

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/38

3:00 p.m., March 9, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors

A. Alfidja

A. Donoso

T. Hirao
J. E. Ismael
R. K. Joyce

G. Laske
G. Lovato

G. Salehkhov

J. Tvedt
N. Wicks
Zhang Z.

Alternate Executive Directors

G. Ercel, Temporary
X. Blandin

M. K. Bush
M. Z. M. Qureshi, Temporary
T. Yamashita

J. R. N. Almeida, Temporary

C. P. Caranicas
A. S. Jayawardena
J. E. Suraisry
T. de Vries
K. G. Morrell

E. I. M. Mtei
E. Portas, Temporary

L. Van Houtven, Secretary
J. A. Kay, Assistant

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Also Present

European Department: B. Rose, Deputy Director; M. T. Hadjimichael, S. M. Thakur. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. Mookerjee, Deputy Director; P. Molajoni. Fiscal Affairs Department: R. J. Hurnard. Legal Department: G. P. Nicoletopoulos, Director; S. A. Silard. Secretary's Department: K. S. Friedman. Western Hemisphere Department: S. T. Beza, Associate Director. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: L. Ionescu, H.-S. Lee, W. Moerke, G. E. L. Nguyen, Y. Okubo, I. R. Panday, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, R. L. Bernardo, Chen J., I. Fridriksson, V. Govindarajan, D. Hammann, N. U. Haque, J. M. Jones, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, M. Rasyid, D. J. Robinson, A. A. Scholten, S. Sornyanontr, Wang C. Y.

1. NEW ZEALAND - 1983 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting (EBM/84/37, 3/9/84) their consideration of the staff report for the 1983 Article IV consultation with New Zealand (SM/84/40, 2/6/84; Cor. 1, 3/6/84; and Sup. 1, 3/6/84). They also had before them a report on recent economic developments in New Zealand (SM/84/46, 2/17/84; and Cor. 1, 3/6/84).

The Chairman made the following summing up:

Executive Directors noted that a comprehensive wage-price freeze had been in effect in New Zealand since mid-1982 and that, aided by a downturn in economic activity and a slowdown in import prices, it had resulted in a decline in the rate of inflation from 17 percent to below 4 percent and in the growth of nominal wages from an annual rate of 16 percent to practically zero. While welcoming this impressive reduction in the rate of inflation, Directors nevertheless voiced their concerns regarding a number of aspects of New Zealand's economic performance and the authorities' policies to deal with them.

Directors felt that during the past year some major underlying imbalances in the economy had become more serious. This deterioration was attributed to a large extent to the fact that, during the protracted period of the freeze, demand management policy had not been sufficiently supportive of the wage-price freeze and that excessive reliance had been placed on the efficacy of direct controls as a method to manage the New Zealand economy. Directors thought that the most noteworthy imbalance was in the area of public finance and they expressed serious concern that the large current and prospective fiscal deficits would have destabilizing effects on the economy through upward pressures on interest rates or a higher rate of monetary expansion. The increasing burden on the budget of debt servicing and of social transfers, the imbalance between direct and indirect taxation, and the magnitude of the structural budget deficit were noted with particular concern. Directors expressed the hope that the authorities would no longer delay taking steps to reduce the budget deficit and would persevere with this goal in a determined and sustained manner. Directors felt that the main emphasis should be placed on expenditure restraint, but, in view of the relatively narrow tax base, efforts to extend this base by raising indirect tax revenue also needed to be pursued.

Directors felt that the task of monetary policy in New Zealand had become extremely difficult, in view of the large fiscal deficit, but also on account of the authorities' policy of interest rate controls. They believed that it was critically important to put in place a tight monetary policy if the gains made on the inflation front were not to be quickly dissipated. In this context, while noting that interest rate controls had

been an important component of the comprehensive freeze, they underscored the urgency of restoring adequate flexibility to interest rates in order to allow an active role for monetary policy as an anti-inflationary instrument. They noted the difficulties encountered by the authorities' program of public debt sales due to their reluctance to allow an increase in interest rates. Directors cautioned that improvements in techniques of debt management, desirable as these were in their own right, did not in any way lessen the need for a firm financial policy.

Firm financial policy was regarded by Directors as a condition for the successful lifting of the wage and price freeze. Many Directors stressed that catch-up increases in wages after the freeze ends should be resisted, lest they nullify the wage moderation achieved in the period of the freeze. Directors also expressed the hope that the tripartite talks currently under way would lead to a system of wage determination that would establish a better balance between real wage gains and productivity increases than had been the case in the past. Many Directors hoped that the encouraging start that was currently being made toward removing wage and price controls would soon be followed up with determined action to eliminate the host of domestic controls and to resume financial and trade liberalization, which in their view was the surest means of achieving improved economic performance over the medium term.

While recognizing that external factors--including the world recession and severe protectionist barriers abroad--had contributed importantly to the worsening of the external accounts, Directors thought that domestic policies, in particular financial policy, had been insufficiently supportive of external adjustment. Directors stressed that the pace of external adjustment should be stepped up; the cost of postponing adjustment, it was noted, would be heavier the longer action is delayed.

Directors underscored the desirability of restoring the flexible arrangement for the determination of the nominal exchange rate prevailing before the imposition of the freeze. It was felt that such flexibility was essential in view of the significant improvement in competitiveness that was required. Noting the importance of import quotas in New Zealand's protective system, many Directors felt that the authorities should accelerate the process of moving to a tariff-based system and of lowering tariffs. This would also facilitate the process of dismantling a large number of export incentives.

Many Directors, while noting that New Zealand continued to enjoy a high credit rating in international financial markets, nevertheless cautioned about the dangers of an excessively rapid growth in external debt and debt service, levels of which were already rather high by international standards. They also

stressed the importance of ensuring that foreign borrowing is used to enhance the nation's productive capacity rather than to sustain consumption. The level of New Zealand's official development assistance, it was noted, is modest but increasing, and the hope was expressed that New Zealand would further strengthen its commitment to assist developing countries.

The next Article IV consultation with New Zealand is expected to take place on the normal annual cycle.

The Executive Directors concluded their 1983 Article IV consultation with New Zealand.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/37 (3/9/84) and EBM/84/38 (3/9/84).

2. BHUTAN - TECHNICAL ASSISTANCE

In response to a request from the Bhutanese authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/84/67 (3/5/84).

Adopted March 9, 1984

APPROVED: August 24, 1984

LEO VAN HOUTVEN
Secretary

