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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/24

10:00 a.m., February 15, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. Kone, Temporary
	L. E. J. M. Coene, Temporary
	X. Blandin
A. Donoso	
	M. K. Bush
	D. C. Templeman, Temporary
	J. C. Williams, Temporary
M. Finaish	
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	L. Leonard
	D. I. S. Shaw, Temporary
	G. W. K. Pickering, Temporary
	H. A. Arias, Temporary
	G. Grosche
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	S. El-Khouri, Temporary
	T. de Vries
	K. G. Morrell
	R. Bernardo, Temporary
	O. Kabbaj
	A. A. Agah, Temporary
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	A. Lindå
	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
S. J. Fennell, Assistant

Also Present

K. Hurst, Budget Director of the Ministry of Finance of Antigua and Barbuda; B. Legarda, Consultant. Asian Department: F. Le Gall, K. Saito, J. Schultz, D. A. Scott, S. Shah, X. Vongsathorn, M. Zavadjil. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitan, K. M. Meesook, W. S. Tseng. Fiscal Affairs Department: H. R. De Zoysa. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel; W. E. Holder, J. K. Oh. Middle Eastern Department: F. Drees. Research Department: E. A. Milne. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; K. Boese, D. S. Cutler, T. Leddy. Western Hemisphere Department: S. T. Beza, Associate Director; J.-P. Amselle, M. A. Da Costa, A. H. Gantt, M. C. Spinola, S. J. Stephens, J. E. Sundgren, G. L. Terrier, G. Yadav. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, C. J. Batliwalla, W. Moerke, G. E. L. Nguyen, Y. Okubo, I. R. Panday. Assistants to Executive Directors: J. Bulloch, M. Camara, R. J. J. Costa, I. Fridriksson, V. Govindarajan, D. Hammann, A. K. Juusela, H. Kobayashi, M. J. Kooymans, M. Rasyid, J. Reddy, D. S. Robinson, A. A. Scholten, S. Sornyanyontr.

1. THAILAND - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Thailand (SM/84/16, 1/12/84; and Cor. 1, 2/7/84), together with a proposed decision concluding the 1983 Article XIV consultation with Thailand. They also had before them a staff report on recent economic developments in Thailand (SM/84/31, 1/31/84; and Cor. 1, 2/7/84).

Mr. Ismael made the following statement:

The Thai economy in 1983 was characterized by a relatively high real growth rate, a continued reduction in inflation, a better than expected fiscal performance, and a widening external payments gap.

Following a marked slowdown in 1982 due to global recession, the Thai economy recovered gradually in the first half of 1983. This momentum strongly accelerated in the second half of the year, mostly as a result of stronger than expected private domestic demand associated with buoyant private fixed investment, replenishment of stock, and, to a lesser extent, increased consumption spending. Real growth for 1983 was 6 percent, up from 4.1 percent the previous year, while the rate of inflation declined from 5.2 percent to 3.8 percent. The slowdown in inflation, together with the improvement in the terms of trade, and the lower costs of energy and credit, were the major factors responsible for increased public confidence and the resultant acceleration of domestic demand.

The performance on the fiscal front was better than had been expected in April 1983. Restraint in expenditure growth, together with increases in nontax revenue, resulted in a fiscal deficit well below the estimated level.

Abundant liquidity in the banking system played an important role in the economic recovery in 1983. Historically high real interest rates generated strong growth in bank deposits throughout 1983. Inundated with this excess liquidity, the commercial banks were compelled to campaign actively to extend credit, especially to new customers in provincial areas. Since midyear, commercial bank credit expansion has become pronounced, reflecting the strong growth in demand.

In an effort to curb the credit expansion, the Bank of Thailand actively pursued a more restrictive monetary policy through net sales in the repurchase market and by tightening access to rediscount facilities. As bank liquidity tightened, the interest rates, which had been left largely to market forces, began to firm up gradually in the second half of the year. However, private credit expanded by 32 percent in 1983, compared with 17 percent the previous year.

Spurred by domestic economic recovery and an exceptionally poor export performance, the balance of payments position became the major source of concern to the authorities toward the end of 1983. Imports, partly stimulated by low import prices and speculative stock building associated with the currency value speculation, increased by 15 percent. This situation must, however, be viewed in a longer-term perspective. Since imports declined by 11 percent in 1982, the average import increase for both 1982 and 1983 remained within a reasonable magnitude.

In the view of my authorities, the deterioration in external payments was caused to a large degree by an exceptionally poor export performance, the value of exports having fallen by 6 percent. Protectionism severely strained exports in several key commodities.

Notwithstanding a sharp increase of 82 percent in net receipts in services and transfers, the current account deficit for 1983 widened to $2.3 billion, compared with the original target under the stand-by arrangement of $2 billion. As stated above, this unfavorable development has been a major concern in the formulation of subsequent economic and financial policies.

In the context of policy formulation and implementation, my authorities have reiterated their continued firm commitment to pursuing appropriate stabilization policies. In recent months, however, they have been confronted with unusual developments and uncertainties, while the choices and timing for appropriate policy action have been most difficult, given, among other things, the sensitivity of the political situation. But once the true nature of the situation has been ascertained, and the timing deemed appropriate, they normally proceed to take firm action forthwith.

Unsettled conditions in the financial market associated with finance companies in the third quarter of 1983 made it necessary for the authorities to be very cautious about taking measures to tighten the liquidity of the banking system. In these difficult circumstances, it was understandable that my authorities were preoccupied with the question of how to prevent the possible collapse of the financial system. However, in the meantime, while interest rates in the market began to shift upward, the Bank of Thailand took what action was deemed possible at the time, i.e., a restrictive stance relating to its repurchase and rediscount windows.

Subsequently, following the collapse of a number of finance companies and the launching of a rescue operation in the form of a "liquidity fund," my authorities moved swiftly and with great courage to implement a number of important demand management measures at the end of 1983 and in early 1984.

As for the problems in the fiscal area associated with increasing budget deficits after the second oil crisis, my authorities feel strongly that proper policy adjustments to improve the imbalances in the public sector resource gap are a necessary condition for sustained medium-term economic growth. Therefore, they recently undertook major policy decisions in five important areas.

The first was the revision of the public investment programs, which resulted in a reduction of total public investment outlays in the Fifth Plan by approximately $1.4 billion from the original figure of $6.7 billion. This policy was approved by the Cabinet in October 1983.

Second, as stated in the staff report on pages 18 and 22, a policy package to raise additional revenue in the order of B 9 billion, or 6 percent of current revenue on an annual basis, was implemented on November 29, 1983. As a result, the overall budget deficit will be reduced to 3.5 percent of GDP compared with 3.8 percent in the previous fiscal year. Efforts to improve tax administration have also been intensified, in accordance with a technical assistance program extended by the Fund.

Third, the proposals to streamline operations and improve the financial status of the state enterprises as indicated on page 19 of the staff report were accepted by the Cabinet on January 3, 1984.

Fourth, with regard to debt management, the Cabinet has decided to reduce the annual commitment ceiling from $2.6 billion, as stipulated in the Fifth Plan, to $2 billion. This measure is expected to alleviate the country's future debt burden to a certain extent.

Finally, it has always been the intention of my authorities to minimize the undesirable impact arising from budget deficits by proper means of financing. This strategy has proved to be extremely successful in that the proportion of budget deficits financed by the Government Savings Bank and the nonbank private sector has increased markedly.

Believing that fiscal discipline is a necessary condition for sustained medium-term economic growth without undue pressure on the external balance, the key government agencies in the recent budget-ceiling consultation agreed unanimously to pursue an austerity budget for fiscal year 1984/85. Apart from payments on debt service, expenditure is expected to remain constant in real terms. I would like to make an observation here that the Thai budget traditionally contains very little in the way of subsidies or entitlement payments, as indicated by a relatively low share of government expenditure in this category in relation to GDP.

In the monetary area, besides the increase in the bank rate, the restraints imposed on the repurchase market, and the freeze on import credit implemented in December 1983, the authorities have expanded and strengthened monetary control further by imposing severe restraints on the growth of bank credit to the private sector, as announced on January 19, 1984. Commercial banks were requested to limit private credit expansion to 9 percent within the first half of 1984 and to 18 percent for the year, compared with 32 percent in the previous year. It is also expected that the Bank of Thailand will shortly raise the ceiling on the loan rate of commercial banks from 17.5 percent to the original 19 percent. These measures are expected to contribute significantly to a better balance of payments outlook for 1984.

On the external side, my authorities are committed to continuing to keep a close surveillance on exchange rate developments. They feel that the competitiveness of Thai exports, assisted to a large degree by wage and price stability, is not a serious problem as long as there is an open market to operate in. At the same time, exchange rate stability is considered crucial for the maintenance of confidence and stability in the economic and financial system. The measure to stimulate the growth of supply in the forward exchange market as pointed out on page 20 of the staff report is intended to strengthen the forward market in the longer run and hence to enhance the authorities' capability of pursuing a more appropriate exchange rate policy.

Being mindful of the implications for developments in the balance of payments in the medium term, my authorities fully share the view of the staff and recognize the need to continue to use rigorous adjustment policies so as to achieve an overall balance of payments surplus at the earliest opportunity. The various measures recently implemented are a clear manifestation of such commitment and determination. Further intensification of the necessary adjustment measures will be rigorously pursued when appropriate.

The authorities would like to take this opportunity to thank the Fiscal Affairs Department, the IMF Institute, and the Bureau of Statistics for valuable technical assistance they have received for several years. They appreciate the active and constructive contribution of the staff to the implementation of their stabilization policies and look forward to continuing a close and cordial relationship with the staff. They are also deeply grateful for the strong support that the Fund has extended to them in the past few years, and they intend to continue a close cooperation with the Fund in the future.

Extending his statement, Mr. Ismael commented that he had been informed by his authorities that on February 11, 1984 the State Railway had raised its charges for the express and night services. The adjustments would yield additional revenues of about B 50 million for 1984 and B 30 million for the fiscal year ending September 30, 1984.

Mr. Hirao indicated his agreement with the staff appraisal and his support for the proposed decision. The Thai economy had expanded strongly in 1983, reflecting the rapid growth of domestic demand and private investment, while inflation, estimated at about 3.5 percent in 1983 in terms of the GDP deflator, had continued to abate. The authorities should be commended for the progress achieved thus far. However, there were several areas of potential weakness in the economy, especially on the external front, and the medium-term outlook for the balance of payments indicated a continued need for adjustment.

The overall fiscal deficit in 1983 was likely to be lower than envisaged, Mr. Hirao observed. Nevertheless, the stance of fiscal policy might have been somewhat expansionary, given the strong private demand and the pressing need to strengthen the balance of payments position. The authorities had rightly recognized that policy adjustments to improve the imbalances in the public sector resource gap were necessary to sustain economic growth over the medium term. The revised public investment program, approved in October 1983, was appropriate. On the revenue side, the elasticity of the tax system had eroded significantly in recent years. Increased efforts would be required to raise revenue through discretionary changes. The introduction of a new revenue package in November 1983, expected to reduce the overall budget deficit to 3.5 percent of GDP, was welcome. Furthermore, he was encouraged to note the vigorous efforts by the authorities to improve tax administration and collection. He hoped that the Fund's technical assistance in that area would prove beneficial in strengthening the tax system over the long term.

Given the sharp rise in gross fixed investment expenditure by public enterprises, Mr. Hirao continued, the authorities should aim to strengthen the profitability of those enterprises and to increase funds generated internally. The timely adjustment of service charges and fares should be encouraged, and he welcomed the information provided by Mr. Ismael. In view of the widening resource gap, the recent decision to reduce planned growth in investment expenditure was prudent and should help to strengthen the financial position of the public enterprise sector. The staff noted that statistics regarding public enterprises were not as reliable or as readily available as those in other parts of the public sector. He hoped that progress would be made in that area as part of the general proposals to streamline operations.

On monetary policy, domestic credit to the private sector had increased sharply in 1983, Mr. Hirao noted. The decision of the Bank of Thailand to shift to a more restrictive policy was appropriate and should help to reduce the pressure on the balance of payments. Acute liquidity shortages in certain nonbank financial institutions had prompted weaker monetary control. The recent amendment of legislation, including the strengthening of the supervisory authority of the Bank of Thailand and more comprehensive disclosure of the financial status of finance and securities companies, should be helpful in that respect. The authorities might also wish to exercise firm supervision over foreign borrowing by commercial banks.

As for exchange rate policy, the staff calculations indicated that the real effective rate had appreciated considerably in recent years, Mr. Hirao observed. The authorities would be well advised to keep the exchange rate policy under close review in order to avoid an erosion in the relative profitability of the export sector, and to take appropriate action whenever necessary. He noted with satisfaction that the Thai authorities continued to maintain an exchange rate system that was free of restrictions on payments and transfers for current international transactions.

Mr. Jayawardena stated that he welcomed the opportunity to discuss Thailand, particularly after the successful completion of the stand-by arrangement in 1983. Thailand had negotiated a two-year stand-by arrangement equivalent to 300 percent of quota in June 1981. That program, involving strong structural reforms in addition to the usual fiscal and credit restraint that was supportive of a program aimed at external stability, had been interrupted in 1981 and replaced by the recent one-year stand-by arrangement. Although he did not intend to understate the need for short-term adjustment, his authorities felt that Thailand's structural problems needed stronger emphasis and called for Fund support on an extended basis. However, during the one-year adjustment program, the authorities had tackled many structural problems and had obtained positive results. He was encouraged by their determination to continue to adjust.

Thailand was a remarkable country in that it had maintained a free economic system and had recorded annual economic growth rates of 7-8 percent at a time when the world economy had been in a recession, Mr. Jayawardena said. The achievements were particularly notable as Thailand was predominantly an agricultural country, subject to the vagaries of weather and the instability of prices for primary products. Thailand's performance reflected the innate dynamism of the economy, the incentive structure within the country, and the pragmatism with which the authorities had adopted the necessary policies.

After a long period of deteriorating terms of trade and an acceleration of inflation following the second oil shock, economic growth had slowed somewhat in 1981, Mr. Jayawardena commented. The balance of payments situation had deteriorated, and the authorities had requested Fund support. The performance criteria under the recent stand-by arrangement had been observed. The fiscal deficit had been reduced in 1983 to about the targeted level. Credit expansion to the Government had declined; with the strong recovery of domestic economic activity toward the second half of the year, however, private sector credit had grown much faster than expected. Consequently, the strong growth in domestic demand had affected exports and increased imports, and the objective of narrowing the balance of payments deficit had not been achieved. On the positive side, inflation had abated, largely owing to a decline in world inflation and improved domestic supply.

The principal question was whether Thailand could achieve a viable external position--namely, a current account deficit of 2.5 percent of GDP--by 1986, Mr. Jayawardena continued. According to the staff projections for 1984, the prospects for an improvement in the balance of payments were not good. Further policy measures would therefore be necessary, and he welcomed the measures being contemplated by the authorities as outlined by Mr. Ismael.

The somewhat relaxed monetary stance in 1983 had probably been the underlying cause of the economic difficulties emerging toward the end of that year, Mr. Jayawardena went on. Although the Bank of Thailand had taken strong measures to meet the expansion of bank credit, the unlimited freedom of commercial banks to borrow abroad for domestic lending had been detrimental. He was pleased that the authorities were addressing that problem.

In the fiscal area, he welcomed the restraint on expenditures, the mobilization of additional resources, and the improvement in the performance of parastatals, Mr. Jayawardena stated. It was difficult to pass judgment on the exchange rate policy, owing to the weaknesses inherent in calculations of the real effective rate for the baht. He was encouraged, however, by the authorities' intention to maintain a flexible policy in the future. The benefits of such a policy for the export-led growth strategy would be evident in the longer term. He was confident that a tighter monetary policy and a more cautious fiscal policy would help Thailand to achieve external viability by the mid-1980s. It would be remarkable if the authorities could achieve external viability while maintaining the high growth rates of the past, an achievement that was not beyond their capability. If the world economy recovered as anticipated, the turnaround of the Thai economy could be even faster.

As to structural aspects of the economy, Mr. Jayawardena observed, 70 percent of the population was employed in agriculture, which contributed only 20 percent of GDP. He wondered how income was distributed among the people; democracies such as Thailand should ensure that benefits of growth were shared equitably. It was an often held, although misguided, view that greater state intervention in production and marketing would help to redistribute income better. Reliance on efficient markets rather than on state monopolies would help more in that regard. He was encouraged that the Fund was discussing those issues with the authorities and that meaningful reforms had been instituted. Thailand had made much progress in that area under recent Fund arrangements. State interference in the marketing of goods did not help the poor to have higher incomes, except when the Government enforced floor prices. In Thailand, the large government marketing operations were geared toward maintaining floor prices.

On the fiscal front, he welcomed the streamlining of the tax administration, which would yield positive results in the longer term, Mr. Jayawardena considered. The Fund was discussing some budgetary procedures with the Thai authorities, including the practice of carrying over to the following year expenditures obligated the previous year. The authorities would be well advised to examine a number of other structural measures spelled out in detail in the staff paper on recent economic developments.

Mr. Templeman commended the authorities for having completed the stand-by arrangement successfully and for having met the performance criteria. Considerable progress had been made in several areas: a strong economic recovery had begun in 1983, inflation had been sharply reduced from the double-digit levels of 1980 and 1981, substantial progress had been made in reducing Thailand's dependence on imported oil, and the ratio of the overall public sector deficit to GDP had been significantly lower in 1983 than in 1982.

Nevertheless, some of the factors accounting for the improvements in 1983 had been temporary, Mr. Templeman observed, and there had been some slippage from earlier targets. Economic recovery had also resulted in some overheating of the economy; the deceleration of inflation had depended, in part, on a decline in import prices that might not continue and, in part, on an appreciation of the exchange rate that might undermine Thailand's competitive position. Moreover, the improvement in the budget reflected, to some extent, one-time revenue gains that would not be repeated. Furthermore, the target for the ratio of the current account deficit to GDP had been exceeded, and the medium-term outlook for the balance of payments gave cause for concern. Some commendable policy adjustments had been made toward the end of 1983 in the fiscal and monetary areas, but he was not sure that they would be sufficient to deal with the underlying problems.

Thailand had demonstrated an enviable record of real economic growth over the years, even in the recent past, when a number of developing countries had been forced to restrict growth sharply and some had experienced negative growth, Mr. Templeman commented. Thailand's investment rate had been quite high, and the business sector had responded to favorable investment conditions. Nevertheless, the authorities should guard against overheating of the economy; they must take steps to ensure that the growth of investments did not outpace the economy's ability to generate savings. In particular, the resource gap in the public sector, which had been high in 1980-83, was forecast to remain high in 1984, while private sector savings in 1984 were expected to be rather low by comparison. Although both the general government component and the public enterprise component of the public sector resource gap had tended to grow, public enterprises had experienced a notable increase in investment without a commensurate increase in internally generated financing. That circumstance pointed to the need for those enterprises to adjust their charges regularly both to improve their investment financing prospects and to help to assure a more efficient allocation of resources through realistic pricing. In that respect, he was encouraged by Mr. Ismael's announcement of an increase in railroad rates.

On the fiscal side, he welcomed the measures taken in November and commended the authorities for improving tax collection, Mr. Templeman continued. However, even if the ratio of the central government deficit to

GDP were reduced in 1984 from 4.4 percent, the figure originally expected, to 3.5 percent, it would remain high in terms of the demand management and balance of payments objectives. At the time of the previous Article IV discussion, concern had been expressed about the lack of buoyancy in Thailand's tax system. Could the staff give an assessment of the progress thus far in that area and an indication of what further steps might be introduced?

The restrictive monetary measures taken in December and January had gone in the right direction, though they might not have gone far enough, Mr. Templeman considered. The initial assessment that the rapid rise in credit to the private sector had mainly reflected the absorption of some informal financial markets into the banking system seemed to be an insufficient explanation for the excessive credit growth.

With respect to the balance of payments, the failure to reach the current account target in 1983--owing to poor real export growth and an increase in imports--raised questions about the medium-term outlook for achieving a sustainable external position and for meeting the debt service burden without difficulty, Mr. Templeman remarked. He was concerned about Thailand's competitiveness, particularly regarding nontraditional exports such as manufactures, given the real effective appreciation of the baht since July 1981, when it had been pegged to the dollar. The faster rate of growth of exports prior to 1981 suggested that there would be potential for export growth with the expansion of the world recovery.

Prices of some energy products had been cut in March and December 1983, Mr. Templeman noted. Did the staff believe that Thailand's energy pricing policy was still consistent with its balance of payments objectives? Hitherto, Thailand had been able to avoid the severe foreign debt problems that had confronted a number of developing countries. Although the debt service ratio had already risen to more than 20 percent--compared with an average in 1976-79 of 14 percent--and the staff projected a ratio of about 25 percent by 1985-86, it was not too late to take steps to avoid a further worsening of the situation.

Thailand, like a number of countries, had allowed its borrowing arrangement with the Fund to expire, Mr. Templeman observed. It was appropriate for member countries to adjust their economies so that financial support from the Fund would no longer be required. However, countries that did so should have reached a sustainable balance of payments position, or they should continue to pursue the adjustment efforts with perseverance so as to achieve that objective as promptly as possible. In that respect, he welcomed Mr. Ismael's assurances that the Thai authorities intended to continue cooperating closely with the Fund.

Mr. Shaw stated that the authorities had made some progress toward economic adjustment over the past year, and he commended them for meeting the performance criteria under the stand-by arrangement. He supported the decision and agreed with the staff appraisal.

On the positive side, the authorities had achieved a growth rate of 6 percent and had reduced inflation to 3.8 percent, as opposed to the targeted 6 percent, Mr. Shaw observed. However, the slowdown in inflation had been due to some inappropriate policy actions.

On the negative side, he was concerned about three areas of the economy, Mr. Shaw indicated. First, regarding fiscal policy, the budget deficit target of 3.5 percent of GDP had not been reached, and it would be reached only in 1984. Although he commended the authorities for the fiscal adjustment, further action would be required. Second, the current account deficit of the balance of payments was a cause for concern. Third, as other Directors had noted, the growth of domestic credit had exceeded the targets for 1983.

The deterioration in the external current account was a disturbing development, Mr. Shaw stated. Recent data suggested that the deficit might be as high as $2.9 billion, as opposed to the $1.8 billion calculated by the staff. Could the staff comment on that issue? The strong upsurge in domestic demand--including the strong recovery in investment expenditure, particularly by the private sector--which had been unmatched by growth in domestic savings, had been a major factor in that deterioration. Furthermore, the worsening trade imbalance raised questions about the appropriateness of the exchange rate. The substantial real effective appreciation of the baht over the past few years appeared to have encouraged the shift of goods from foreign markets to the domestic market and to have contributed to real income gains as a result of lower import prices. Although the fiscal and monetary measures taken recently by the authorities represented an appropriate response to the upsurge in domestic demand and credit, further action would be necessary, particularly with respect to the exchange rate, if the medium-term objectives were to be achieved.

The growing central government deficit had contributed to the deterioration of the external position, Mr. Shaw went on, and he was concerned that a fall in capital expenditure and a substantial rise in current expenditures had accompanied that increasing deficit. While he welcomed the authorities' commitment as indicated in Mr. Ismael's statement and the new revenue measures and expenditure cuts, he urged the authorities to make further expenditure cuts. He had reservations about further reductions in domestic oil prices. Admittedly, the lower cost of oil imports in the past had reflected a strengthening exchange rate. However, the appropriateness of the exchange rate was the important factor; when the exchange rate was overvalued and there was a substantial fall in exports and a strong growth in imports--only partly as a result of the economic recovery--a downward adjustment in oil prices would be inappropriate. Moreover, in order to encourage energy conservation and to increase revenues, the maintenance of higher oil prices seemed to be justified.

The reduction in export duties on rice was appropriate, despite the need for government revenue, Mr. Shaw considered. Could an alternative source of revenue be found to replace the 1.5 percent of government revenue derived from export taxes, in view of the need to encourage exports?

As for the public sector, he shared the staff's concern about the need to improve the monitoring and control of public enterprise investment and to increase the proportion of investment financed externally, Mr. Shaw indicated. The growing debt service ratio was worrying.

He welcomed the recent measures to tighten monetary policy, Mr. Shaw stated, although the authorities would need to monitor the situation closely to ensure adequate restraint on domestic demand. The authorities should be commended for reducing inflation, but inflationary pressures could re-emerge unless demand were restrained. Particular attention should be directed to that policy area, should the need for external adjustment lead to a more flexible exchange rate policy. In conclusion, he encouraged the authorities to continue with the adjustment program.

Mr. Zhang noted that since the mid-1970s Thailand had experienced rapid growth in real GDP, coupled with a deceleration in inflation. That favorable trend had continued in 1983, as reflected in the increase in GDP of 6 percent and in the cost of living of only 3.8 percent. Both consumption and investment had been buoyant. As a result of restraint in expenditure growth and increases in nontax revenues, a smaller than estimated budget deficit had been achieved. Public confidence in the economy had been restored.

Those achievements reflected successful government policy, Mr. Zhang considered. The Fifth National Economic and Social Development Plan for 1981/82-1985/86 contained stabilization, structural adjustment, and economic development objectives. The realization of the objectives during 1983 had been greatly facilitated by the stand-by arrangement with the Fund as well as the structural adjustment loan from the World Bank. The performance criteria under the stand-by arrangement had been met.

Recognizing the need to continue their efforts in connection with demand management both in 1984 and in the medium term, the Thai authorities had decided to take additional fiscal and monetary measures, Mr. Zhang observed. In the fiscal area, they would introduce an austerity budget in 1984/85. To support that move, they had recently undertaken new measures to curtail public investment expenditure, increase current revenue, streamline the financial operations of the state enterprises, reduce external borrowing, and engage in noninflationary financing of the budget deficit. They would also introduce a more restrictive monetary policy in 1984. During recent months, the Bank of Thailand had increased its rate of interest, and rates for commercial loans had also been raised. Restrictions had been introduced in the repurchase market, import credits had been frozen, and the rate of expansion of commercial bank credit to the private sector had been restricted.

In marked contrast to the overall favorable developments in the domestic economy, the external sector had begun to show some signs of deterioration in late 1982 and had worsened significantly by the end of 1983, Mr. Zhang considered. Under the Fifth Plan, the authorities intended to develop a strong export sector and to pursue an export-led growth strategy. The Plan also included various export-promotion measures. When drawing up the Fifth Plan, however, the authorities had not foreseen the timing or intensity of the present world recession, nor had they anticipated the shift in international capital markets that had emerged in mid-1982. In fact, the deterioration in the trade account had been attributable only in part to the increase in imports resulting from the recovery of domestic demand and from the speculative inventory accumulation. The deterioration had been caused principally by an exceptionally poor export performance, reflecting both slow recovery in the world economy and the increase in protectionism by some of Thailand's major trading partners.

There was broad agreement between the staff and the Thai authorities in the assessment of policy impact and future policy directions, Mr. Zhang observed. But a consensus seemed to be lacking with respect to two aspects of the external sector, namely, the external debt and the exchange rate. As for the external debt problem, he agreed with the staff that it would be prudent to avoid further net use of external resources by the commercial banks. Although the staff stated in SM/84/16 that exchange rate developments had impeded external adjustment and that greater use of exchange rate policy for the purpose of achieving such adjustment would be appropriate, it did not elaborate on the policy content, nor did it indicate whether the staff had discussed any specific recommendations with the authorities. There had not been any apparent serious distortion in the price-cost structure in Thailand, and the recent unfavorable balance of payments experience could not be easily attributed to the domestic price factor; what kind of exchange rate policy adjustment did the staff have in mind?

The baht was estimated to have appreciated by 9-13 percent, and the staff had concluded that "there has been a more pronounced appreciation since 1976-78," Mr. Zhang noted. How had the staff computed that appreciation? Would the results be significantly different if different weightings or other price indices were used? Was that figure acceptable to the Thai authorities, and did the staff intend to recommend a devaluation on the basis of its calculation? If so, what did the staff think would be the effect of such a devaluation? Would it affect primarily demand or supply? Had the staff undertaken any statistical analysis of actual market fluctuations in the demand for and the supply of the major exports and imports under restriction? As neighboring countries exported many similar commodities, would a devaluation stimulating Thai exports not provoke competitive devaluations by those competitors? He would be grateful if the staff could clarify those points. In conclusion, he supported the proposed decision.

Mr. Grosche recalled that Mr. Ismael and the staff had identified the rapid rise of domestic demand--and, hence, the increase in imports--as a major cause for concern. Together with a poor export performance, that rise had led to a substantial increase in the current account deficit, which, in turn, had added to the external debt burden. The authorities had to face the difficult task of improving the internal and external imbalances without harming the favorable growth performance of the economy.

To that end, it was important that the large gap between receipts and expenditures be reduced. Mr. Ismael had informed the Executive Board that the Government had approved a package of measures to reduce total public investment outlays substantially, to increase revenues, and to improve tax administration. He hoped that the investment cuts would affect the least productive projects first. He welcomed the close monitoring of the financial position of the public enterprises to ensure an appropriate balance between investments and available savings. Those combined actions should help the authorities to achieve a more balanced budget; but further measures were certainly needed to achieve, and then consolidate, progress in public sector finances.

As for monetary policy, he welcomed the recent steps taken to curb credit expansion and to reduce some of the excess liquidity, Mr. Grosche continued. The expansionary course initiated in 1982 had contributed to the rise in demand. A reorientation of monetary policy was essential, not only to prevent inflation from increasing again, but also to improve the current account.

On exchange rate policy, the pegging of the baht to the U.S. dollar had led to a substantial revaluation, Mr. Grosche observed. While Mr. Ismael's statement that his authorities were committed to monitoring exchange rate developments closely was welcome, he had not conveyed the impression that his authorities were convinced by the staff's arguments concerning a loss of competitiveness by Thailand since 1978. The authorities should reconsider their policy stance; a flexible exchange rate policy would be more responsive to actual developments in the balance of payments. Finally, he commended the authorities for maintaining an external payments system that was virtually free of restrictions on payments and transfers.

Mr. Clark stated that he endorsed the staff appraisal. Like other Directors, he had some concerns regarding the results under the previous stand-by arrangement. The quantitative performance criteria had been met, although there had been a midterm waiver; real GDP had increased by 6 percent; inflation had remained low. But in terms of one of the fundamental objectives of the program--the restoration of a viable external position--the program had not been successful. Even if the program objectives had been achieved, there would still be the prospect of some strain on external financing during 1984-86 as previous loans from the Fund matured. That strain was reflected in the relatively high, although still manageable, debt service ratio. He fully endorsed the staff view that the authorities' principal aim must be to achieve a sufficient balance of payments surplus to avoid the need for further net borrowing from the commercial market. To bring about such a surplus on the overall balance, a substantial improvement in the balance of trade would be required.

Balance of payments pressures had been substantially increased in 1983 by the resurgence of domestic demand, led by private and public sector investment and supported by large domestic credit expansion and foreign borrowing, Mr. Clark commented. He therefore welcomed the authorities' reappraisal of the public investment program and the measures taken in December 1983 and January 1984 to curb credit expansion. He was surprised that investment remained so buoyant when real interest rates were well over 10 percent. How far had investment demand been influenced by other factors, such as tax concessions available from the Board of Investment?

Since mid-1981, the baht had been effectively pegged to the dollar and, as a consequence, had appreciated substantially, Mr. Clark observed. At the same time, export performance had been poor, and imports had increased rapidly. As the staff had pointed out, historical evidence indicated that Thai exports were responsive to changes in the exchange rate. The extent of the recent speculation against the baht suggested the need for a reappraisal of the exchange rate. Additionally, as noted by Mr. Ismael, the expected depreciation seemed to have been a factor in the recent large increase in imports. In the circumstances, he shared the staff view that a more flexible exchange rate policy was necessary to support both the objectives of the Fifth Plan--to encourage a strong export sector and export-led growth--and the objectives of the second structural adjustment loan from the World Bank.

Mr. El-Khouri indicated his agreement with the thrust of the staff analysis and his support for the proposed decision. The authorities were to be commended for the successful completion of the 1983 stand-by arrangement with the Fund. All the quantitative performance criteria had been observed, but observance of performance criteria did not necessarily lead to a realization of the targets of the program. In Thailand, the output and inflation targets had been achieved; however, the balance of payments situation had worsened considerably, owing, in part, to factors beyond the authorities' control.

The external payments position was expected to remain under strain in the medium term, Mr. El-Khouri observed. The staff had projected that the current account deficit would be well above the target of the Fifth Plan. The ratio of debt service to current account receipts was expected to rise to 25 percent during 1984-86, with repayments to the Fund also increasing considerably. The authorities should therefore pursue a strong adjustment effort.

On fiscal policy, there was a need to contain both the budget deficit and the extent of its financing from the domestic banking system, Mr. El-Khouri considered. He welcomed the package of corrective measures adopted in November 1983 to raise revenue and reduce expenditure under the 1983/84 budget. They should help to contain the nominal budget deficit to approximately the same level as in the previous year. He welcomed the authorities' intention to continue their efforts to strengthen tax administration and collection procedures. The technical assistance provided by the Fund had been valuable in that respect.

He commended the authorities for scaling down investment expenditures by public enterprises in 1984, Mr. El-Khouri went on. The gap between public enterprise investment and internal savings should not be allowed to increase, so as to reduce the need for external financing and domestic budgetary support. He was encouraged by Mr. Ismael's statement that the Thai Cabinet had recently accepted proposals to reform the public enterprise sector.

As for monetary policy, high positive real interest rates had not dampened the demand for credit by the private sector, Mr. El-Khouri remarked. The open economy and the resulting capital flows had greatly complicated the implementation of monetary policy. The measures taken by the authorities in late 1983 and early 1984 to limit bank credit for non-oil import financing and to raise the requirement ratio of holdings of government securities to bank deposits should help in the stabilization efforts.

On the external side, he welcomed the authorities' indication that a strong export sector and an export-led growth strategy remained fundamental objectives of their development plan, Mr. El-Khouri commented. A healthy export performance was essential for the achievement of a sustainable balance of payments position in the framework of growth-oriented objectives. The exchange rate should be kept under close review to ensure that competitiveness was maintained. Finally, he commended the authorities for meeting all the terms under the two structural adjustment loans from the World Bank.

Mr. Bernardo stated that he was in broad agreement with the staff appraisal. The vigorous rebound in domestic demand, led by private investment during the second half of 1983, had not been anticipated at the time of the Executive Board's previous discussion on Thailand in June 1983. At that time, Directors had agreed with the staff that the proposed increases in credit ceilings would not jeopardize the achievement of the inflation and balance of payments objectives of the adjustment program. The staff had also held the view that prevailing high interest rates had deterred the recovery, and had urged the authorities to reduce nominal interest rates. In fact, demand had grown by 10 percent in 1983, inducing a sharp expansion of imports by 15 percent, with volume of non-oil imports rising by 29 percent. At the same time, exports had declined; despite an unanticipated increase in workers' remittances of $450 million, the current account deficit had increased from $1 billion in 1982 to an estimated $1.9 billion in 1983, in excess of the revised target of $1.6 billion.

With the benefit of hindsight, it was tempting to conclude that the relaxation of credit ceilings in the second half of 1983 and the reduction in interest rates might not have been necessary to activate demand, Mr. Bernardo said. It might even be concluded that had interest rates been reduced further, the benefits of a much larger inflow of workers' remittances might not have been realized; the current account deficit would have been substantially larger than targeted.

Overall, the adjustment program had been a success, Mr. Bernardo noted. The key short-term policy objective of containing the growth of the external deficit, while encouraging investment and economic activity to return to more normal levels, had been achieved. He welcomed the authorities' determination to build on those gains by continuing to pursue prudent financial management policies over the medium term.

Thailand's external situation was not serious compared with that of many other developing countries, Mr. Bernardo observed. There was room for adjustment without sacrificing the growth and industrialization objectives, even in the short term.

As for monetary policy, he welcomed the authorities' intention to implement a package of measures to tighten liquidity, including measures already taken to stem bank credit growth and plans to raise the primary reserve requirement and control the foreign liabilities of commercial banks, Mr. Bernardo went on. He appreciated the difficulties of the Bank of Thailand in tightening credit at a time when there was a need to direct additional liquidity to distressed financial institutions. He was confident that the authorities would take firm action.

In the fiscal area, he shared the staff's view that the public sector deficit of 4.4 percent of GDP, financed largely by the banking system, was not consistent with the need to moderate domestic demand, Mr. Bernardo continued. Recent action taken to reduce deficits was welcome, and, although the medium-term strategy to strengthen tax administration and tax collection procedures was appropriate, he encouraged the authorities to move further in that direction.

The authorities' adherence to an exchange system free of restrictions on payments and transfers was commendable, Mr. Bernardo commented. The trade-weighted exchange rate had appreciated by about 9 percent between July 1981 and September 1983, and by 17 percent between 1976-78 and September 1983. It was therefore appropriate for the authorities to keep the exchange rate policy under review. The baht had been a stable currency over the past thirty years, having moved only from 21 bahts to the dollar in 1951 to 23 bahts to the dollar currently. There would be benefits in maintaining that stability. Only recently had the stability of the exchange rate contributed to the control of inflation and the recovery in private investment through the reduction of import prices.

The elimination of fiscal burdens on important export sectors was welcome, Mr. Bernardo said; it would be useful to determine the impact of those measures on cost structure and competitiveness at the industry level before exchange rate action was taken. The staff indicated that a large part of the marked appreciation in the export-weighted exchange rate of the baht in 1983 could be attributed to the depreciation of the Indonesian rupiah against the dollar. However, Indonesia competed with Thailand mainly in the markets for rice, rubber, tin, and tapioca--basic commodities whose prices were given largely in dollar terms. Therefore, there would be little immediate gain in Thailand's competitiveness through a depreciation.

Moreover, many export items--including tapioca, textiles, and garments--were impeded not by a lack of competitiveness but by noncompetitiveness, as evidenced by the existence of quotas and other import restrictions. Could the staff comment further on the exchange rate?

The most optimistic medium-term scenario for the balance of payments and external debt prospects indicated that a sustainable position could be achieved, Mr. Bernardo noted. The total debt service burden of Thailand would reach 25 percent in 1985, not a large ratio in comparison with other developing countries. Nevertheless, the authorities would be well advised to limit the growth of external debt beyond that figure. The cumulative overall balance of payments deficit of $350 million in 1984-86 was financeable through the banking system; recourse to additional short-term borrowing would not be necessary. Finally, with the authorities' commitment to rigorous adjustment, economic growth could continue in spite of the external strains.

Mr. Coene remarked that new imbalances were emerging in the Thai economy, mainly because of a strong surge in private investment as a result of a restoration of confidence brought about by price stability and economic recovery in some of Thailand's major trading partners. The previous stand-by arrangement had been successful in rebuilding confidence in the economy. The growth of investment, however, had not been matched by increased domestic savings; consequently, the rapid expansion of credit to the private sector had contributed to the deterioration of the balance of payments. Such a development was a cause for concern since Thailand would already experience a large debt service burden in 1985/86. At present, the external debt structure--with medium-term and long-term debt making up 80 percent of the total--did seem sound.

Thailand was faced with the urgent problem of adjusting its domestic economy in order to improve its external position, Mr. Coene observed. The authorities had two options as a means of achieving their objective: either they could restrain domestic demand at the prevailing exchange rate through restrictive budgetary and monetary policies with a view to generating domestic savings, particularly in the public sector, or they could adjust the exchange rate, thereby restricting domestic demand through a change in relative prices. Those options were not mutually exclusive, and a combination of the two could be implemented, although the repercussions on inflation and economic activity would be different. It was not clear which strategy the authorities intended to pursue. He had the impression that they would place emphasis on fiscal policy adjustments. The staff apparently favored a combined approach, namely, an improved fiscal position that would generate the higher domestic savings necessary to finance the surge in private investment, and also an exchange rate adjustment that would shift incentives from the domestic market to exports. He shared the staff's view on the need to improve the fiscal balance. However, some more detailed analysis of the medium-term forecast of the balance of payments would have been useful to show more clearly the implications of an exchange rate adjustment for the external balance and the adjustment process.

The assumptions on which the staff had based its medium-term projections of the balance of payments in Table 6 of SM/84/16 were unclear, Mr. Coene went on. It appeared from the current account projections that no exchange rate adjustment would be required, as the current account deficit would stabilize and the overall balance of payments would show a surplus by 1987. Some additional explanation was warranted. Nevertheless, he agreed that some emphasis should be placed on increasing economic activity in the export sector. Indeed, although part of the appreciation of the baht had been neutralized by the reduction of export taxes, even exports not subject to export taxes had become much less competitive. Moreover, a larger debt service burden could be alleviated by higher exports. In sum, although he agreed with the staff's view, the case for an exchange rate adjustment could have been better documented, particularly as the authorities did not seem to share fully the staff's view on that issue.

Thailand's problem of external imbalance stemmed primarily from the de facto peg of the baht to the dollar, although formally the baht was pegged to a currency basket, Mr. Coene observed. Had any consideration been given to a different exchange rate policy?

Monetary policy should be strengthened, and the Bank of Thailand needed to use more effective instruments to monitor liquidity, Mr. Coene commented. The containment of the demand for credit within available resources required an effective monetary policy, which could not be achieved while commercial banks were able to circumvent the restrictions on domestic liquidity by building up foreign liabilities. Some action in that regard would be necessary, in addition to more effective supervision of the banking system. The Thai authorities were facing the consequences of an oversuccessful Fund-supported adjustment policy. They should strengthen their control over the economy and bring about internal and external equilibrium.

Mr. de Vries stated that he had been impressed by the growth rate achieved by the Thai authorities and by the reduction in inflation during a period when the international climate had not been accommodating. There were some weaknesses, although they stemmed from the achievement of buoyant private investment, one of the authorities' objectives. Total domestic savings had been insufficient to match the high investment ratio of about 25 percent of GDP. Furthermore, there had been a rapid increase in M-2, and the waiver agreed by the Executive Board had allowed further credit expansion.

The budget deficit had been reduced to 3.8 percent of GDP, rather than the target of 3.5 percent of GDP, because private investment had been more buoyant than expected, Mr. de Vries observed. In order to get the budget back on track, public enterprises would have to finance a much larger share of their own investment than the one third financed in recent years. He welcomed Mr. Ismael's announcement that tariffs for some enterprises would be increased, which should help to increase the self-financing of the public enterprises.

With respect to monetary policy, the authorities had been restricted by the difficulties in some nonbank financial institutions, Mr. de Vries remarked. Rapid liquidity creation had contributed to the unexpectedly high level of private investment. He wondered, with the benefit of hindsight, whether it had been appropriate for the Executive Board to grant the waiver on domestic credit expansion. Could the staff indicate its views on that issue? In any event, it was clear that the authorities should pursue a stricter monetary policy.

He wondered why a number of Directors had urged the authorities to change their exchange rate policy, Mr. de Vries went on. Exports from Thailand had been steadily increasing since 1975. The problem seemed to be on the import side; domestic adjustment should therefore be pursued in order to achieve a sustainable balance of payments position. While he agreed with much of Mr. Coene's intervention, he disagreed that the authorities had two alternatives to deal with the resource gap between savings and investment. Although the authorities would have to decide between increasing savings or reducing investment, there was no clear choice between restraining domestic demand and increasing savings or adjusting the exchange rate. The present situation did not call for a change in exchange rate policy, and the authorities were not in favor of such action. Instead, they intended to take further measures to restrain domestic demand.

Mr. Agah observed that the main targets of the Thai Development Plan--the restoration of domestic and external financial stability, and an improved quality of life, especially of the rural population--had been pursued since mid-1981 under stand-by arrangements with the Fund. The most recent stand-by arrangement had been generally satisfactory, particularly with respect to growth and inflation.

While he commended the authorities for having observed all the performance criteria under the adjustment program, Mr. Agah pointed out that Thailand, being an open economy, remained vulnerable to external factors. He thereore urged the authorities to continue pursuing the present economic and financial policies and implementing the same appropriate and well-planned measures. Mr. Ismael, in his statement, had indicated the commitment of the Thai authorities in that respect.

On the external side, the three major areas of concern identified by the staff were poor export performance in the medium term, relatively high domestic demand, and the poor outlook for external financing on favorable terms and the large obligations due to the Fund in 1985 and 1986, Mr. Agah went on. However, the adjustment policies under the Fifth Plan aimed at achieving a strong export sector. The authorities considered that a stable exchange rate was of first priority in order to maintain confidence in the economic and financial systems; and they continued to keep exchange rate policy under close surveillance. Their commitment to achieving an overall balance of payments surplus in the medium term was evident from the various measures recently implemented in line with the staff's suggestions.

As for fiscal policy, the authorities were implementing appropriate adjustment measures to diminish the imbalances in the public sector, Mr. Agah commented. Mr. Ismael had indicated that the authorities had recently undertaken major policy discussions in five areas of fiscal policy; he had also announced that additional measures would be taken. The Government's decision to pursue an austerity budget in fiscal year 1984/85 in an effort to sustain medium-term economic growth, while avoiding undue pressure on the external balance, was welcome.

With respect to monetary policy, the authorities had imposed restrictions on the growth of bank credit to the private sector in order to expand and strengthen the Government's control over liquidity, Mr. Agah observed. Finally, he could support the proposed decision.

The staff representative from the Asian Department, describing the general environment within which the consultation discussions had been conducted in October 1983, said that there had been political changes in the Government at the end of April 1983. Associated with changes in the Constitution, which had also become effective early in 1983, the political changes had resulted in new and not yet fully defined relationships between the Thai military and the Government. Additionally, 1982 had been a year of adverse economic growth, an unusual development in Thailand that had been a source of deep concern to the authorities. At the time of the April discussion, there had been few signs of an important upturn in demand and output. Consequently, the acceleration in domestic demand in the third quarter of 1983 had been initially greeted with relief, rather than with the anxiety that the staff, with hindsight, now considered more appropriate.

In August-September 1983, the staff representative recalled, the monetary authorities also had been confronted with unsettled conditions in certain nonbank financial institutions, which had diverted attention from macroeconomic issues. The medium-term projections presented in the staff papers had been prepared by the Thai authorities based on the stance of policies at that time. Those projections reflected the emerging awareness of the strong growth of domestic demand and the absence of a consensus on the appropriate policy response. The staff had stated in SM/84/16 that the current account deficit in 1983 would probably be considerably larger than estimated, perhaps about \$2.3 billion, with an overall deficit of \$0.6 billion. The World Bank staff, recently returned from Bangkok, had confirmed that the Thai authorities considered that a \$2.3 billion deficit on current account would be likely, although some agencies in Government had estimated a deficit as high as \$2.7 billon.

In sum, the staff discussions with the Thai authorities had taken place during a period of rapid change away from economic trends that had troubled the authorities, the staff representative explained. A consensus on the degree and direction of those changes had been difficult to reach. Furthermore, it was not the nature of the Thai political process to decide immediately on an appropriate course of action. The authorities frequently took several months to reach a consensus on important policy adjustments.

Partly for this reason, Thailand needed to maintain a strong reserve position and could not afford to permit the burden of debt service to reach levels that might require prompt and substantial policy adjustments should the economy be faced with an unexpected adverse development.

At the time of the consultation discussions, the staff had been concerned about the stance of fiscal policy in 1983/84, in view of the prospective large deficit and the rapid expansion of private sector credit, the staff representative went on. The authorities had also been troubled about fiscal policy, but there had been less consensus on the degree to which private sector credit had been expanding. The authorities estimated that total credit to the private sector had increased by 32 percent in the year ended December 1983, reflecting a marked acceleration compared with the 20 percent increase in the year ended June 1983. In view of the severe problems regarding nonbank financial institutions, and the abruptness of the strong growth in private capital demand, the authorities had felt that it would be inappropriate to adjust credit policy in November 1983.

The authorities and the staff had agreed on the medium-term outlook for Thailand based on the stance of policies at the time of the discussions, the staff representative remarked. That outlook, which did not make allowance for the expected wider current account deficit of $2.3 billion that seemed likely to emerge in 1983, was presented in Table 6 in the staff report. That outlook was troublesome partly because of the lower export growth and higher current account deficit, which meant that the burden of debt servicing through 1986 would be greater than projected earlier. Also, the combined effect of the overall deficit currently projected and the large repurchases due to the Fund would necessitate substantial borrowing from commercial banks by the monetary authorities if excessive recourse to short-term financing by commercial banks were to be avoided.

As for exchange rate policy, the authorities attached great value to maintaining a stable exchange rate vis-à-vis the U.S. dollar and a relatively open economy, the staff representative indicated. Furthermore, they hoped to avoid an excessive accumulation of external debt and to achieve a strong export sector. The authorities hoped that, by adopting markedly more restrictive demand management policies, they would reduce the immediate causes of excessive pressure on the balance of payments.

The staff's judgment on the exchange rate policy had been based on the adverse balance of payments trends already evident in October-November 1983 and the less favorable medium-term outlook, the staff representative went on. The staff had also examined movements in the effective exchange rate index both since July 1981 and over a much longer period: those indices indicated a substantial effective strengthening of the baht, a development that was at variance with the need to strengthen export performance. Further, real wages had risen in Thailand during 1979-81, so that costs in manufacturing industries might have risen more rapidly than the consumer price index. The Bank of Thailand had used different calculations to determine changes in the effective exchange rate index, which showed a lesser increase. The trade-off between further intensification of the demand management policies and the adjustment of the exchange rate would be closely reviewed by the authorities after sufficient time had elapsed to assess the impact of recent policy adjustments.

As for fiscal policy, the staff representative explained, the present development plan had been formulated during a period of higher rates of inflation and a more optimistic outlook regarding the growth of revenues. However, since 1981 revenues had grown more slowly than expected, and the authorities had had to accept a more restrained growth in expenditure, which had not been easy. On the revenue side, in addition to the introduction of annual tax packages, the authorities had been trying to improve tax administration. The staff was optimistic that progress was being made, but a strengthening of the revenue system was a long, slow task. In the meantime, an increasing burden of fiscal adjustment would have to fall on curtailing the growth in expenditure.

On the expenditure side, the staff representative remarked, the authorities had undertaken a comprehensive review of the performance of public enterprises. The slower than projected growth in demand for electricity would permit some phasing out of capital investment in the power sector. More generally, the recently completed review of the Fifth Plan had resulted in important recommendations for broad rephasing of capital spending as indicated in Mr. Ismael's buff statement.

Energy policies were generally consistent with the needs for external adjustment, the staff representative continued. Not only had the increase in the international price for oil been passed through to the domestic markets, but the authorities had increased the tax burden on imported petroleum products from an average of 18 percent in 1978 to about 20 percent at present. In March 1983, the reduction in domestic retail prices of energy products had been only about one third of the lower price of crude oil. In December 1983, the reduction in domestic retail prices of energy products had been only about one third of the lower price of crude oil. In December 1983, prices of certain products had been reduced to improve the relative price structure and, in addition, excise taxes had been increased. In effect, some of the financial resources accruing to the Oil Fund--a form of tax not included in the budget--had been transferred through an excise tax increase to the central government budget. Although the Oil Fund continued to accumulate a surplus, it amounted to only about B 50 million a month. The staff generally approved of the authorities' energy pricing policies, although reservations had been expressed about the desirability of overall price reductions recently adopted.

Commenting on whether the staff had been mistaken in modifying the credit ceilings under the stand-by arrangement in June, the staff representative stated that, on balance, that modification appeared to have been correct. In April 1983, there had been no sign of either an emerging strong recovery in private sector demand or increasing investment activity. The Fund would have been perceived as being inflexible if it had not modified the ceilings, especially in view of the then favorable outlook for the balance of payments, which could have made the subsequent discussions with the authorities more difficult. It was most important to consider at present whether the authorities had responded appropriately to the more recent developments regarding private sector demand. The recent measures indicated a strong commitment to imposing demand restraint and to improving the external position. The impact of those adjustments on the balance of payments should be evaluated.

Responding to a question by Mr. El-Khouri, the staff representative from the Asian Department remarked that one important reason why the current account position of the balance of payments had turned out to be less favorable than expected was the poor export performance of the category of "other" goods. It was also true that the rapid credit expansion and the strong growth in imports had caused part of the deterioration in the balance of payments. Furthermore, there had been substantial speculation during August-December 1983 on the exchange rate, as evidenced by the premium on the dollar in the forward market. Additionally, the restocking of inventories, which had been reduced in 1982, was another form of speculation that was closely related to credit expansion and import growth.

The Chairman said that it was evident that the staff was more concerned about the poor performance of exports recorded in 1983--particularly the nontraditional exports--than about the increase of imports.

The staff representative from the Asian Department commented that the growth of Thai exports had been most impressive during the period when the U.S. dollar had been weakening. After 1978, Thai export growth had slackened considerably. In the past six years, many other countries of East and Southeast Asia had pursued a more vigorous diversification into manufactured exports than Thailand. It was essential for the authorities to increase the strength of the export sector.

Mr. Ismael observed that the staff report indicated that the baht had appreciated substantially by 9-13 percent. Calcuations by the Thai authorities, however, showed an appreciation of only 3-5 percent. The difference was mainly due to the different currencies and weights employed in the calculations. The Thai authorities were reviewing the composition of the basket and the weight of each currency in the basket.

The Chairman made the following summing up:

Directors were in general agreement with the thrust of the views expressed in the staff appraisal for the 1983 Article IV consultation with Thailand. Directors were impressed by the strong rebound in economic activity and the 6 percent growth rate achieved in 1983, following a marked slowdown in 1982, although they noted that nearly all the stimulus had come from the strong growth in domestic demand. The further slowing of inflation in 1983 and the moderation of minimum wage increases were particularly welcome, but it was observed that a fall in import prices and the appreciation of the exchange rate had been some of the factors in moderating price pressures. The strong growth in domestic demand contributed to a sharp rise in the deficit on external current account to a level considerably above that expected in June 1983.

Directors commented favorably on the lower than expected fiscal deficit in 1982/83 and the much lower than planned recourse to bank financing. However, Directors expressed concern about the sharp increase in the budget deficit for the current fiscal year, which was estimated to reach B 46 billion or 4.4 percent of GDP at the time of the consultation discussions. They were also troubled by the planned sharp rise in new investment by public enterprises. Most Directors agreed with the staff view that both the projected budget deficit and the planned level of new investment by public enterprises would be incompatible with the need to redress the widened external payments imbalance.

Directors noted with concern the sharp expansion in money and credit during 1983. Although part of the expansion was a result of the quickened absorption of informal financial markets into the banking system, it was also associated with the strong growth in domestic demand. Therefore, Directors supported the view that greater credit restraint, including firmer control over the foreign liabilities of commercial banks, would be required.

Directors commended the authorities for the openness of the exchange and trade regime in Thailand. They noted that the exchange rate of the baht had remained fixed to the U.S. dollar since July 1981, despite the pronounced strengthening of the dollar vis-à-vis most currencies. In view of the weakness of the balance of payments position and the need to give priority to external adjustment by strengthening export growth, Directors urged the authorities to keep the exchange rate policy under close review in order to avoid any erosion in external competitiveness and to take action when necessary.

The medium-term outlook for the balance of payments, external debt, and debt servicing was also cause for concern. In this regard, Directors endorsed the staff view that Thailand should aim at a sufficiently strong balance of payments position to enable the monetary authority to meet obligations to the Fund without sustained recourse to commercial borrowings from abroad. Given the magnitude of the debt service obligations over the medium term, the payments position should also be strong enough to avoid a further increase in short-term foreign borrowing by commercial banks on a sustained basis, other than for trade-related purposes.

Directors noted that subsequent to the consultation discussions the authorities had implemented a number of fiscal and monetary policy adjustments to moderate the strong growth in domestic demand. In particular, they stressed that the adoption of a tax package, together with efforts to curtail expenditure, would make an important contribution to a more appropriate budgetary stance in the current fiscal year. They also commended the reduction in planned investment expenditure of public enterprises and welcomed the stepped-up efforts to adjust their tariffs and to improve their operational efficiency, statistical reporting, and budgeting procedures.

Some concern was expressed by a number of Directors on the recent retail price reductions in oil products. The recent shift to a stance of credit restraint, supported by measures to increase interest rates, reduce bank liquidity, and to limit private credit expansion of commercial banks, was highly appropriate. Nonetheless, a number of Directors felt that further policy adjustments were needed, particularly to enhance domestic savings, to restore the historic role of exports as a source of domestic growth, and to strengthen the balance of payments, if the principal objectives of the medium-term strategy were to be realized.

It is expected that the next Article IV consultation with Thailand will be held on a 12-month cycle.

The Executive Board took the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Thailand, in the light of the 1983 Article IV consultation with Thailand conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Thailand continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 7627-(84/24), adopted
February 15, 1984

2. ANTIGUA AND BARBUDA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Antigua and Barbuda (SM/84/13, 1/11/84). They also had before them a report on recent economic developments in Antigua and Barbuda (SM/84/19, 1/19/84; and Cor. 1, 2/1/84).

Mr. Keith Hurst, Budget Director of the Ministry of Finance of Antigua and Barbuda, was present at the meeting.

Mr. Leonard made the following statement:

The Executive Board last discussed the economy of Antigua and Barbuda on April 30, 1982, when the staff report for the 1982 Article IV consultation was presented. At that time, the economy had entered a period of difficultuy that has since continued. The attention of the Board centered on the following: the slowdown in the rate of growth and the widening deficit in the current account of the balance of payments, the overall public sector deficit and factors underlying it, the need for balanced diversification of economic activity, the provision of adequate economic infrastructure and training as part of the development effort, and the operation of monetary policy. Problems in these areas continue to have the attention of the authorities.

In the period leading up to the recent consultations, factory closures and the shrinkage of manufacturing output tended to pull down overall growth, as did declines in construction and trade. Fortunately, the agricultural sector maintained its recovery and tourism showed a sharp upturn, which, together with buoyancy in other areas, resulted in an estimated growth of GDP in 1983 which, though less than in 1982, was still positive.

The current balance of the Central Government in 1983 moved more deeply into deficit for the third successive year, and the consolidated figures for the overall public sector show a similar movement, with a decline from a surplus of EC$5.7 million in the current account in 1981 to deficits of EC$2.7 million in 1982 and an estimated EC$11.2 million in 1983. Figures for current and capital spending both for the Central Government and the consolidated public sector show a somewhat brighter picture. For the Central Government, the overall deficit improved significantly in 1983 as a result of a fall in capital expenditure from the high 1982 level, and the overall public sector figures also narrowed for the same reason. As a proportion of GDP, the consolidated deficit, after rising to 12.5 percent in 1982, fell to 8 percent in 1983. Despite this fall, the continuing fiscal imbalances remain a source of concern to the authorities.

About 30 percent of the overall deficit in 1982 was financed by a buildup of arrears, over three quarters of which were due to foreign creditors. In 1983, the buildup of arrears accounted for 67 percent of the financing, and almost all were due externally. The accrual of substantial arrears to domestic creditors has been avoided by various ad hoc arrangements, as outlined on page 6 of the staff report.

By reason of the high unemployment rate, the lack of job opportunities in the private sector, and the role of the Government in making good the shortfall in some part, the public sector pay bill has been a substantial factor in the deterioration of public finances. It continues to be a source of concern, but there are indications that, in addition to the number of permanent civil servants being kept stable, the recruitment of temporary workers is leveling off. The authorities appreciate that the extent to which employment can be provided in the public sector is severely constrained; as signaled in the staff report, they intend to pursue a tough line on pay increases for all central government employees through 1985 and have indicated that recruitment policy will also be directed to curbing the growth of the pay bill.

The rate of rise in consumer prices has continued to slow and for 1983 dropped to an estimated 2.6 percent. The real effective exchange rate has risen, but not by as much as in other islands of the East Caribbean. The divergence is probably a factor in the revival of tourism in the island in spite of a sharp rise in hotel rates. Second, the deficit in the current external account after stabilizing in 1982 further improved in 1983, when it fell to 12 percent of GDP. This fall came about as a result of higher receipts from tourism and reduced imports consequent on the contraction of investment.

The trend in the overall external deficit continued to rise mainly because of a fall in net official capital receipts and private capital flows. The deficit amounted to about 5 percent of GDP in 1983 and was largely financed by the accumulation of arrears in payments of interest and principal on external borrowing already referred to.

The staff report identifies pay restraint in the public and private sectors as a first requirement in putting the economy on a sound basis for balanced growth. In particular, the report argues that, as long as changes in the parity of the currency are precluded for institutional reasons, the tight containment of wage increases--in addition to being necessary for balancing the public finances--is required to promote the price competitiveness of goods and services. The staff also urges immediate action to turn around fiscal trends by cutting back public expenditure and raising revenue. As part of this effort, the staff proposes that the private sector be used to the maximum extent to provide employment. The reform of administrative procedures and the abandonment of present ad hoc arrangements in tax collection and expenditure payments would be further integral elements of the process. Finally, the staff see the overhang of debt and accumulated arrears as a serious threat to a return to good fiscal order. They, therefore, advise the authorities to renegotiate their obligations to creditors and to agree on a mechanism to deal with arrears.

The authorities in Antigua and Barbuda accept the importance of pay restraint as a policy element in the future management of the economy. They are not convinced, however, that price competitiveness was a major factor accounting for the falloff in manufacturing exports in 1983; in their view, changes in the external trading environment were more important. Also, while the authorities do not regard as unreasonable the broad trends in the medium-term outlook for the balance of payments as depicted in Table 6 of SM/84/13, they would expect the overall external deficit to narrow more quickly than projected. In this connection, they point to the possibility of slowing down imports over the period of the projection through tax measures affecting consumption. They also regard the estimate of private capital inflows in 1984 as unduly low and in practice would expect the rising trend shown in Table 16 to start from a higher base.

Apart from the reservations listed, the authorities agree with the staff analysis and the thrust of the staff's recommendations. Preparation of the 1984/85 budget is under way. It is understood from recent discussions with officials of the Ministry of Finance that the budget will address the need for reducing the current deficit. A range of possible expenditure cuts and tax increases is being explored, and related measures are being drawn up. It is considered, however, that, with the prospect of elections later in 1984, the scope for extensive action is necessarily limited in the short term and is more likely to be fully dealt with in the postelection period. The authorities are also of the view that if private investment is to be encouraged and the burden of providing employment taken over by the private sector, the infrastructural needs of the economy cannot be overlooked and, to the maximum extent possible, must be provided for within the framework of the budget.

The Government is giving its attention to the staff's recommendations on renegotiating obligations to creditors and on reaching agreement with them on the handling of arrears; its decisions on these matters have yet to be indicated.

Finally, I have been asked by my authorities in Antigua and Barbuda to say that they value the comments and advice offered by the Fund in the course of these consultations. They greatly appreciate the spirit in which the talks were conducted and look forward to future good relations with the Fund.

Extending his statement, Mr. Leonard commented that the Government of Antigua and Barbuda had agreed to take measures to raise revenues and reduce expenditures, and also to deal with arrears and the country's obligations to creditors.

Mr. Clark commended the authorities for having taken action in November 1983 to accept the obligations of Article VIII. Antigua and Barbuda was one of the more open economies of the Caribbean, but the authorities' action in other policy areas had not been completely appropriate. The staff and the authorities agreed on the need to reduce the internal and external imbalances of the economy. However, the authorities' policy responses thus far did not seem to be sufficient to deal with the situation. While he could understand the authorities' reluctance to adopt unpopular policies in advance of the elections, it was clear that the delay would worsen the primary problem, that of the fiscal deficit. Furthermore, in some respects, there could hardly be a better time for taking tough action on wages and taxes, as inflation was only 2.5 percent.

He was encouraged by Mr. Leonard's statement that the 1984/85 budget would aim at reducing the current account deficit, Mr. Clark went on. Tax reform was long overdue, and he hoped the authorities would implement some of the staff's recommendations regarding new sources of revenues. He also urged them to take measures to rationalize revenue collection and control systems. On the expenditure side, cautious evaluation of capital projects remained essential. Could the World Bank play a role in that context, especially in relation to the larger-scale projects?

There was an urgent need to gain control of wages, Mr. Clark considered. Several key wage contracts were to be negotiated in 1984 and 1985, and he hoped that the authorities would base their stance in those negotiations more closely on the underlying competitive position of the economy. That task would not be easy, especially following the surprising 40 percent increases granted to public sector employees in 1983. Could the staff or Mr. Leonard comment on the rationale for such a large increase after two years of inflation at substantially less than 5 percent?

The need for early and decisive action on fiscal and wage policy was heightened by the authorities' reluctance to consider a change in the parity of the East Caribbean dollar, Mr. Clark commented. An inflexible exchange rate distorted resource allocation and entailed more severe and costly domestic policies than would otherwise be needed. While he recognized that the real effective exchange rate for Antigua and Barbuda had appreciated much less than for other members of the East Caribbean Currency Area (ECCA), he nevertheless supported the staff in urging the authorities to review with other members of the ECCA their current exchange rate policy. In view of the different objectives and constraints of those members, it might be difficult to reach a consensus. He therefore felt that a joint Article IV consultation among the Caribbean islands might be helpful. Did the staff consider that such a procedure was more feasible now that the ECCA had been converted into a central bank? Finally, he could accept the staff suggestion that the next Article IV consultation should be held before June 1985. However, if the economy continued to deteriorate, a degree of flexibility on the timing might be valuable.

Mr. Arias remarked that the economic situation in Antigua and Barbuda was better than the staff had indicated in its paper. First, there had been an improvement in both private and national savings since 1979. Although the staff had not provided any specific reasons for that improvement, he suspected that the competitive attitude of the commercial banks in raising time deposit rates had helped to maintain and even increase domestic savings. Second, there had been consistent improvement in the terms of trade over the past few years. Third, the authorities had pursued a firm price policy; consequently, inflation had slowed to a rate below that of world inflation.

Nevertheless, the problems of an economy excessively dependent on tourist earnings could not be minimized, Mr. Arias considered. The proportion of tourist receipts in foreign exchange earnings had increased from 52 percent in 1980 to 70 percent in 1983, an outcome that seemed unfavorable in terms of a diversification of export earnings. Could the staff elaborate on that point?

There had been an improvement in the public sector deficit in 1983, despite some reduction in current revenues, Mr. Arias observed. Unfortunately, most of that improvement had been caused by a sharp decline in capital expenditures, which might jeopardize future growth. Nevertheless, the present deficit was too high and needed to be reduced further. He was encouraged to hear from Mr. Leonard that the authorities were taking action to limit current expenditures, particularly by controlling the public wage bill more tightly. He agreed with the staff that revenues and expenditures should be centralized. A better monitoring of the tax system and an improvement in administrative procedures were essential.

Wages policy was appropriate, Mr. Arias considered. The present system of adjusting wages every three years permitted long-term planning and increased labor security. Inflation rates were low, and there was no reason to change wage policy. As for price competitiveness, the appreciation in the real effective exchange rate of Antigua and Barbuda by less than 1 percentage point in 1983 indicated that no change in overall policy was necessary.

Mr. de Vries said that he agreed with the staff appraisal. The primary problem facing the authorities was with respect to the budget deficit. He was also concerned about the accumulation of arrears by the Government, particularly, to its domestic creditors. External arrears were accumulating at an annual rate of 5 percent of GDP, and had reached 12 percent of GDP. The external situation needed to be dealt with immediately.

The large wage increases were worrying, particularly given the relative price stability in Antigua and Barbuda, Mr. de Vries went on. Despite the low inflation, he was concerned about the difficulty in adapting the exchange rate of the East Caribbean dollar. A number of countries in the region were experiencing problems with respect to the exchange rate, and he therefore encouraged the authorities to reach a consensus on adjusting the rate. He supported Mr. Clark's suggestion of a joint consultation with members of the ECCA. Furthermore, he shared Mr. Clark's view that there should be a careful evaluation of investment projects, perhaps with the assistance of the World Bank.

Mr. Donoso recalled that the external environment had not been helpful to Antigua and Barbuda in recent years. The fiscal imbalances in the economy were the major cause of the difficult payments position faced by the authorities. Although they were aware of the need for action on the fiscal side, there seemed to be some divergence of view between the staff and the authorities on the magnitude and the pace of the adjustment required. He recognized the difficulty of raising taxes in an election year, but wondered how long the current situation could be maintained without strong fiscal measures to reduce expenditures or to increase revenues. In view of the country's high debt service ratio, action was urgently required.

On the expenditure side, Mr. Donoso remarked, he agreed with the need for trade unions to moderate wage demands. The growth of real wages over the past three years in both the private and public sectors had not only eroded external competitiveness but had also contributed to the increase in demand for imports, which was unsustainable with the present exchange rate. In view of Antigua and Barbuda's membership in the ECCA, the task of adjustment should center on demand management. He therefore supported a restrictive wage policy to encourage wage moderation in the private sector and to improve the fiscal situation.

With respect to the public investment program, the completed feasibility study for the Deep Bay Complex had not yet been reviewed by the World Bank, Mr. Donoso observed. Could the staff or Mr. Leonard provide some information on that issue? Did the staff consider it feasible to postpone some of the large projects under way until the fiscal situation improved or until adequate sources of foreign financing became available?

As for domestic credit developments, he encouraged the continuation of the present interest rate policy, as it contributed to an efficient allocation of financial resources while reducing pressures on the balance of payments, Mr. Donoso concluded. Private capital flows were not contributing to the extent expected to reducing the balance of payments deficit. In spite of increased receipts from tourism, the overall deficit had risen steadily over the past three years to about 5 percent of GDP in 1983. The domestic interest rate structure was reasonably competitive; therefore, behavior of capital flows could not be attributed to interest rate differentials. However, the large fiscal imbalances could have exerted adverse effects on private expectations; if they had indeed done so, there was an urgent need for action on the fiscal side to avoid a further deterioration in the balance of payments. In conclusion, the authorities should not delay implementing the necessary measures in order to restore fiscal equilibrium and external competitiveness.

Mr. Williams indicated his agreement with the staff appraisal and with the comments of other Directors. He had two questions. First, with respect to the exchange rate, Table 5 of SM/84/13, which compared the comparative index of real effective exchange rates of the ECCA members, revealed that developments in the real effective exchange rate had been most favorable in Antigua and Barbuda compared with those in other countries of the ECCA. However, the staff had mentioned that there might have been a more serious erosion of the real effective exchange rate for Antigua and Barbuda than indicated by those figures. Did that imply that exchange rate developments in other members of the ECCA had also been worse than indicated in Table 5? If so, the exchange rate policies of the ECCA should be re-examined. In that context, could the staff comment on the need to examine more closely the exchange rate of Antigua and Barbuda? Second, could the staff comment on the discussions between the World Bank and the authorities on investment priorities? He thought that the World Bank had commented not favorably on the investment priorities of the authorities.

The staff representative from the Western Hemisphere Department commented that Antigua and Barbuda had a strong comparative advantage in tourism. The tourist facilities on the islands were good, and there was an international airport. It has been difficult to develop a productive export-oriented agricultural sector owing to problems related, in particular, to land tenure. Agricultural production, primarily of vegetables, was directed toward domestic markets. It would appear that tourism would remain as important, or even more important, in the economy. Most investment in infrastructure was geared to tourism, including the Deep Bay Project.

After the recent donors' meeting, the authorities were revising the Deep Bay Project, the staff representative indicated. The authorities were meeting with creditors to determine the best way to proceed with the project. The staff believed that, given the weak financial and fiscal situation, the financing of any investment projects should not rely on commercial borrowing.

The deterioration of the balance of payments reflected changes in the capital account--namely, capital inflows and imports--the staff representative remarked. The deficit had grown because of an increase in arrears, which were included below the line. Tables 4 and 6 of SM/84/13 indicated that a further deterioration in the deficit would be caused primarily by an increase in arrears. Arrangements were currently being worked out with creditors to reschedule payments of those arrears or to eliminate outstanding indebtedness by liquidating some government assets, including counterpart deposits held abroad.

Prices were determined to a large extent by external pressures, because of the openness of the economy, the staff representative indicated. Costs had increased mainly as a result of wage settlements. The recent increase in wages in two major public enterprises--of the order of about 40 percent for a three-year period--reflected a drag in wage negotiations. Now that the rate of inflation had come down substantially, wage increases would undoubtedly put pressures on costs.

With respect to the question on the different computations of competitiveness, the staff representative from the Western Hemisphere Department stated that the staff had examined the effect of the exchange rate on prices, rather than on costs. If costs had been used in the computations, the results might not have been as favorable as indicated in Table 5 of SM/84/13. The East Caribbean Central Bank was engaged in a study to consider the use of other factors in the computation of indices of the real effective exchange rate.

The Deputy Director of the Exchange and Trade Relations Department commented that the staff had at different times in the past considered the possibility of having a joint consultation with members of the ECCA to discuss such issues as exchange rates, interest rates, and exchange controls. Although there were positive features of a joint consultation, there were also problems. First, the fiscal and wage situations in each of the countries would have to be examined on a case-by-case basis, especially since those policies would affect the exchange rate policy. Second, the staff requirements for a joint consultation would be considerable; in the past, priority had been given to holding Article IV consultations on a regular cycle and monitoring closely the adjustment programs. In sum, the staff had not thus far considered a joint consultation to be practical. However, the East Caribbean Central Bank was studying the exchange rate policy of members, and the Fund staff was providing support.

Mr. Leonard said that the authorities recognized that the fiscal situation had deteriorated, and that corrective action was needed. In fact, they had already taken some action, and they had agreed on further measures to be introduced. However, the authorities had to consider political and social factors in deciding on an appropriate time for them to proceed. The deterioration in the fiscal situation had come about, in part, because of high unemployment, the need to invest in infrastructure, and the desire to provide health and education services.

While the authorities recognized that corrective measures were needed, they did not wish to change the direction of policy too suddenly, as so doing could undermine the confidence of the community, Mr. Leonard continued. They therefore considered that a less rapid turnaround was warranted; they wished to begin the adjustment from a strong political position, with the elections behind them. Nevertheless, he would convey Executive Directors' concerns about the need for early action to his authorities.

As for future borrowing by the Government, Mr. Leonard went on, Mr. Marshall, at a meeting of the Caribbean Group for Cooperation and Economic Development, had indicated the Government's intention to exercise greater prudence in undertaking future investment, while avoiding stagnation in development. Borrowed funds would be sought only for viable and self-liquidating projects. Furthermore, the terms of such loans should be concessional.

The Deep Bay Project had been suspended, although the authorities were still discussing the project with the Banco Central do Brasil, Mr. Leonard explained. A feasibility study had been prepared, but the authorities had not yet finished their thinking on it.

The Chairman made the following summing up:

> Directors were in general agreement with the thrust of the staff appraisal. They welcomed the favorable results with respect to savings and inflation. Concern was expressed, however, at the deteriorating fiscal situation, which had been manifested in a rapid accumulation of arrears of payments to local and foreign creditors, as well as at the size of recent wage settlements in the public sector. These developments, together with the continued appreciation of the East Caribbean dollar, posed problems for the competitiveness of the region.
>
> Directors were of the view that rapid and effective action, including a tight rein on the size of the public sector wage bill, was required to bring about a much needed improvement in the public finances. Directors thought that under present fiscal conditions a close and cautious review of public expenditures was called for. Some Directors felt that the World Bank could play a very useful role in this regard.
>
> In view of the recent trend in wages within the economy as a whole, and the need to enhance the country's export performance and competitiveness, several Directors urged the authorities to review the exchange rate policy together with the other members of the East Caribbean Central Bank.
>
> It was recognized that the magnitude of the external debt and the accumulated arrears of debt-service payments posed a special problem. The authorities were urged to take the necessary steps to deal with the existing payments arrears, to be very cautious in relying on commercial borrowing, and to set up an effective system to manage external debt operations.
>
> It is expected that the next Article IV consultation with Antigua and Barbuda will be held before June 1985.

3. TRANSFERABILITY OF CLAIMS UNDER GENERAL ARRANGEMENTS TO BORROW, AND UNDER BORROWING AGREEMENT WITH SAUDI ARABIA

The Executive Directors considered staff papers on transferability of claims under the General Arrangements to Borrow (EBS/84/17, 1/20/84), and on the transferability of claims of Saudi Arabia under its borrowing agreement associated with the General Arrangements to Borrow (EBS/84/18, 1/20/84).

The Counsellor stated that the two decisions included in the staff papers had been drafted on the assumption that Switzerland would become a participant in the General Arrangements to Borrow (GAB). The Swiss National Bank was expected to deposit its instrument of participation within the next four weeks or, in any event, before the Interim Committee meeting. There were no outstanding claims under any of the agreements, so that there was no operational urgency to hold up acceptance of the decisions. However, the decisions would become effective only after Switzerland became a participant in the GAB. If there were an unexpected delay in Switzerland's participation and if there were outstanding claims under the GAB, the Executive Board could reconsider the issue and take a decision that would not depend on the participation of the Swiss National Bank.

Mr. Nimatallah indicated his support for the proposed decision on the transferability of claims by Saudi Arabia under the borrowing agreement associated with the GAB. As the staff pointed out, it was standard Fund practice to determine in advance the criteria on which lenders might transfer claims on the Fund. The establishment of those criteria enhanced the liquidity of lenders' claims, and it made lending to the Fund a more attractive proposition. Furthermore, the conditions proposed by the staff for a possible transfer by Saudi Arabia were in line with those normally applied by the Fund. It was appropriate--as Saudi Arabia's borrowing agreement was associated with the GAB--to include the simplified criteria that would apply for future transfers of claims under the GAB.

With respect to the transferability of GAB claims, it was necessary to amend the 1979 decision in view of the fact that the Swiss National Bank would shortly become a full participant, Mr. Nimatallah went on. The recent reforms of the GAB also provided an appropriate opportunity to simplify the conditions for transferring GAB claims among participants. He welcomed the staff's assurance that the new provisions would be sufficient to protect the Fund's liquidity position. Furthermore, the Fund would retain the authority to approve other transfers on an ad hoc basis, which provided an important element of flexibility for both the Fund and the GAB participants.

Mr. Pickering commented that the revisions of the GAB in 1983 had necessitated an updating of the Executive Board's decision. He welcomed the staff's suggestion for simplifying the criteria governing transfers. He fully supported the draft decisions with regard to both the transferability of GAB claims and the transferability of Saudi Arabia's claims under its associated borrowing arrangement with the GAB.

Mr. Tvedt observed that the proposed decision on transferability of claims under the GAB differed only slightly from the existing one, and that the changes proposed reflected mainly the fact that the Swiss National Bank would become a full participant. He agreed that the transferability of claims should be based on the transferee's balance of payments and exchange reserve strength rather than on the existing "net creditor" criterion. With respect to the transferability of claims of Saudi Arabia, the scope of transferability was somewhat wider than in the case of claims under the GAB. Finally, he could support both the proposed decisions.

Mr. Grosche remarked that the proposed amendments updated and simplified the criteria governing the transfer of claims under the GAB and were therefore welcome. Those changes might have positive effects on the Fund's liquidity, as they would tend to enhance the transferability of GAB claims. He fully supported both the proposed decisions.

Mr. Clark indicated his agreement with the draft decisions. It seemed sensible to incorporate the Swiss National Bank as a full participant in the GAB with minimal disturbance to the existing arrangements, and the proposals with respect to the lending agreement with Saudi Arabia seemed a logical extension of that principle.

He could also support the amendment that would update and simplify the criteria governing the transfer of claims, Mr. Clark stated. However, regarding the criterion of sufficient exchange reserve strength, he suggested that that reserve strength should be expected to continue for the foreseeable future, a criterion that was used to identify the currencies of members that would be included in the operational budget. That practice might also be adopted under the transfer of GAB claims. Finally, it was envisaged that the simplified criteria for transferability would become standard for future borrowing arrangements between the Fund and members. Could the staff clarify whether the transferability provisions applying to claims outstanding under existing non-GAB borrowing agreements would remain unchanged or whether they would be adjusted along the lines proposed in the staff papers?

The Counsellor remarked that the staff intended to use the same criterion for the transferability of claims under the GAB as that used to determine which members' currencies could be used in the operational budget. The staff had eliminated the words "in the foreseeable future" from the earlier decision, because the time horizon would be the three months for which the operational budget was determined.

Mr. Clark observed that on page 4 of EBS/83/259 the staff had stated that "in connection with the transferability of certain loan claims on the Fund, the relevant borrowing agreements referred to a member's currency being usable in the opinion of the Fund in net sales in the Fund's currency budget for the foreseeable future." Could that kind of provision be extended to cover the claims arising under the GAB?

The Chairman commented that the clause "for the foreseeable future" was used for determining the strength of balance of payments in the framework of existing borrowing arrangements. Mr. Clark was asking whether that method should be used to determine the transferability of claims under the GAB. Such a clause would not be easy to implement, as it would require a delicate judgment to be made on the durability of the strength of the balance of payments position of members.

The Counsellor noted that Mr. Clark was concerned about an issue of uniformity; nonetheless, if the term "foreseeable future" were eliminated in the proposed decisions on transferability of claims under the GAB, then it should also be dropped from other existing decisions. There was a question of legality regarding that proposal.

The Deputy General Counsel remarked that to include "for the foreseeable future" in the decision would imply that the Fund would make a decision on a transferee's balance of payments position on a case-by-case basis, which would run counter to the objective of simplifying and standardizing the criteria for transferability.

It was the staff's intention to introduce the new simplified criteria into future borrowing agreements, but the staff had not formed a view on how the members with existing agreements other than the GAB would be treated, the Deputy General Counsel indicated. The staff wished to see the reaction of the Executive Directors to the criteria, before considering whether to make any proposal for extending it to existing agreements.

Mr. de Vries said that he was concerned about one phrase on page 3 of EBS/84/17, which stated that "a participant would only need to refer to the current list." The operational budget was drawn up quarterly and circulated in advance of its adoption by the Board. How would the staff deal with the situation in which a country on the current list of the operational budget had been dropped from the list being circulated to Executive Directors?

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/23 (2/13/84) and EBM/84/24 (2/15/84).

4. APPROVAL OF MINUTES

a. The minutes of Executive Board Meeting 83/111 are approved. (EBD/84/24, Sup. 1, 2/3/84)

Adopted February 14, 1984

b. The minutes of Executive Board Meetings 83/117 and 83/119 are approved. (EBD/84/39, 2/8/84)

Adopted February 14, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/33 (2/10/84), and by Advisors to Executive Directors as set forth in EBAP/84/33 (2/10/84), is approved.

APPROVED: August 6, 1984

JOSEPH W. LANG, JR.
Acting Secretary