering both capital and current expenditures. In case of revenue shortfalls, those expenditures should be cut in a more balanced way with the objective of meeting the original budget deficit envisaged for 1985.

Mr. Romuâldez said that he was in general agreement with the staff appraisal of Jordan's economic situation and urged the authorities to resist the temptation of responding to current difficulties by intervening in the economy through subsidies, regulations, or restrictive trade practices. Fiscal policy was appropriate, but there was nevertheless a need for a more comprehensive and consistent approach to adjustment that would allow for a gradual reduction of reliance on foreign grants; more rigorous fiscal restraint, including a program to reduce or eliminate subsidies; and monetary policies that would be more supportive of the policy of fiscal restraint that had been followed for some years, without full success.

Although the authorities had expressed their intention to adjust central government expenditures and domestic revenues in line with the reduction in external grants, the effort might prove ineffective because it seemed to be based on overoptimistic assumptions about the levels of foreign grants and domestic revenues, Mr. Romuâldez continued. In addition, monetary policies had been much too accommodating.

The staff had done well to caution the authorities against heavy commercial borrowing for budgetary and balance of payments purposes, Mr. Romuâldez remarked. Although Jordan's debt service ratio had remained low--at 7.6 percent in 1984--it was difficult to see a turnaround in the basic economic indicators, barring a comprehensive and consistent adjustment program, because the country was still largely dependent on external grants and on economic developments in neighboring countries. The significant impact of the errors and omissions entry on the balance of payments also created much uncertainty about the prospects for Jordan's external position. Thus, in the light of recent economic developments, the staff's recommendations to the authorities seemed appropriate, and he supported the proposed decision.

The Director of the Middle Eastern Department recalled that when the staff had visited Jordan to discuss the request for a compensatory financing purchase, provisional data for both revenues and expenditures had been available only for the first nine months of 1984. At the time, the staff had been assured by the Jordanian authorities that expenditures for 1984 would be held well below the 1983 level. The worsening of the budgetary situation in 1984 had occurred mainly on account of expenditures, revenues having been somewhat higher than projected. In March 1985, the Article IV consultation mission had noted that reserves had declined by almost $200 million between September 1984 and February 1985, to $450 million. The decrease in reserves in addition to the projected drop in foreign aid had prompted the staff to make various recommendations.

A much stronger tightening of credit policy was being recommended because of three specific developments, the Director remarked. First, the budget deficit for 1984 had been much higher than expected. Second, the 1985 deficit was likely to be higher than had been indicated by the Jordanian authorities, although expenditures were not expected to surpass the 1983 level. Third, there had been a decline in reserves. It should be noted that the staff had recommended a tightening of credit in its paper on the request for a compensatory financing purchase, but in less clear terms because it was necessary to consider both public and total credit provided to the economy.

One important measure that the staff had recommended was raising the price of petroleum products, which had already been raised in December 1984, the Director added. However, according to the latest information, no action had been taken yet in that respect.

The staff representative from the Exchange and Trade Relations Department explained that although the guidelines for conducting Article IV consultations did not precisely define the circumstances in which consultations would be held annually, a 12-month cycle was in keeping with the spirit of those guidelines when a country was experiencing problems in the external sector. The requirement of cooperation would also call for a country to be willing to receive Fund missions if it wished to draw under the compensatory financing facility, even in the lower tranches. However, the use of the term "cycle" could be misleading; the staff was recommending only that the next Article IV consultation with Jordan should be held one year hence, not that all consultations henceforth should be held on an annual cycle.

Mr. Finaish observed that the Jordanian authorities had found the staff's assessment to be on the pessimistic side, particularly regarding the medium-term prospects, and to have shown little appreciation of the adverse external changes that had recently taken place and over which the authorities had little control. Uncertainty about foreign aid and external grants had been a particularly important factor. The authorities had also felt that the staff report did not reflect an adequate recognition of the adjustment effort that had been undertaken.

The occupation of the West Bank since 1967 had affected Jordan's past economic performance and future potential, Mr. Finaish said. Jordan had become smaller in size, its resources had been reduced, and it had had to contend with an influx of new refugees. Other serious development constraints had also arisen from various implications of the generally unsettled security situation. Nevertheless, for the past ten years, Jordan had made effective use of external grants and foreign aid and had done well in terms of growth of output, inflation, and financial stability.

Flows of foreign exchange in the form of export receipts and remittances and grants from neighboring countries had fallen suddenly during 1983 and 1984, and the authorities had undertaken effective measures to counter the impact on the budget and the balance of payments.

Foreign budgetary assistance had declined from 22 percent of GDP in 1980 to less than 11 percent of GDP estimated for 1985, and the authorities had responded appropriately by reducing total spending and increasing domestic revenue, Mr. Finaish noted. Domestic revenue had increased from 23 percent of GDP in 1980 to 30 percent of GDP estimated for 1985, while total expenditure had dropped from 52 percent to 45 percent of GDP. The overall budget deficit, including grants, had declined by almost one half relative to GDP during the same period and was estimated to represent about 5 percent of GDP in 1985. Moreover, the authorities had largely succeeded in meeting current expenditure from domestic revenues. In 1981, domestic revenues had covered about 67 percent of current expenditures compared with about 95 percent estimated for 1985. Nevertheless, the authorities recognized that a more stringent adjustment effort was needed, particularly if recent trends continued.

Monetary policy had had two conflicting aims, Mr. Finaish remarked. On the one hand, monetary policy was designed to complement the tightened fiscal policy called for by the reduction of external flows. Thus, domestic liquidity expansion had been reduced substantially since 1980, from 27 percent to 20 percent, 19 percent, 15 percent, and finally 9 percent in 1984. On the other hand, and with nominal rates of growth of GDP of about 9 percent in 1983 and 6 percent in 1984, monetary policy was of course still mildly expansionary, because of the need to compensate for the absence of external stimuli to the economy and the emergence of recessionary conditions. On balance, monetary policy had become more and more restrictive, and inflation was less than 4 percent in Jordan.

There was no evidence that Jordan was veering away from a free, market-oriented economy, Mr. Finaish stated. The Jordanian economy was basically a liberal one; certain regulations that had been introduced were limited in scope and designed to meet specific ends. For example, there had been a surplus for some years of certain crops--such as tomatoes, eggplant, and cauliflower--which had not responded to market forces, and licensing requirements had been introduced. Increased demand for other crops, like wheat and potatoes, was being met through price incentives and demonstration projects to encourage production. In industry, regulations had been limited to offsetting the dumping by foreign producers of certain commodities; the infant-industry argument had been used to justify tariffs to protect certain new industries. All new restrictive measures were temporary, and the Government had been reviewing them with the intention of eliminating them and increasing liberalization.

Interest rate policy was flexible, despite the ceilings imposed on deposit and lending rates, and was based on two considerations, Mr. Finaish explained. On the one hand, the authorities sought to mobilize domestic resources and encourage savings; on the other hand, they wanted to avoid excessively high or fluctuating interest rates, particularly in the present recessionary conditions. If the cost of credit could be kept relatively stable and reasonable, the private sector would be encouraged to participate in the development process. In late 1983 and early 1984, the authorities had adjusted interest rates, which were at present 4-6 percent in real terms.

The exchange rate had depreciated on balance over the 1983-84 period in real terms, and the authorities saw no need to change the peg to the SDR, Mr. Finaish said. Wider margins were, however, being considered to increase exchange rate flexibility while maintaining a degree of relative stability, which was viewed by the authorities as a source of confidence in economic performance and hence as an important factor in attracting workers' remittances. The staff itself had not recommended any change in exchange rate policy other than to keep it under consideration.

Jordan was not likely to return to the high rates of growth of the 1970s, especially if the reduced stimulus from the external sector continued, Mr. Finaish suggested. Much would depend on the world economic situation in general and the regional outlook. Exports to oil exporting countries, and external receipts from them of remittances, grants, and aid were the crucial factors underlying any assessment of Jordan's medium-term prospects.

There was no guarantee that the expected increase in the demand for oil in the 1990s would materialize, Mr. Finaish remarked. However, Jordan's exports had recorded a substantial increase in 1984 following a successful export promotion effort by the authorities. Trade protocols had been concluded with Egypt and Ethiopia, and trade and credit facilities had been strengthened with Iraq. Together with the expected expansion in production capacity in certain major industries, such as phosphate and cement, the authorities foresaw good prospects.

It was not clear whether the 17 percent rise in workers' remittances in 1984 represented a trend or was merely an indication that some workers had returned to Jordan with their savings, Mr. Finaish observed. Although remittances were not likely to increase at such high rates in the near future, there was no reason to expect them to decline. Jordan was unique because it imported unskilled labor from certain countries--Egypt, India, Pakistan, and the Philippines--but exported skilled labor, mostly teachers and administrators, to the Gulf region. Thus, demand for skilled Jordanians was likely to sustain modest increases in remittances over the coming years, unless an improvement in the situation of oil exporting countries led to a surge in economic activity, in which case remittances would increase at higher rates. The Jordanian authorities had shown an ability and willingness to adjust to changes in external circumstances that they felt had not been sufficiently recognized.

The Jordanian authorities had stated their preference for Article IV consultations to be held every 18 months, Mr. Finaish noted. Jordan was not an extensive user of Fund resources and was not a problem country; therefore, he saw no specific reason for changing the consultation cycle from 18 months to 12 months.

The Chairman made the following summing up:

Executive Directors were in general agreement with the thrust of the appraisal in the staff report for the 1985 Article IV consultation with Jordan. They noted that Jordan had pursued prudent economic policies for many years and, as a result, had enjoyed a long period of rapid growth along with internal and external balance. They also noted that Jordan's economy had recently had to cope with the deterioration in the external economic environment, characterized by a fall in exports and a reduction in foreign grants. As a consequence, economic growth had slowed, and, despite adjustment measures, strong pressures on both the budget and the balance of payments had emerged. In view of those developments and the difficult medium-term balance of payments prospects, Directors emphasized the need for strong and comprehensive adjustment policies, which, some regretted, had not already been before them when they had approved Jordan's request for a drawing under the compensatory financing facility.

Directors commended the authorities for having kept budgetary expenditures virtually unchanged during 1983-84 and for having expanded domestic revenue at a rate exceeding that of GDP growth. Nevertheless, because of a shortfall in grants, the 1984 budget deficit had been larger than expected. Without further action, Directors added, the 1985 deficit could again exceed the budgeted level by a substantial margin and become unsustainable. Consequently, a determined policy of enhancing domestic revenues and constraining the growth of both current and capital expenditure was necessary over the medium term. Special reference was made to the need to eliminate the energy subsidy at an early date. Directors also pointed out that a budgetary reform aimed at consolidating central government accounts would facilitate the use of fiscal policy as a demand management tool.

Directors noted that during 1983-84, a relatively fast rate of growth in credit to the private sector had contributed to pressures on the balance of payments, and they therefore recommended a tightening of credit policy. They also urged the pursuit of a more flexible interest rate policy in order to improve resource allocation and encourage the holding of liquid assets denominated in Jordan dinars.

Concern was expressed regarding the recently introduced mandatory investment policies for commercial banks. Directors urged Jordan to uphold its traditional market-oriented policies in the domestic economy and in international trade and not to yield to economic pressures by expanding intervention in the economy through subsidies, regulations, or restrictive trade policies. Such measures would reduce the flexibility of the economy, impair its efficient operation, and adversely affect its growth potential and performance.

Directors noted that the medium-term outlook was for continued balance of payments pressures, despite a projected restrained import growth and a significant increase in exports. In view of those prospects and the recent decline in external reserves to a relatively low level, Directors thought that the authorities should give priority to improving the balance of payments and reducing the economy's dependence on foreign grants. The desirability of increasing the level of external reserves was noted. In addition to conducting a more active demand management policy, the authorities should keep the exchange rate under review and not hesitate to use the exchange rate as a policy tool.

Directors recommended that the next Article IV consultation with Jordan be held in approximately 12 months.

The Chairman, in response to Mr. Goos, said that as a matter of general policy, it made sense to include in staff reports any evaluation of a country's situation made between Article IV consultations, for instance, in connection with the use of Fund resources.

On the periodicity of Article IV consultations with Jordan, the Chairman noted that the reduction in grants and external aid was clearly complicating the management of the economy, which raised more problems than it had for many years in the past. Reserves had reached a fairly low level, and Jordan had made use of Fund resources. Thus, it seemed appropriate to hold the next Article IV consultation with Jordan within approximately 12 months instead of 18 months. In line with the procedures used in the recent request to the authorities of Luxembourg to lengthen the cycle to 24 months from 18 months, he suggested that the Board ask Mr. Finaish to make an appropriate request to his Jordanian authorities.

Mr. Dallara recalled that in January Executive Directors had had to assess Jordan's request for a compensatory financing purchase above 50 percent of quota in the absence of the more convenient framework of an arrangement in the upper credit tranches and the more comprehensive information provided by a staff report for an Article IV consultation. A judgment had had to be made based on the assumption that Jordan would be able to repay the Fund, use the resources in a manner consistent with the Fund's purposes, and meet the test of cooperation under the compensatory financing facility. Directors had supported the request because of the policies to which the Jordanian authorities had committed themselves, but the recent performance of the economy argued strongly in favor of shortening the consultation cycle to 12 months.

Mr. Polak said that as one who had supported Jordan's request for a compensatory financing drawing in January 1985, he had been disappointed by the information on the current status of the Jordanian economy. In the circumstances, holding the 1986 Article IV consultation one year from July 1985 might prove useful, even if it gave a signal that developments in the economy were of more concern than usual to the Board.

The Chairman observed that a 12-month interval before the 1986 Article IV consultation took place would be in accordance with previous Executive Board decisions on the requirements for cooperation under the compensatory financing facility. Even in the lower tranches, the criterion of cooperation implied a willingness to receive Fund missions; Jordan had drawn in the upper tranche, and its economic situation had deteriorated since the Executive Board had approved its use of Fund resources. Therefore, it seemed reasonable to hold the next consultation after 12 months, but not necessarily all subsequent consultations.

Mr. Finaish pointed out that the Jordanian authorities might interpret a shortening of the cycle as a sign that their adjustment efforts had been insufficient and that the Board felt that extremely difficult problems lay ahead of them.

The Chairman remarked that the summing up was not intended to give the impression that the Jordanian authorities' adjustment effort had fallen short of what had been planned; rather, it showed that despite certain actions, including limits on the growth of expenditure, there were indications that the 1985 budget situation would deteriorate, among other reasons, because of the possibility that external assistance might remain unchanged from the 1984 level. As a result, there was a desire to see Jordan embark on a more comprehensive adjustment program. The fact that the Board wanted to review the Jordanian economic situation in 12 months did not imply that Jordan had failed to live up to its undertakings; rather, the Board wished to assist Jordan in dealing with its difficult problems.

Mr. Finaish remarked that countries encountering the gravest of problems were discussed by the Board daily, without their economies' being singled out for closer and more frequent reviews. However, he believed that the Jordanian authorities would go along with the wishes of the Executive Board.

The Chairman proposed that the 1986 Article IV consultation should be held in one year's time.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Jordan, in the light of the 1985 Article IV consultation with Jordan conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Jordan continues to operate a liberal exchange system.

Decision No. 8012-(85/100), adopted
June 26, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/99 (6/21/85) and EBM/85/100 (6/26/85).

3. ASSISTANT TO EXECUTIVE DIRECTOR - RECLASSIFICATION OF SALARY

The Executive Board approves the reclassification of the salary of an Assistant to an Executive Director, effective as of the date of appointment, as set forth in EBAP/85/160 (6/19/85).

Adopted June 21, 1985

4. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 84/131 through 84/135 (EBD/85/148, 6/18/85) are approved.

Adopted June 24, 1985

b. The minutes of Executive Board Meetings 84/136 through 84/139 (EBD/85/150, 6/19/85) are approved.

Adopted June 25, 1985

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/162 (6/20/85) and EBAP/85/165 (6/24/85), and travel by an Advisor as set forth in EBAP/85/163 (6/21/85), is approved.

APPROVED: April 2, 1986

JOSEPH W. LANG, JR.
Acting Secretary