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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/43

3:00 p.m., March 19, 1984

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

Executive Directors	Alternate Executive Directors
A. Alfidja	A. Kone, Temporary
	L. E. J. M. Coene, Temporary
	X. Blandin
	M. Teijeiro
R. D. Erb	
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
	Jaafar A.
R. K. Joyce	L. Leonard
	J. R. N. Almeida, Temporary
G. Laske	
G. Lovato	
R. N. Malhotra	
	J. E. Suraisry
J. J. Polak	T. de Vries
	H.-S. Lee
G. Salehkhou	H. Alaoui-Abdallaoui, Temporary
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	
	T. A. Clark
	Wang E.

L. Van Houtven, Secretary
J. C. Corr, Assistant

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Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; F. d'A. Collings, S. E. Cronquist, A. B. Diao, I. S. McCarthy, M. Sidibe. European Department: L. A. Whittome, Counsellor and Director; P. Dhonte, H. B. Junz, L. G. Manison, K.-W. Riechel, J. S. Van't dack. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; B. de Schaetzen, G. G. Johnson. Legal Department: Ph. Lachman, J. V. Surr. Research Department: L. U. Ecevit, M. D. Knight. Treasurer's Department: D. Gupta, T. B. C. Leddy. Bureau of Statistics: D. K. McAlister. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. E. L. Nguyen, J.-C. Obame, I. R. Panday, D. C. Templeman. Assistants to Executive Directors: M. Eran, G. Ercel, C. Flamant, V. Govindarajan, D. Hammann, J. M. Jones, A. K. Juusela, H. Kobayashi, G. W. K. Pickering, M. Rasyid, J. Reddy, D. J. Robinson, A. A. Scholten, S. Sornyanyontr, N. Toé, Wang C. Y., J. C. Williams.

1. NETHERLANDS - 1983 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting (EBM/84/42, 3/19/84) their consideration of the staff report for the 1983 Article IV consultation with the Netherlands (SM/84/47, 2/15/84; and Cor. 1, 3/16/84). They also had before them a report on recent economic developments in the Netherlands (SM/84/58, 3/1/84).

Mr. Joyce commented that the authorities in the Netherlands clearly faced fundamental problems, many of which were structural in nature. Those problems would take time to correct, as many Directors had pointed out. However, the authorities had begun to address the structural defects, albeit carefully and in some cases hesitantly. He welcomed their declared determination to persevere in their efforts. Certain developments in the Netherlands over the past year had been encouraging. The economy had continued to experience low inflation, wages had moderated, and the current account continued to register a significant surplus. More important, business profitability appeared to be improving, although slowly, and the downward trend in domestic demand and employment appeared to have leveled off. Nonetheless, the public sector deficit remained large and, as Mr. Polak had appropriately stated, the size of the public sector itself had "led to a suffocating burden of taxes." Moreover, the rate of unemployment in the Netherlands was among the highest in Europe and was continuing to climb, and the revitalization of the private sector had yet to take place.

The recent signs of recovery in Europe provided a good opportunity for the authorities in the Netherlands to pursue more vigorously the needed adjustments, Mr. Joyce continued. The current Government had taken some important first steps toward reversing the exceptional growth of the public sector and correcting some of the structural weaknesses in the industrial sector and in the labor market. He welcomed the authorities' willingness to accept some short-term costs in the pursuit of medium-term objectives. However, the results of their fiscal policies over the previous 16 months were not particularly striking. He agreed with Mr. Polak that there might be new signs of a turnaround in public sector finances; on the other hand, the staff had reservations in that regard. It was expected that there would be a small reduction in government expenditures in 1984 and in the government deficit as a percentage of net national income. A modest reduction in the "collective burden" was also anticipated, but it remained to be seen whether those improvements were sustainable.

More generally, as Mr. Polak had pointed out, the authorities could not concentrate solely on an expenditure norm, Mr. Joyce remarked. He was not convinced that the staff had actually suggested such a policy; he agreed with the staff's view that the tax burden was already far too high and that the authorities should, therefore, set explicit goals to ensure that the size of the public sector was compatible with the desired rate of growth in the economy. The authorities referred to an "implicit norm and time path" for the size of the public sector, but it was not clear whether the norm and path outlined by the authorities were regarded by the staff as adequate. He invited the staff to comment on the question. The major problem that fiscal policy would ultimately have to deal with was the burden of social security payments, reflecting the staggering expansion of the social security system over the previous decade. The authorities' actions in that area to date were commendable, but data in SM/84/58 indicated that the total number of beneficiaries of the social security system was approaching the total number of persons employed in the Dutch economy. In such circumstances, it was questionable whether a policy of gradualism was appropriate, and the authorities might need to consider taking much more radical action.

Monetary policy seemed to be directed almost exclusively to the maintenance of a stable relationship between the deutsche mark and the guilder, Mr. Joyce suggested. His Canadian authorities could well understand the strong interest in maintaining such a relationship. However, in view of the authorities' concern that continuing increases in the liquidity ratio could compromise the goal of low inflation, it was surprising that no forecast for the growth of liquidity balances in 1984 had been presented, nor had the staff provided Directors with an indication of the level of liquidity growth that it would consider excessive. He invited the staff and Mr. Polak to comment on that point.

Commenting on structural rigidities, Mr. Joyce remarked that the major concern emerging from the staff report was that the growth of the public sector and the extent of regulation of the private sector might have seriously undermined the flexibility of the economy, as reflected in both the labor market and the industrial sector. In the labor market, the authorities had made progress during the past year in restraining wages, particularly in the public sector. Nevertheless, high real wages and statutory wage controls continued to make it difficult to reallocate labor to competitive sectors. Dutch employers and trade unions had to reduce further the rigidities if medium-term growth prospects for employment were to improve. In addition, the staff was correct in noting that the recent moves toward work-sharing arrangements had not only had questionable success in stimulating employment but might add further rigidities to already highly inflexible markets.

As to the industrial sector, Mr. Joyce remarked, while the measures suggested so far by the Dutch authorities represented an easing of the regulatory burden on business, they were fairly tentative. If the rigidities were as serious as the staff suggested, the inflation potential of a significant revival of domestic demand could be substantial. Even more worrisome was Mr. Polak's comment that nearly one half of the private sector enterprises continued to experience losses. Although the authorities had taken steps to reduce wage costs and to ease corporate taxes, there was still a need for further measures to increase business confidence. Private investment was simply not taking place at adequate levels. The capital investment scheme might provide some assistance in the short run, but it could perpetuate money-losing companies; it might not be the most effective way of using scarce budgetary resources. Finally, the Netherlands authorities were to be congratulated for their liberal attitude toward trade policies. His authorities particularly appreciated the important role that the Netherlands played in helping to ensure that the European Community resisted the worst kind of protectionist pressures. With regard to aid, the Netherlands had an exemplary record that many countries would like to emulate.

Mr. Blandin remarked that the case of the Netherlands was paradoxical because good performance in some areas was associated with worrying developments in the real economy. The Dutch authorities had to be commended for the good results achieved in the area of inflation, which, at less than 3 percent, was among the lowest in the OECD countries, as well as in the external sector where there was a current account surplus of 3 percent of GDP, projected to increase to 3.8 percent in 1984. On the other hand, a number of structural problems, well described by Mr. Polak, were worrisome. In its appraisal, the staff had correctly judged that policy should focus on the three underlying imbalances in the economy: the size of the public sector, the profitability of the business sector, and unemployment.

The most troublesome aspect of the Dutch economy at present was unemployment, both current and in prospect, Mr. Blandin continued. Over 800,000 persons, equivalent to 17.7 percent of the labor force, were unemployed, a rate matched in Europe only by Spain. The composition of unemployment was perhaps even more disquieting: male unemployment, related to the decline in manufacturing and construction activities, had risen sharply in 1984, and young people represented approximately 5 percent of total unemployment. In addition, the continuous rise in unemployment had increased the burden on the employed, so that the ratio of employed persons to beneficiaries was approximately 1:1, clearly unsustainable. As a number of Directors had suggested, a major reason why unemployment remained inelastic to the resumption of economic growth was the nature of the welfare system, which had perhaps been expanded too much in the Netherlands, especially with regard to the coverage of inactive persons. Year after year more rigidities had been introduced into the system, making it increasingly difficult to be flexible. The main rigidity was the narrowness of the gap between the incomes of active workers and the unemployed, resulting in a reduced incentive to work. The staff correctly suggested that more flexibility needed to be introduced into the labor market, especially with regard to the restrictive laws covering layoffs, in order to create greater geographic and interenterprise mobility.

With regard to the measures aimed at reducing working time and increasing work sharing, Mr. Blandin remarked, France had been among the pioneers in that area. His authorities had always favored coordinated measures within the European Community because action by an individual country could result in the loss of competitiveness vis-à-vis its trading partners. However, while such measures were a prerequisite for the establishment of a more favorable economic environment, they could not in themselves bring about a rapid improvement in employment.

On a technical point, Mr. Blandin added, the information in Table 3 of SM/84/47 concerning unemployment benefits did not appear wholly accurate, at least with regard to France. First, the special allocation, which had been 80 percent, not the 90 percent mentioned in the staff report, no longer existed in France. Second, as the staff mentioned in footnote 2 to Table 3, the granting of benefits in relation to a worker's former salary occurred only when the unemployment was the result of economic factors. Recent statistics showed that only 6.7 percent of unemployed persons received unemployment benefits on that basis. Thus, such benefits could not be said to apply to an "unemployed typical worker," the terminology used by the staff.

The restoration of profitability in the nonenergy sector was one of the key structural reforms that needed to occur over the medium term, Mr. Blandin suggested. It was a matter of concern that about one half of Dutch private enterprises were losing money while the others were barely profitable. In addition, 3 percent of nonagricultural enterprises were bankrupt. It was, therefore, crucial to correct such imbalances; in that respect, the budget measures aimed at reducing social contributions and corporate taxes went in the right direction. The goodwill of the social partners in wage negotiations and the recent progress in manufacturing productivity should also provide urgent help to the enterprise sector.

Commenting on fiscal policy and domestic demand, Mr. Blandin suggested that two important questions needed to be addressed. First, what was the short-term impact of public spending cuts on consumption and unemployment? Second, did the existence of a high current account surplus in conjunction with the weakness of domestic demand not create a dangerous disequilibrium? Although the aim of reducing public spending in the medium term was commendable, the authorities should take carefully into account the implications of its policy in the short term. If the reduction in spending brought about an increase in unemployment and a decrease in revenues as a result of the sluggishness of the economy, it could have an adverse effect, perhaps widening the fiscal deficit. With regard to the second issue, it was open to question whether the increase in exports would result in increased profits for enterprises other than the largest firms already oriented toward foreign markets. A major imponderable was the extent to which Dutch multinationals might be encouraged to locate some of their investments at home. Thus, it might be appropriate to consider measures favoring the domestic market in order to rekindle enterprise activity.

It was impossible to eliminate rapidly the rigidities and distortions in the economy, Mr. Blandin considered. However, given the high level of outward investment, perhaps one problem was that the Netherlands lacked confidence in itself, despite all its advantages. In that respect the problems were not dissimilar to those faced by France, differing more in degree than in nature. His authorities would monitor the Dutch experience closely to see what lessons it might provide. Finally, the Dutch authorities should be warmly commended for their official development assistance policies.

Mr. Malhotra observed that there had been a number of encouraging developments in the Dutch economy recently. The authorities had been very successful in controlling inflation, and there were some indications that output and activity in the economy were on the upswing, although sufficient momentum had not yet been achieved. The current account of the balance of payments was in surplus, a measure of restraint in wages had been achieved, and competitiveness had improved. However, the economy continued to face fundamental structural problems that had been building over several years, and they had yet to be strongly addressed.

Although tentative attempts had been made to control public expenditure during the past decade, Mr. Malhotra continued, public expenditure as a proportion of net national income had increased from 60 percent to 70 percent. While a slight decline in the ratio was in prospect, it was clear that the Netherlands authorities faced a difficult task and that they would have to persist with their policies for a long time, perhaps with greater zeal than had been possible to date. It had been suggested that there might be a contradiction between reducing the "collective burden" and cutting the fiscal deficit. The authorities appeared to attach similar priority to both, though the staff believed that, to encourage the private sector, reducing the collective burden should be given higher priority. The important objective should be to curtail expenditures, otherwise it would not be possible to lower the collective burden in a meaningful fashion. Furthermore, without such action, it might not be possible to lower the public sector borrowing requirement and to prevent the burden of debt servicing from increasing steadily, thereby making it more difficult to reduce the deficit in the future.

It was disturbing that about one half of the private enterprises in the Netherlands were experiencing losses while the others were barely profitable, Mr. Malhotra commented. For that reason, according to Mr. Polak, investment premiums had to be continued; and it was considered administratively unfeasible to introduce selectivity into such subsidies because of the large number of firms involved. In view of that serious situation, the position of the private sector should be examined in greater depth. Perhaps more positive action than simply a reduction in taxes was needed to overcome the weaknesses in the industrial structure.

There was high unemployment, Mr. Malhotra noted, which the Government proposed to tackle through measures such as work sharing. However, while such policies might be justified on a short-term basis, they could increase rigidities over the medium term. Some Directors had suggested that an experiment along such lines might be worth trying if the overall cost to enterprises did not increase. It was questionable, however, whether workers already employed would accept a reduction in remuneration, particularly when unemployment benefits were already so high. Furthermore, what would be the position of the additional workers employed under work-sharing arrangements? Would they have the same protection against layoffs as other workers? If so, arrangements such as work sharing might only increase the labor rigidities in the economy.

On the expenditure side, Mr. Malhotra went on, social security payments and the benefits associated with unemployment insurance required attention. The case of the Netherlands was not unique, although the extent of the problem might be greater than in many other industrial countries.

As he had mentioned on the occasion of the 1982 Article IV consultation with the United Kingdom (EBM/83/36, 2/23/83), Mr. Malhotra recalled, The Economist had carried the results of a survey of the unemployed in that country, indicating that, despite a sharp increase in unemployment, unemployed workers were not particularly unhappy with the Government. The fundamental question that had been raised by the survey was whether a society was emerging in which a large number of people would be satisfied with a state of unemployment because of the high benefits. The Dutch doubtless had a long-standing tradition of hard work. However, good habits could decline rapidly, whereas it might be more difficult to bring about a reversal of easy attitudes. The issue should be seen in the broader context of the structural problems facing industrial societies in general, including those affecting the world trading system as manifested in increased protectionism. In that regard, the Dutch authorities should be congratulated for maintaining their support for an open world trading system as well as for their good record with regard to official development assistance which, despite their current difficulties, they had maintained at a level above 1 percent of GDP. He was confident that the people of the Netherlands had the determination and ability to overcome the present serious imbalances.

Mr. Suraisry said that he agreed with the staff and Mr. Polak that priority had to be given to tackling the deep-rooted structural imbalances in the economy. Those imbalances--in the public finances, in the distribution of national income, and in the labor market--presented serious obstacles to a sustained revival of activity in the private sector. It was encouraging, therefore, that the present Government had adopted a medium-term strategy designed to correct the structural weaknesses.

The authorities had already made a useful start, particularly in bringing the public finances under control, Mr. Suraisry continued. As Mr. Polak had pointed out, the moves toward fiscal restraint had contributed to an improvement in the business climate. The short-term outlook for growth was more favorable than it had been for several years. However, it was clear that the present policy stance would have to be maintained, or even strengthened, if the authorities were to achieve their objectives. That consideration applied particularly on the fiscal side, where further efforts were needed to break the momentum of government expenditure and to reduce the collective burden of taxes and social security premiums. If expenditure could be brought down, room would be provided to reduce the burden of corporate taxation. He supported the continuing efforts to limit public sector incomes and to reduce social security transfers. In the Netherlands, as in other countries, those transfers should not only be at levels that the Government could afford, but also at levels that encouraged output and productivity in the private sector. There was an optimal point beyond which such transfers might distort work incentives and efficient resource allocation. Such a development should not be allowed to occur.

The authorities should also press ahead with other initiatives to restore the vitality and profitability of the private sector, Mr. Suraisry suggested. In the longer run, such measures were the surest way of bringing than half the enterprises in a country was at stake, or a similar problem existed, a government was likely to come down on the side of pragmatism and to take the necessary steps to provide assistance. The difference between developing and developed countries was that the former were much less able to withstand the strains caused by the imbalances likely to arise from such a decision, thereby making the choices required of them more difficult.

The staff representative from the European Department observed that a number of Directors had commented on the paradox of a large external surplus existing side by side with the large public sector deficit. As with most paradoxes, the contradiction was more apparent than real. The problem was not so much oversaving, but underspending. The fact that the private enterprise sector was spending so little on investment, which had a high import content, accounted for much of the high external surplus. However, the Netherlands had gained market shares in recent months and wage moderation had improved competitiveness; thus, the external surplus was not altogether a reflection of weak demand. Indeed, there was evidence of a structural external surplus at present, which suggested that there was no objective reason for considering a devaluation of the guilder in order to accelerate the return to profitability in the private sector. Even if it were feasible within the context of the European Monetary System, such an approach would result in exporting the problem to other countries.

The basic problem was how to deal with the public sector deficit, particularly from the expenditure side, the staff representative continued. Allowing for the inadequacies of international comparisons, it was striking that in Hungary, a nonmarket economy, 62 percent of GDP was intermediated through the public sector whereas in the Netherlands the proportion was 70 percent. The result was a stifling of the flexibility of the private sector to such an extent that short-term remedies would not suffice. The issue could appropriately be addressed in terms of setting a medium-term goal for the size of the public sector considered to be compatible with the restoration of economic vitality. A clear change in the trend of public sector growth was necessary, and that development would very likely change public perceptions and business confidence, bringing about a substantial increase in urgently needed replacement investment. Such investment would carry a high marginal rate of return and it could be brought on stream quickly if circumstances allowed.

For similar reasons, the staff representative went on, the staff had been more concerned about the wisdom of work-sharing arrangements than it might have been under other circumstances. In a country that was already experiencing a high degree of rigidity in the labor market, anything that added to such inflexibility would probably be counterproductive. Attitudes toward taking on new labor in the Netherlands at present were revealing. Employers were willing to hire temporary labor, but they were unwilling to make the kind of commitment that was required when taking on permanent labor even when demand justified an expansion of output. Layoffs were associated virtually only with bankruptcies. In such circumstances, it was difficult to say how far the relative price of labor would have to decline before new employment was created.

The situation in the Netherlands was different from that in other countries with regard to mismatches in the labor market, the staff representative stated. For example, the vacancy/unemployment ratio tended to rise sharply in the early stages of a recession and to remain high even when activity resumed, suggesting that the unemployment problem was not simply frictional. The authorities had also provided qualitative information in support of that judgment. Despite the very high level of unemployment existing at present, there continued to be areas of labor shortage, although part of the problem might arise from employers' reluctance to take on permanent labor until they were absolutely sure that they could afford to do so.

The increase in liquidity was directly related to the budget deficit since there had been a considerable amount of bank financing of the deficit, the staff representative commented. Unfortunately, the distribution of liquidity was unclear, although indirect evidence, such as information from confidence surveys and from tax revenue data, suggested that it had gone to the enterprise sector to a considerable extent. It was regrettable that the Netherlands, a country that had pioneered modern quantitative analysis in economics, was unable to provide the Fund with the analytical basis to monitor movements in the important area of financial flows. Similarly, there was little hard evidence about the extent to which Dutch multinationals were responsible for the increase in profits. Information from the annual reports of multinational enterprises indicated that profits had risen considerably, and the fact that many such enterprises were based in the petrochemical and chemical sectors, which had undergone a revival, suggested that they had had a more than proportionate share in the increase in profitability.

The adequacy of the budget estimates for FY 1983/84 was difficult to judge, the staff representative from the European Department remarked, and some evidence suggested that the problem of overestimating revenues and underestimating expenditures had not yet been overcome. For example, in a recent letter to Parliament, the Finance Minister had requested further cuts in expenditure of f. 3 billion, of which about f. 2 billion was to make up for breaches in the previous year's target, and about f. 1 billion was to compensate for errors in forecasting, such as disappointing natural gas sales, lower than expected economic growth, and higher than expected unemployment. Natural gas accounted for about 15 percent of GDP, half through exports, which had been about f. 15 billion in 1982, and half through domestic sales. Current expectations were that the output level in the next few years would remain about the same as in recent years, rather than declining as had been forecast earlier. However, because prices could not be predicted, it was difficult to say what the effect on the current account would be. Finally, with regard to wage indexation, although that practice continued to exist, it was no longer automatic or centrally directed, but was left to contractual bargaining between individual employers and employees.

Mr. Polak remarked that Directors' views on the situation in the Netherlands had indicated a significant degree of consensus with regard to both criticisms and commendations of various aspects of policy. There had been strong emphasis on the need to cut the high level of government expenditure, a policy with which his Netherlands authorities agreed despite the practical difficulties involved. A number of speakers had suggested that cutting expenditure, rather than raising taxes, should be given priority in efforts to reduce the budget deficit.

With regard to the overall balance between receipts and expenditures, Mr. Polak continued, it was not easy to judge the degree of progress that had been made simply by looking at the size of the deficit, because expenditures and receipts were difficult to estimate in advance and they tended to fluctuate from year to year. For example, in 1983 the outturn had been better than expected, but the implications for 1984 of that result were not clear. It might be that some expenditures that should have been made in 1983 would actually be made in 1984, resulting in a worse outturn in 1984 than expected, or there might be an underlying improvement in the trend that would be continued into 1984. Because of the uncertainties involved, the Finance Minister had requested Parliament to make additional cuts in 1984 expenditure, as the staff representative from the European Department had mentioned. The authorities did not believe that the outturn in 1984 would be worse than in 1983.

The specific fiscal measures implemented by the Government should help to restore business confidence, Mr. Polak went on. The steps taken to narrow the difference between remuneration in employment and unemployment benefits and the reductions in civil service salaries were clear evidence of the authorities' determination to tackle the fundamental problems. As a number of Directors had noted, the private sector was now much more confident about the Government's resolve in that regard, despite the unlikelihood that the deficit would be reduced to 7.5 percent of NNI in 1986, as originally intended.

Directors had differed on the question of how useful investment subsidies were in present circumstances, Mr. Polak observed. There were valid arguments on both sides of the issue. Some Directors had suggested that a solution might be to make such subsidies more selective. The Netherlands had already experimented with selective subsidies, but the authorities had given up that approach. The decision to do so had been appropriate because there was little evidence to suggest that the Government was able to distinguish effectively good investments from bad or to judge which regions deserved a higher rate of subsidy than others.

Commenting on the labor market, Mr. Polak said that it was a serious problem when many people felt comfortable with unemployment because they could receive almost as much income in benefits as in wages from work. Such a situation existed in the Netherlands at present. Whether work-sharing schemes could provide an answer was questionable. The Dutch authorities, aware of the potential negative effects of such a policy, allowed decisions on work sharing to be made on a decentralized basis at the level of individual enterprises. They were concerned that such arrangements should not undermine the profitability of enterprises. In particular, the President of the central bank had warned against the disadvantages of such arrangements.

While monetary policy in the Netherlands was, to some extent, determined by the desire to maintain the fixed rate between the guilder and the deutsche mark, Mr. Polak noted, the authorities stood ready to tighten monetary policy if they believed that liquidity was becoming excessive. They were primarily concerned that the guilder should not be weaker than the deutsche mark; a tightening of monetary policy would, at worst, make it stronger. In that regard, the authorities had not considered that they could solve the country's problems through a devaluation, as one Director had suggested. There were many reasons against such an approach, one of which was membership of the Netherlands in the European Monetary System, which did not permit exchange rate changes that were not justified on the basis of economic underlying conditions. Similarly, adherence by the Netherlands to its obligations as a member of the Fund ruled out a competitive devaluation.

The Chairman made the following summing up:

Executive Directors commended the Dutch authorities on achieving wage moderation and a low rate of inflation, but they observed that deep imbalances remained in the economy in many respects. They noted that the rate of unemployment was one of the highest among industrial countries, that domestic demand had been declining for four consecutive years, and that, notwithstanding repeated attempts at reversing the trend, public sector expenditure and the tax burden had been rising steadily as a proportion of net national income up to 1983. Meanwhile, the current account balance of payments had been showing growing surpluses, reflecting in part weak domestic demand and in part gains in competitiveness.

Directors observed that business profitability remained at very low levels, despite both the wage moderation of recent years and fiscal actions, which in 1983 had aimed at restoring the profit share of enterprises. They noted that about one half of the Dutch enterprises were experiencing losses while the profits of the others were modest. Nevertheless, recent developments had succeeded in halting the deteriorating trend of business profitability, and Directors considered that the outlook for a revival of investment and economic activity had improved for the first time in many years. However, they believed that that favorable development needed to be strengthened by a predictable and steady implementation of the Government's medium-term policy plan to correct the structural weaknesses in the economy, and, in particular, to bring the public finances under control. Therefore, some Directors supported, inter alia, a move toward explicit formulation of policy goals for the size of the public sector in the medium term.

Directors were pleased to note that in 1984, for the first time in many years, the shares of government expenditure and of the "collective burden" in net national income (NNI) were expected to fall. However, the forecast reductions in those variables and in the public sector deficit were modest, and Directors noted that the objective of reducing the public sector deficit to 7.5 percent of NNI by 1986 appeared to be compromised. They emphasized the necessity of containing the rapid growth of expenditures under entitlement programs if further increases in the tax burden were to be avoided. They also stressed that a return to flexibility in the economy required a continued reduction in the size of the public sector. In that context, they expressed strong support for a policy of stabilizing and eventually reducing the collective burden while reducing the public sector borrowing requirement.

Directors welcomed the progress made in cutting the link between price changes and wages and in creating scope for greater wage differentiation. They considered that progress in that area needed to be extended to reducing rigidities in other areas, notably those affecting the labor market, including the regulations covering layoff procedures, the excessively generous system of unemployment compensation, and the minimum wage. Such rigidities were considered to be major obstacles toward stemming the shrinkage of work opportunities, and Directors did not regard labor-sharing schemes as a viable solution to the unemployment problem in the medium term. The prospect of a further sizable increase in unemployment in the near future was viewed by Directors with considerable concern.

Directors observed that the surplus on the external current account had facilitated the monetary authorities' efforts to lower domestic interest rates despite the large fiscal deficit. Nevertheless, real interest rates continued to be among the highest in Europe, not least because of the fiscal deficit, and concern was expressed about their negative impact on productive investment. Some Directors noted that the flexibility of monetary policy was limited, given the priority that was attached to maintaining a stable exchange rate vis-à-vis the deutsche mark.

Directors commended the authorities on their continued commitment to a free trade system, on the openness of the capital market, and on the good performance of the Netherlands in the area of official development assistance.

It is expected that the next Article IV consultation with the Netherlands will take place on the standard 12-month cycle.

The Executive Directors concluded the 1983 Article IV consultation with the Netherlands.

2. CHAD - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Chad, together with a proposed decision concluding the 1983 Article XIV consultation (SM/84/56, 2/24/84; and Sup. 1, 3/16/84). They also had before them a report on recent economic developments in Chad (SM/84/59, 3/7/84).

Mr. Alfidja made the following statement:

My authorities in Chad highly appreciate the valuable work done by the staff and thank them for the papers prepared for the 1983 Article IV consultation.

The reasons why an Article IV consultation with Chad has not taken place for the past four years are well known and are fully explained in the staff papers. The protracted armed conflict which began in 1979 was brought to a halt in 1982. Since then the new Government of Chad has been trying to implement a number of measures for reviving economic and financial activities in the country. As the armed conflict resumed in mid-1983 and the security situation deteriorated, the authorities were confronted with the difficulty of giving their full attention to the formulation and implementation of policies for re-establishing the foundations of a peacetime economy. Although the situation in this large landlocked economy is still very difficult, the authorities are determined to implement policies that will improve the overall economic and financial performance.

My authorities are aware that an adequate review of the economic and financial developments as well as the formulation of appropriate policies depend on the availability of up-to-date comprehensive statistical data. Since most of these have been destroyed, they are devoting attention to organizing such information to assist them in the formulation and implementation of policies. They have therefore requested Fund technical assistance to supplement their efforts in this regard.

On the basis of the limited information available, agricultural production, the main component of GDP, is estimated to have shown a significant improvement during the 1982/83 crop season. This was largely a reflection of the 43 percent expansion in the output of cotton, which is the principal cash and export crop, and also a reflection of an increase in the output of staple crops such as millet and sorghum. The cotton productivity program, which was initiated in the mid-1960s with the objective of raising yields through modern and intensive cultivation methods will continue to be implemented. During the 1983/84 crop season the producer price for cotton was increased by CFAF 10 to CFAF 80 per kilo. The authorities intend to pursue a flexible pricing policy in the cotton sector in order to encourage further gains in productivity and farm incomes in real terms. In this connection, consideration will be given to a further increase in the cotton producer price during the 1984/85 crop season if prices on the world market become favorable.

Chad's major foodcrops, millet and sorghum, are cultivated mainly in the Sahelian zone. Despite the increase in the output of these crops and a further increase projected for the 1983/84 crop year, total output will still be inadequate to provide the nation's food requirements. A national food deficit estimated at about 136,000 tons has thus been projected for 1984. This is expected to be covered by emergency assistance from the international community, which has shown great understanding of Chad's economic and financial problems.

In addition to the agricultural sector, the manufacturing sector is also showing signs of recovery. In 1983, the major industrial enterprises for cotton ginning, textiles, beverages, sugar, and tobacco maintained their production activities despite the financial and marketing constraints that they encountered. It is expected that as normal economic and financial conditions are restored, this sector will expand its productive capacity.

In their efforts to reconstruct and develop the economy, the authorities have given priority to the reactivation of existing projects which can be fully supported with foreign financing. Major emphasis has therefore been placed on projects in the agricultural and livestock sectors, including the rehabilitation of irrigation projects, particularly for rice and other foodcrops, water supply, and eradication of cattle disease.

Chad's financial policies in recent years have largely reflected the severe difficulties which the authorities are facing in rebuilding the economic and financial structure of the country. In the fiscal area, the new Government adopted a budget for the 1983 fiscal year, the first since 1979. This was formulated within the overall framework of the need to cater to the essential financial requirements for reconstituting the country's central administrative machinery and, in particular, to provide the resources needed for maintaining the country's security. The authorities are aware that it is prudent financial management to limit expenditures to levels that can be financed from both fiscal receipts and extrabudgetary sources. It must, however, be accepted that the peculiar circumstances now prevailing would not permit normal fiscal procedures to be followed, especially when several factors are currently beyond their control. However, the 1984 budget has been adopted on the basis of scaled-down appropriations, as a reflection of the difficult financial situation. With respect to fiscal revenue, the authorities have examined various alternatives for raising new revenue.

In this connection, a national reconstruction tax has been introduced. In addition, taxes will be levied on the sale of livestock and the domestic production of sugar. The taxes on business turnover and on imports of petroleum products have been increased. The authorities estimate that their intensified efforts to improve tax collection would result in an increase in budget receipts in 1984. It must be borne in mind that the realization of their fiscal objectives depends to a great extent on the pace at which the program for reconstituting the central administrative machinery proceeds, since budget execution and tax administration depend on civil service personnel who have not as yet been fully re-established in their posts. The buildup of domestic and external payments arrears reflects the constraints on their limited resources, and the authorities anticipate additional budgetary aid and further rescheduling and debt relief to enable them to ease the debt service burden. The authorities are giving priority to the processes for initiating action on refinancing, rescheduling, and possible cancellation of debt.

In the area of monetary and credit policies, commercial banking operations have not been fully resumed to provide the domestic financial services that are essential for the reconstruction and rehabilitation program. With the reopening of the office of the Banque des Etats de l'Afrique Centrale and the resumption of activities of a second commercial bank in the capital, the authorities expect that credit will gradually be made available to enterprises that are reorganizing their activities under the reconstruction program.

In the external sector, the difficult situation is a reflection of the unstable political environment which has necessitated rising imports of equipment for security purposes compared with exports, the bulk of which is from the cotton crop. The current account deficit has thus continued to widen. Despite increasing official transfers, especially in 1983, the overall balance of payments registered a deficit, causing a decline in net foreign exchange reserves and an accumulation of external payments arrears. The outlook for 1984 is still uncertain as external sector developments will depend on several factors over which the authorities have no control. The need for renegotiation of external obligations is thus recognized as an important element that would contribute to easing the difficult external situation.

The Chadian authorities are making steady progress toward the economic and financial reconstruction of the country. The conditions under which policies are being formulated and implemented are difficult. The authorities, therefore, hope that their efforts will continue to gain the sympathy of the international community and attract the necessary support for achieving their national economic objectives.

Mr. Blandin welcomed the resumption of Article IV consultations with Chad, almost five years after the Executive Board had concluded the previous consultation. The resumption was in itself a clear sign that the situation in the country had greatly improved in recent months. Security had been restored to most parts of the country, the only exception being the northern region, which was relatively unpopulated and which had little economic weight. The authorities should be warmly commended for having undertaken the difficult task of rebuilding public administration and reviving economic activity after years of war. Following four years without a budget, it had been possible to establish a budget in 1983. The restoration of confidence was well exemplified by the reopening of two banks and of the local branch of the Banque des Etats de l'Afrique Centrale (BEAC). Those developments should play a major role in the return of normal financial transactions, a prerequisite for the development of trade and the resumption of growth.

The situation clearly remained difficult, given the large internal and external imbalances, Mr. Blandin continued. Budgetary revenues fell far short of expenditures and there had been an accumulation of external payments arrears. However, the magnitude of those imbalances was small in absolute amounts. The overall budget deficit had been less than CFAF 6 billion--$15 million--in 1983, and total external debt, including principal and arrears, had amounted to only SDR 152 million at the end of 1983, with scheduled debt service equivalent to 14.6 percent of exports in 1983.

If the situation in the north returned to normal, Mr. Blandin commented, the authorities would be in a much better position to address the economic and financial problems; and there was no doubt that a strong potential for growth existed if appropriate policies could be implemented. That judgment was particularly valid in the agricultural sector where there had been a sizable increase in cotton production in 1982/83, with good prospects for 1983/84, despite the fact that producer prices were low in comparison with international prices or prices in neighboring countries. He agreed with the staff that cotton production could be further encouraged by granting the producers higher prices, given that there was considerable room to do so. With regard to foodcrops, if the drought had not depressed production in 1983, the country would be self-sufficient, for it had good potential to feed all its population. The main problems were the distribution of cereals from surplus regions in the south to deficit areas in the north and storage. Improving that situation would necessitate the rehabilitation of infrastructure, currently a major bottleneck after years of poor maintenance because of disruptions caused by the war.

It was also necessary that the international community should support the efforts of the Government by making available sufficient amounts of technical and financial assistance, Mr. Blandin stated. He welcomed the technical assistance in the fiscal area provided by the Fund, which had an important role to play in helping the Government to restore public finances. The Chadian authorities deserved support for the strenuous efforts that they were making toward the reconstruction of their country. Those efforts had already borne some fruit, and he was confident that the pursuit of sound policies would further improve the situation.

Mr. Mtei suggested that Directors should consider the Chadian case with care because it differed from others that the Executive Board had reviewed recently. The country was going through a most difficult situation. Besides being the largest landlocked country in Africa, Chad had been suffering from the impact of a protracted armed internal conflict that continued to paralyze economic activity in the north and that had dislocated the national economy. Consequently, the task of economic management had become very difficult. Severe drought had compounded the already adverse situation.

The destruction of data had also been so serious that Chad's real economic situation might be considerably different from the Executive Board's perception of it, Mr. Mtei continued. Nevertheless, in the south the real sector remained strong, and agricultural production, particularly cotton, had resumed its upward momentum. The rotational cropping introduced by the authorities would help to maximize the use of arable land that had hitherto been monopolized by cotton and thereby permit diversification in favor of foodcrops, such as cereals. The impact on cereal imports could, therefore, be significant. The relocation of cattle, the mainstay of the economy until production had almost been wiped out as a result of the internal strife, showed the real concern of the authorities and deserved commendation.

The problems on the fiscal front had been clearly set out by the staff, Mr. Mtei remarked. Little could be achieved until national security and stability were guaranteed. In the meantime, however, the authorities should devote as soon as possible an increasing share of government expenditure to the rehabilitation of the economy. They should also take account of the limited availability of both domestic and external resources in order to narrow the budget deficit and, if possible, to reduce the level of accumulated arrears.

There was also little that could be done immediately in the monetary area in light of the virtual disintegration of the financial system, Mr. Mtei added. The authorities recognized that the full resumption of commercial banking operations was a sine qua non for economic rehabilitation. The reopening of one bank and the anticipated reopening of a second in the near future were encouraging signs. However, the south, which at present constituted the economic backbone of the country, had only one bank branch, with the result that most financing was provided either by nonbank sources or by banks in neighboring countries. That situation should be examined and rectified as soon as possible.

With regard to the external situation, Mr. Mtei remarked, it was not surprising that payments arrears had accumulated. It was pointless to call on Chad to reduce those arrears in the prevailing circumstances. Greater understanding on the part of creditors was needed in order to provide debt relief through rescheduling and, most important, through the cancellation of bilateral official debt. He hoped that the authorities would soon be successful in restoring stability and proper management to the economy to bring it through the present difficult period.

The staff representative from the African Department stated that the staff had recently received confirmation that the second commercial bank had opened in the capital.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the thrust of the views expressed in the staff appraisal in the report on the 1983 Article IV consultation with Chad. They noted the security problems in the country and the authorities' efforts to rebuild the public administration. Directors encouraged the Chad authorities to pursue actively the rehabilitation of the economy, which was suffering the effects of the drought and the prolonged armed conflict. In that context, they welcomed the emphasis on projects in agriculture, such as in the cotton sector, and they stressed the need for appropriate pricing policies.

Directors emphasized the precarious financial situation of the country and the importance of avoiding a further buildup of debt service arrears. They encouraged the authorities to continue the dialogue with the official creditors regarding refinancing, rescheduling, and/or cancellation of debt. They welcomed the resumption of banking facilities as a necessary condition of Chad's economic rehabilitation.

Chad's dependence on, and urgent need for, foreign assistance in the form of grants and other concessional aid was stressed. Directors also underlined the importance of technical assistance, and they welcomed the efforts of the Fund in that field.

It was agreed that a flexible approach should be taken toward the timing of the next consultation with Chad.

The Executive Board then took the following decision:

Decision Concluding 1983 Article XIV Consultation

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

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

Decision No. 7652-(84/43), adopted March 19, 1984

APPROVED: August 30, 1984

LEO VAN HOUTVEN
Secretary